International Financial Reporting Standard 1

First-time Adoption of International Financial Reporting Standards

This version includes amendments resulting from the following amendments issued in 2004: IFRICs 1 and 4; IFRS 6; Amendment to IAS 19 Employee Benefits—Actuarial Gains and Losses, Group Plans and Disclosures*; Amendment to IAS 39* Financial Instruments: Recognition and Measurement—Transition and Initial Recognition of Financial Assets and Financial Liabilities.

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International Financial Reporting Standard 1 *First-time Adoption of International Financial Reporting Standards* (IFRS 1) is set out in paragraphs 1–47E and Appendices A–C. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in the Standard. Definitions of other terms are given in the Glossary for International Financial Reporting Standards. IFRS 1 should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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Introduction

Reasons for issuing the IFRS

IN1 The IFRS replaces SIC-8 *First-time Application of IASs as the Primary Basis of Accounting*. The Board developed this IFRS to address concerns that:

(a) some aspects of SIC-8's requirement for full retrospective application caused costs that exceeded the likely benefits for users of financial statements. Moreover, although SIC-8 did not require retrospective application when this would be impracticable, it did not explain whether a first-time adopter should interpret impracticability as a high hurdle or a low hurdle and it did not specify any particular treatment in cases of impracticability.

(b) SIC-8 could require a first-time adopter to apply two different versions of a Standard if a new version were introduced during the periods covered by its first financial statements prepared under IASs and the new version prohibited retrospective application.

(c) SIC-8 did not state clearly whether a first-time adopter should use hindsight in applying recognition and measurement decisions retrospectively.

(d) there was some doubt about how SIC-8 interacted with specific transitional provisions in individual Standards.

Main features of the IFRS

IN2 The IFRS applies when an entity adopts IFRSs for the first time by an explicit and unreserved statement of compliance with IFRSs.

IN3 In general, the IFRS requires an entity to comply with each IFRS effective at the reporting date for its first IFRS financial statements. In particular, the IFRS requires an entity to do the following in the opening IFRS balance sheet that it prepares as a starting point for its accounting under IFRSs:

(a) recognise all assets and liabilities whose recognition is required by IFRSs;

(b) not recognise items as assets or liabilities if IFRSs do not permit such recognition;

(c) reclassify items that it recognised under previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under IFRSs; and

(d) apply IFRSs in measuring all recognised assets and liabilities.

IN4 The IFRS grants limited exemptions from these requirements in specified areas where the cost of complying with them would be likely to exceed the benefits to users of financial statements. The IFRS also prohibits retrospective application of IFRSs in some areas, particularly where retrospective application would require judgements by management about past conditions after the outcome of a particular transaction is already known.

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IN5 The IFRS requires disclosures that explain how the transition from previous GAAP to IFRSs affected the entity's reported financial position, financial performance and cash flows.

IN6 An entity is required to apply the IFRS if its first IFRS financial statements are for a period beginning on or after 1 January 2004. Earlier application is encouraged.

Changes from previous requirements

IN7 Like SIC-8, the IFRS requires retrospective application in most areas. Unlike SIC-8, the IFRS:

(a) includes targeted exemptions to avoid costs that would be likely to exceed the benefits to users of financial statements, and a small number of other exceptions for practical reasons.

(b) clarifies that an entity applies the latest version of IFRSs.

(c) clarifies how a first-time adopter's estimates under IFRSs relate to the estimates it made for the same date under previous GAAP.

(d) specifies that the transitional provisions in other IFRSs do not apply to a first-time adopter.

(e) requires enhanced disclosure about the transition to IFRSs.

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International Financial Reporting Standard 1
First-time Adoption of
International Financial Reporting Standards

Objective

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

(a) is transparent for users and comparable over all periods presented;

(b) provides a suitable starting point for accounting under *International Financial Reporting Standards (IFRSs)*; and

(c) can be generated at a cost that does not exceed the benefits to users.

Scope

2 An entity shall apply this IFRS in:

(a) its first IFRS financial statements; and

(b) each interim financial report, if any, that it presents under IAS 34 *Interim Financial Reporting* for part of the period covered by its first IFRS financial statements.

3 An entity's first IFRS financial statements are the first annual financial statements in which the entity adopts IFRSs, by an explicit and unreserved statement in those financial statements of compliance with IFRSs. Financial statements under IFRSs are an entity's first IFRS financial statements if, for example, the entity:

(a) presented its most recent previous financial statements:

(i) under national requirements that are not consistent with IFRSs in all respects;

(ii) in conformity with IFRSs in all respects, except that the financial statements did not contain an explicit and unreserved statement that they complied with IFRSs;

(iii) containing an explicit statement of compliance with some, but not all, IFRSs;

(iv) under national requirements inconsistent with IFRSs, using some individual IFRSs to account for items for which national requirements did not exist; or

(v) under national requirements, with a reconciliation of some amounts to the amounts determined under IFRSs;

(b) prepared financial statements under IFRSs for internal use only, without making them available to the entity's owners or any other external users;

(c) prepared a reporting package under IFRSs for consolidation purposes without preparing a complete set of financial statements as defined in IAS 1 *Presentation of Financial Statements*; or

(d) did not present financial statements for previous periods.

4 This IFRS applies when an entity first adopts IFRSs. It does not apply when, for example, an entity:

(a) stops presenting financial statements under national requirements, having previously presented them as well as another set of financial statements that contained an explicit and unreserved statement of compliance with IFRSs;

(b) presented financial statements in the previous year under national requirements and those financial statements contained an explicit and unreserved statement of compliance with IFRSs; or

(c) presented financial statements in the previous year that contained an explicit and unreserved statement of compliance with IFRSs, even if the auditors qualified their audit report on those financial statements.

5 This IFRS does not apply to changes in accounting policies made by an entity that already applies IFRSs. Such changes are the subject of:

(a) requirements on changes in accounting policies in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; and

(b) specific transitional requirements in other IFRSs.

Recognition and measurement

Opening IFRS balance sheet

6 An entity shall prepare an *opening IFRS balance sheet* at the *date of transition to IFRSs*. This is the starting point for its accounting under IFRSs. An entity need not present its opening IFRS balance sheet in its first IFRS financial statements.

Accounting policies

7 An entity shall use the same accounting policies in its opening IFRS balance sheet and throughout all periods presented in its first IFRS financial statements. Those accounting policies shall comply with each IFRS effective at the reporting date for its first IFRS financial statements, except as specified in paragraphs 13–34.

8 An entity shall not apply different versions of IFRSs that were effective at earlier dates. An entity may apply a new IFRS that is not yet mandatory if it permits early application.

Example: Consistent application of latest version of IFRSs
Background The reporting date for entity A's first IFRS financial statements is 31 December 2005. Entity A decides to present comparative information in those financial statements for one year only (see paragraph 36). Therefore, its date of transition to IFRSs is the beginning of business on 1 January 2004 (or, equivalently, close of business on 31 December 2003). Entity A presented financial statements under its *previous GAAP* annually to 31 December each year up to, and including, 31 December 2004. **Application of requirements** Entity A is required to apply the IFRSs effective for periods ending on 31 December 2005 in: (a) preparing its opening IFRS balance sheet at 1 January 2004; and (b) preparing and presenting its balance sheet for 31 December 2005 (including comparative amounts for 2004), income statement, statement of changes in equity and cash flow statement for the year to 31 December 2005 (including comparative amounts for 2004) and disclosures (including comparative information for 2004). If a new IFRS is not yet mandatory but permits early application, entity A is permitted, but not required, to apply that IFRS in its first IFRS financial statements.

9 The transitional provisions in other IFRSs apply to changes in accounting policies made by an entity that already uses IFRSs; they do not apply to a *first-time adopter's* transition to IFRSs, except as specified in paragraphs 25D, 34A and 34B.

10 Except as described in paragraphs 13–34, an entity shall, in its opening IFRS balance sheet:

(a) recognise all assets and liabilities whose recognition is required by IFRSs;

(b) not recognise items as assets or liabilities if IFRSs do not permit such recognition;

(c) reclassify items that it recognised under previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under IFRSs; and

(d) apply IFRSs in measuring all recognised assets and liabilities.

11 The accounting policies that an entity uses in its opening IFRS balance sheet may differ from those that it used for the same date using its previous GAAP. The resulting adjustments arise from events and transactions before the date of transition to IFRSs. Therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to IFRSs.

12 This IFRS establishes two categories of exceptions to the principle that an entity's opening IFRS balance sheet shall comply with each IFRS:

(a) paragraphs 13–25F grant exemptions from some requirements of other IFRSs.

(b) paragraphs 26–34B prohibit retrospective application of some aspects of other IFRSs.

Exemptions from other IFRSs

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

(a) business combinations (paragraph 15);

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

(c) employee benefits (paragraph 20);

(d) cumulative translation differences (paragraphs 21 and 22);

(e) compound financial instruments (paragraph 23);

(f) assets and liabilities of subsidiaries, associates and joint ventures (paragraphs 24 and 25);

(g) designation of previously recognised financial instruments (paragraph 25A);

(h) share-based payment transactions (paragraphs 25B and 25C);

(i) insurance contracts (paragraph 25D);

(j) decommissioning liabilities included in the cost of property, plant and equipment (paragraph 25E);

(k) leases (paragraph 25F); and

(l) fair value measurement of financial assets or financial liabilities at initial recognition (paragraph 25G).

An entity shall not apply these exemptions by analogy to other items.

14 Some exemptions below refer to fair value. IFRS 3 *Business Combinations* explains how to determine the fair values of identifiable assets and liabilities acquired in a business combination. An entity shall apply those explanations in determining fair values under this IFRS, unless another IFRS contains more specific guidance on the determination of fair values for the asset or liability in question. Those fair values shall reflect conditions that existed at the date for which they were determined.

Business combinations

15 An entity shall apply the requirements in Appendix B to business combinations that the entity recognised before the date of transition to IFRSs.

Fair value or revaluation as deemed cost

16 An entity may elect to measure an item of property, plant and equipment at the date of transition to IFRSs at its fair value and use that fair value as its deemed cost at that date.

17 A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to IFRSs as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:

(a) fair value; or

(b) cost or depreciated cost under IFRSs, adjusted to reflect, for example, changes in a general or specific price index.

18 The elections in paragraphs 16 and 17 are also available for:

(a) investment property, if an entity elects to use the cost model in IAS 40 *Investment Property*; and

(b) intangible assets that meet:

  (i) the recognition criteria in IAS 38 *Intangible Assets* (including reliable measurement of original cost); and

  (ii) the criteria in IAS 38 for revaluation (including the existence of an active market).

An entity shall not use these elections for other assets or for liabilities.

19 A first-time adopter may have established a deemed cost under previous GAAP for some or all of its assets and liabilities by measuring them at their fair value at one particular date because of an event such as a privatisation or initial public offering. It may use such event-driven fair value measurements as deemed cost for IFRSs at the date of that measurement.

Employee benefits

20 Under IAS 19 *Employee Benefits*, an entity may elect to use a 'corridor' approach that leaves some actuarial gains and losses unrecognised. Retrospective application of this approach requires an entity to split the cumulative actuarial gains and losses from the inception of the plan until the date of transition to IFRSs into a recognised portion and an unrecognised portion. However, a first-time adopter may elect to recognise all cumulative actuarial gains and losses at the date of transition to IFRSs, even if it uses the corridor approach for later actuarial gains and losses. If a first-time adopter uses this election, it shall apply it to all plans.

20A An entity may disclose the amounts required by paragraph 120A(p) as the amounts are determined for each accounting period prospectively from the transition date.

Cumulative translation differences

21 IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires an entity:

(a) to classify some translation differences as a separate component of equity; and

(b) on disposal of a foreign operation, to transfer the cumulative translation difference for that foreign operation (including, if applicable, gains and losses on related hedges) to the income statement as part of the gain or loss on disposal.

22 However, a first-time adopter need not comply with these requirements for cumulative translation differences that existed at the date of transition to IFRSs. If a first-time adopter uses this exemption:

(a) the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to IFRSs; and

(b) the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to IFRSs and shall include later translation differences.

Compound financial instruments

23 IAS 32 *Financial Instruments: Disclosure and Presentation* requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of IAS 32 involves separating two portions of equity. The first portion is in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component. However, under this IFRS, a first-time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to IFRSs.

Assets and liabilities of subsidiaries, associates and joint ventures

24 If a subsidiary becomes a first-time adopter later than its parent, the subsidiary shall, in its financial statements, measure its assets and liabilities at either:

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

(b) the carrying amounts required by the rest of this IFRS, based on the subsidiary's date of transition to IFRSs. These carrying amounts could differ from those described in (a):

  (i) when the exemptions in this IFRS result in measurements that depend on the date of transition to IFRSs.

  (ii) when the accounting policies used in the subsidiary's financial statements differ from those in the consolidated financial statements. For example, the subsidiary may use as its accounting policy the cost model in IAS 16 *Property, Plant and Equipment*, whereas the group may use the revaluation model.

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.

25 However, if an entity becomes a first-time adopter later than its subsidiary (or associate or joint venture) the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the financial statements of the subsidiary (or associate or joint venture), after adjusting for consolidation and

equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary. Similarly, 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.

Designation of previously recognised financial instruments

25A IAS 39 *Financial Instruments: Recognition and Measurement* (as revised in 2003) permits a financial instrument to be designated on initial recognition as a financial asset or financial liability at fair value through profit or loss or as available for sale. Despite this requirement, an entity is permitted to make such a designation at the date of transition to IFRSs.

Share-based payment transactions

25B A first-time adopter is encouraged, but not required, to apply IFRS 2 *Share-based Payment* to equity instruments that were granted on or before 7 November 2002. A first-time adopter is also encouraged, but not required, to apply IFRS 2 to equity instruments that were granted after 7 November 2002 that vested before the later of (a) the date of transition to IFRSs and (b) 1 January 2005. However, if a first-time adopter elects to apply IFRS 2 to such equity instruments, it may do so only if the entity has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in IFRS 2. For all grants of equity instruments to which IFRS 2 has not been applied (eg equity instruments granted on or before 7 November 2002), a first-time adopter shall nevertheless disclose the information required by paragraphs 44 and 45 of IFRS 2. If a first-time adopter modifies the terms or conditions of a grant of equity instruments to which IFRS 2 has not been applied, the entity is not required to apply paragraphs 26–29 of IFRS 2 if the modification occurred before the later of (a) the date of transition to IFRSs and (b) 1 January 2005.

25C A first-time adopter is encouraged, but not required, to apply IFRS 2 to liabilities arising from share-based payment transactions that were settled before the date of transition to IFRSs. A first-time adopter is also encouraged, but not required, to apply IFRS 2 to liabilities that were settled before 1 January 2005. For liabilities to which IFRS 2 is applied, a first-time adopter is not required to restate comparative information to the extent that the information relates to a period or date that is earlier than 7 November 2002.

Insurance contracts

25D A first-time adopter may apply the transitional provisions in IFRS 4 *Insurance Contracts*. IFRS 4 restricts changes in accounting policies for insurance contracts, including changes made by a first-time adopter.

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

25E IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* requires specified changes in a decommissioning, restoration or similar liability to be added to or deducted from the cost of the asset to which it relates; the adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life. A first–time adopter need not comply with these requirements for changes in such liabilities that occurred before the date of transition to IFRSs. If a first–time adopter uses this exemption, it shall:

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

(b) to the extent that the liability is within the scope of IFRIC 1, estimate the amount that would have been included in the cost of the related asset when the liability first arose, by discounting the liability to that date using its best estimate of the historical risk–adjusted discount rate(s) that would have applied for that liability over the intervening period; and

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

Leases

IFRIC 4 Determining whether an Arrangement contains a Lease

25F A first–time adopter may apply the transitional provisions in IFRIC 4 *Determining whether an Arrangement contains a Lease*. Therefore, a first–time adopter may determine whether an arrangement existing at the date of transition to IFRSs contains a lease on the basis of facts and circumstances existing at that date.

Fair value measurement of financial assets or financial liabilities

25G Notwithstanding the requirements of paragraphs 7 and 9, an entity may apply the requirements in the last sentence of IAS 39 paragraph AG76, and paragraph AG76A, in either of the following ways:

(a) prospectively to transactions entered into after 25 October 2002; or

(b) prospectively to transactions entered into after 1 January 2004.

Exceptions to retrospective application of other IFRSs

26 This IFRS prohibits retrospective application of some aspects of other IFRSs relating to:

(a) derecognition of financial assets and financial liabilities (paragraph 27);

(b) hedge accounting (paragraphs 28–30);

(c) estimates (paragraphs 31–34); and

(d) assets classified as held for sale and discontinued operations.

Derecognition of financial assets and financial liabilities

27 Except as permitted by paragraph 27A, a first-time adopter shall apply the derecognition requirements in IAS 39 prospectively for transactions occurring on or after 1 January 2004. In other words, if a first-time adopter derecognised non-derivative financial assets or non-derivative financial liabilities under its previous GAAP as a result of a transaction that occurred before 1 January 2004, it shall not recognise those assets and liabilities under IFRSs (unless they qualify for recognition as a result of a later transaction or event).

27A Notwithstanding paragraph 27, an entity may apply the derecognition requirements in IAS 39 retrospectively from a date of the entity's choosing, provided that the information needed to apply IAS 39 to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time of initially accounting for those transactions.

Hedge accounting

28 As required by IAS 39 *Financial Instruments: Recognition and Measurement*, at the date of transition to IFRSs, an entity shall:

(a) measure all derivatives at fair value; and

(b) eliminate all deferred losses and gains arising on derivatives that were reported under previous GAAP as if they were assets or liabilities.

29 An entity shall not reflect in its opening IFRS balance sheet a hedging relationship of a type that does not qualify for hedge accounting under IAS 39 (for example, many hedging relationships where the hedging instrument is a cash instrument or written option; where the hedged item is a net position; or where the hedge covers interest risk in a held-to-maturity investment). 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 under IFRSs, provided that it does so no later than the date of transition to IFRSs.

30 If, before the date of transition to IFRSs, an entity had designated a transaction as a hedge but the hedge does not meet the conditions for hedge accounting in IAS 39 the entity shall apply paragraphs 91 and 101 of IAS 39 (as revised in 2003) to discontinue hedge accounting. Transactions entered into before the date of transition to IFRSs shall not be retrospectively designated as hedges.

Estimates

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

32 An entity may receive information after the date of transition to IFRSs about estimates that it had made under previous GAAP. Under paragraph 31, an entity shall treat the receipt of that information in the same way as non-adjusting events after the balance sheet date under IAS 10 *Events after the Balance Sheet Date*. For example, assume that an entity's date of transition to IFRSs is 1 January 2004 and new information on 15 July 2004 requires the revision of an estimate made under previous GAAP at 31 December 2003. The entity shall not reflect that new information in its opening IFRS balance sheet (unless the estimates need adjustment for any differences in accounting policies or there is objective evidence that the estimates were in error). Instead, the entity shall reflect that new information in its income statement (or, if appropriate, other changes in equity) for the year ended 31 December 2004.

33 An entity may need to make estimates under IFRSs at the date of transition to IFRSs that were not required at that date under previous GAAP. To achieve consistency with IAS 10, those estimates under IFRSs shall reflect conditions that

existed at the date of transition to IFRSs. In particular, estimates at the date of transition to IFRSs of market prices, interest rates or foreign exchange rates shall reflect market conditions at that date.

34 Paragraphs 31–33 apply to the opening IFRS balance sheet. They also apply to a comparative period presented in an entity's first IFRS financial statements, in which case the references to the date of transition to IFRSs are replaced by references to the end of that comparative period.

Assets classified as held for sale and discontinued operations

34A IFRS 5 requires that it shall be applied prospectively to non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and operations that meet the criteria to be classified as discontinued after the effective date of the IFRS. IFRS 5 permits an entity to apply the requirements of the IFRS to all non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and operations that meet the criteria to be classified as discontinued after any date before the effective date of the IFRS, provided the valuations and other information needed to apply the IFRS were obtained at the time those criteria were originally met.

34B An entity with a date of transition to IFRSs before 1 January 2005 shall apply the transitional provisions of IFRS 5. An entity with a date of transition to IFRSs on or after 1 January 2005 shall apply IFRS 5 retrospectively.

Presentation and disclosure

35 This IFRS does not provide exemptions from the presentation and disclosure requirements in other IFRSs.

Comparative information

36 To comply with IAS 1 *Presentation of Financial Statements*, an entity's first IFRS financial statements shall include at least one year of comparative information under IFRSs.

Exemption from the requirement to restate comparative information for IAS 39 and IFRS 4

36A In its first IFRS financial statements, an entity that adopts IFRSs before 1 January 2006 shall present at least one year of comparative information, but this comparative information need not comply with IAS 32, IAS 39 and IFRS 4. An entity that chooses to present comparative information that does not comply with IAS 32, IAS 39 and IFRS 4 in its first year of transition shall:

(a) apply its previous GAAP in the comparative information to financial instruments within the scope of IAS 32 and IAS 39 and to insurance contracts within the scope of IFRS 4;

(b) disclose this fact together with the basis used to prepare this information; and

(c) disclose the nature of the main adjustments that would make the information comply with IAS 32, IAS 39 and IFRS 4. The entity need not quantify those adjustments. However, the entity shall treat any adjustment

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between the balance sheet at the comparative period's reporting date (ie the balance sheet that includes comparative information under previous GAAP) and the balance sheet at the start of the *first IFRS reporting period* (ie the first period that includes information that complies with IAS 32, IAS 39 and IFRS 4) as arising from a change in accounting policy and give the disclosures required by paragraph 28(a)–(e) and (f)(i) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Paragraph 28(f)(i) applies only to amounts presented in the balance sheet at the comparative period's reporting date.

In the case of an entity that chooses to present comparative information that does not comply with IAS 32, IAS 39 and IFRS 4, references to the 'date of transition to IFRSs' shall mean, in the case of those Standards only, the beginning of the first IFRS reporting period.

Exemption from the requirement to provide comparative disclosures for IFRS 6

36B An entity that adopts IFRSs before 1 January 2006 and chooses to adopt IFRS 6 *Exploration for and Evaluation of Mineral Resources* before 1 January 2006 need not present the disclosures required by IFRS 6 for comparative periods in its first IFRS financial statements.

Historical summaries

37 Some entities present historical summaries of selected data for periods before the first period for which they present full comparative information under IFRSs. This IFRS does not require such summaries to comply with the recognition and measurement requirements of IFRSs. Furthermore, some entities present comparative information under previous GAAP as well as the comparative information required by IAS 1. In any financial statements containing historical summaries or comparative information under previous GAAP, an entity shall:

(a) label the previous GAAP information prominently as not being prepared under IFRSs; and

(b) disclose the nature of the main adjustments that would make it comply with IFRSs. An entity need not quantify those adjustments.

Explanation of transition to IFRSs

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

Reconciliations

39 To comply with paragraph 38, an entity's first IFRS financial statements shall include:

(a) reconciliations of its equity reported under previous GAAP to its equity under IFRSs for both of the following dates:

  (i) the date of transition to IFRSs; and

  (ii) the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP;

(b) 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 IFRSs for the same period; and

(c) if the entity recognised or reversed any impairment losses for the first time in preparing its opening IFRS balance sheet, the disclosures that IAS 36 *Impairment of Assets* would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition to IFRSs.

40 The reconciliations required by paragraph 39(a) and (b) shall give sufficient detail to enable users to understand the material adjustments to the balance sheet and income statement. If an entity presented a cash flow statement under its previous GAAP, it shall also explain the material adjustments to the cash flow statement.

41 If an entity becomes aware of errors made under previous GAAP, the reconciliations required by paragraph 39(a) and (b) shall distinguish the correction of those errors from changes in accounting policies.

42 IAS 8 does not deal with changes in accounting policies that occur when an entity first adopts IFRSs. Therefore, IAS 8's requirements for disclosures about changes in accounting policies do not apply in an entity's first IFRS financial statements.

43 If an entity did not present financial statements for previous periods, its first IFRS financial statements shall disclose that fact.

Designation of financial assets or financial liabilities

43A An entity is permitted to designate a previously recognised financial asset or financial liability as a financial asset or financial liability at fair value through profit or loss or as available for sale in accordance with paragraph 25A. The entity shall disclose the fair value of any financial assets or financial liabilities designated into each category and the classification and carrying amount in the previous financial statements.

Use of fair value as deemed cost

44 If an entity uses 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 (see paragraphs 16 and 18), the entity's first IFRS financial statements shall disclose, for each line item in the opening IFRS balance sheet:

(a) the aggregate of those fair values; and

(b) the aggregate adjustment to the carrying amounts reported under previous GAAP.

Interim financial reports

45 To comply with paragraph 38, if an entity presents an interim financial report under IAS 34 *Interim Financial Reporting* for part of the period covered by its first IFRS financial statements, the entity shall satisfy the following requirements in addition to the requirements of IAS 34:

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(a) Each such interim financial report shall, if the entity presented an interim financial report for the comparable interim period of the immediately preceding financial year, include reconciliations of:

(i) its equity under previous GAAP at the end of that comparable interim period to its equity under IFRSs at that date; and

(ii) its profit or loss under previous GAAP for that comparable interim period (current and year-to-date) to its profit or loss under IFRSs for that period.

(b) In addition to the reconciliations required by (a), an entity's first interim financial report under IAS 34 for part of the period covered by its first IFRS financial statements shall include the reconciliations described in paragraph 39(a) and (b) (supplemented by the details required by paragraphs 40 and 41) or a cross-reference to another published document that includes these reconciliations.

46 IAS 34 requires minimum disclosures, which are based on the assumption that users of the interim financial report also have access to the most recent annual financial statements. However, IAS 34 also requires an entity to disclose 'any events or transactions that are material to an understanding of the current interim period'. Therefore, if a first-time adopter did not, in its most recent annual financial statements under previous GAAP, disclose information material to an understanding of the current interim period, its interim financial report shall disclose that information or include a cross-reference to another published document that includes it.

Effective date

47 An entity shall apply this IFRS if its first IFRS financial statements are for a period beginning on or after 1 January 2004. Earlier application is encouraged. If an entity's first IFRS financial statements are for a period beginning before 1 January 2004 and the entity applies this IFRS instead of SIC-8 *First-time Application of IASs as the Primary Basis of Accounting*, it shall disclose that fact.

47A An entity shall apply the amendments in paragraphs 13(j) and 25E for annual periods beginning on or after 1 September 2004. If an entity applies IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* for an earlier period, these amendments shall be applied for that earlier period.

47B An entity shall apply the amendments in paragraphs 13(k) and 25F for annual periods beginning on or after 1 January 2006. If an entity applies IFRIC 4 *Determining whether an Arrangement contains a Lease* for an earlier period, these amendments shall be applied for that earlier period.

47C An entity shall apply the amendments in paragraph 36B for annual periods beginning on or after 1 January 2006. If an entity applies IFRS 6 *Exploration for and Evaluation of Mineral Resources* for an earlier period, these amendments shall be applied for that earlier period.

47D An entity shall apply the amendments in paragraph 20A for annual periods beginning on or after 1 January 2006. If an entity applies the amendments to

IAS 19 *Employee Benefits—Actuarial Gains and Losses, Group Plans and Disclosures* for an earlier period, these amendments shall be applied for that earlier period.

47E An entity shall apply the amendments in paragraphs 13(l) and 25G for annual periods beginning on or after 1 January 2005. If an entity applies the amendments to IAS 39 *Financial Instruments: Recognition and Measurement—Transition and Initial Recognition of Financial Assets and Financial Liabilities* for an earlier period, these amendments shall be applied for that earlier period.

Appendix A
Defined terms

This appendix is an integral part of the IFRS.

date of transition to IFRSs	The beginning of the earliest period for which an entity presents full comparative information under IFRSs in its **first IFRS financial statements**.
deemed cost	An amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost.
fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
first IFRS financial statements	The first annual financial statements in which an entity adopts **International Financial Reporting Standards (IFRSs)**, by an explicit and unreserved statement of compliance with IFRSs.
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**.
International Financial Reporting Standards (IFRSs)	Standards and Interpretations adopted by the International Accounting Standards Board (IASB). They comprise: (a) International Financial Reporting Standards; (b) International Accounting Standards; and (c) Interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).
opening IFRS balance sheet	An entity's balance sheet (published or unpublished) at the **date of transition to IFRSs**.
previous GAAP	The basis of accounting that a **first-time adopter** used immediately before adopting IFRSs.
reporting date	The end of the latest period covered by financial statements or by an interim financial report.

Appendix B
Business combinations

This appendix is an integral part of the IFRS.

B1 A first-time adopter may elect not to apply IFRS 3 *Business Combinations* retrospectively to past business combinations (business combinations that occurred before the date of transition to IFRSs). However, if a first-time adopter restates any business combination to comply with IFRS 3, it shall restate all later business combinations and shall also apply IAS 36 *Impairment of Assets* (as revised in 2004) and IAS 38 *Intangible Assets* (as revised in 2004) from that same date. For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 2002, it shall restate all business combinations that occurred between 30 June 2002 and the date of transition to IFRSs, and it shall also apply IAS 36 (as revised in 2004) and IAS 38 (as revised in 2004) from 30 June 2002.

B1A An entity need not apply IAS 21 *The Effects of Changes in Foreign Exchange Rates* (as revised in 2003) retrospectively to fair value adjustments and goodwill arising in business combinations that occurred before the date of transition to IFRSs. If the entity does not apply IAS 21 retrospectively to those fair value adjustments and goodwill, it shall treat them as assets and liabilities of the entity rather than as assets and liabilities of the acquiree. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate applied under previous GAAP.

B1B An entity may apply IAS 21 retrospectively to fair value adjustments and goodwill arising in either:

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

(b) all business combinations that the entity elects to restate to comply with IFRS 3, as permitted by paragraph B1 above.

B2 If a first-time adopter does not apply IFRS 3 retrospectively to a past business combination, this has the following consequences for that business combination:

(a) The first-time adopter shall keep the same classification (as an acquisition by the legal acquirer, a reverse acquisition by the legal acquiree, or a uniting of interests) as in its previous GAAP financial statements.

(b) The first-time adopter shall recognise all its assets and liabilities at the date of transition to IFRSs that were acquired or assumed in a past business combination, other than:

    (i) some financial assets and financial liabilities derecognised under previous GAAP (see paragraph 27); and

    (ii) assets, including goodwill, and liabilities that were not recognised in the acquirer's consolidated balance sheet under previous GAAP and also would not qualify for recognition under IFRSs in the separate balance sheet of the acquiree (see paragraph B2(f)–B2(i)).

The first-time adopter shall recognise any resulting change by adjusting retained earnings (or, if appropriate, another category of equity), unless the change results from the recognition of an intangible asset that was previously subsumed within goodwill (see paragraph B2(g)(i)).

(c) The first-time adopter shall exclude from its opening IFRS balance sheet any item recognised under previous GAAP that does not qualify for recognition as an asset or liability under IFRSs. The first-time adopter shall account for the resulting change as follows:

(i) the first-time adopter may have classified a past business combination as an acquisition and recognised as an intangible asset an item that does not qualify for recognition as an asset under IAS 38 *Intangible Assets*. It shall reclassify that item (and, if any, the related deferred tax and minority interests) as part of goodwill (unless it deducted goodwill directly from equity under previous GAAP, see paragraph B2(g)(i) and B2(i)).

(ii) the first-time adopter shall recognise all other resulting changes in retained earnings.*

(d) IFRSs require subsequent measurement of some assets and liabilities on a basis that is not based on original cost, such as fair value. The first-time adopter shall measure these assets and liabilities on that basis in its opening IFRS balance sheet, even if they were acquired or assumed in a past business combination. It shall recognise any resulting change in the carrying amount by adjusting retained earnings (or, if appropriate, another category of equity), rather than goodwill.

(e) Immediately after the business combination, the carrying amount under previous GAAP of assets acquired and liabilities assumed in that business combination shall be their deemed cost under IFRSs at that date. If IFRSs require a cost-based measurement of those assets and liabilities at a later date, that deemed cost shall be the basis for cost-based depreciation or amortisation from the date of the business combination.

(f) If an asset acquired, or liability assumed, in a past 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 it in its consolidated balance sheet on the basis that IFRSs would require in the balance sheet of the acquiree. To illustrate: if the acquirer had not, under its previous GAAP, capitalised finance leases acquired in a past business combination, it shall capitalise those leases in its consolidated financial statements, as IAS 17 *Leases* would require the acquiree to do in its IFRS balance sheet. Conversely, if an asset or liability was subsumed in goodwill under previous GAAP but would have been recognised separately under IFRS 3, that asset or liability remains in goodwill unless IFRSs would require its recognition in the financial statements of the acquiree.

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* Such changes include reclassifications from or to intangible assets if goodwill was not recognised under previous GAAP as an asset. This arises if, under previous GAAP, the entity (a) deducted goodwill directly from equity or (b) did not treat the business combination as an acquisition.

(g) The carrying amount of goodwill in the opening IFRS balance sheet shall be its carrying amount under previous GAAP at the date of transition to IFRSs, after the following three adjustments:

   (i) If required by paragraph B2(c)(i) above, the first-time adopter shall increase the carrying amount of goodwill when it reclassifies an item that it recognised as an intangible asset under previous GAAP. Similarly, if paragraph B2(f) requires the first-time adopter to recognise an intangible asset that was subsumed in recognised goodwill under previous GAAP, the first-time adopter shall decrease the carrying amount of goodwill accordingly (and, if applicable, adjust deferred tax and minority interests).

   (ii) A contingency affecting the amount of the purchase consideration for a past business combination may have been resolved before the date of transition to IFRSs. If a reliable estimate of the contingent adjustment can be made and its payment is probable, the first-time adopter shall adjust the goodwill by that amount. Similarly, the first-time adopter shall adjust the carrying amount of goodwill if a previously recognised contingent adjustment can no longer be measured reliably or its payment is no longer probable.

   (iii) Regardless of whether there is any indication that the goodwill may be impaired, the first-time adopter shall apply IAS 36 *Impairment of Assets* in testing the goodwill for impairment at the date of transition to IFRSs and in recognising any resulting impairment loss in retained earnings (or, if so required by IAS 36, in revaluation surplus). The impairment test shall be based on conditions at the date of transition to IFRSs.

(h) No other adjustments shall be made to the carrying amount of goodwill at the date of transition to IFRSs. For example, the first-time adopter shall not restate the carrying amount of goodwill:

   (i) to exclude in-process research and development acquired in that business combination (unless the related intangible asset would qualify for recognition under IAS 38 in the balance sheet of the acquiree);

   (ii) to adjust previous amortisation of goodwill;

   (iii) to reverse adjustments to goodwill that IFRS 3 would not permit, but were made under previous GAAP because of adjustments to assets and liabilities between the date of the business combination and the date of transition to IFRSs.

(i) If the first-time adopter recognised goodwill under previous GAAP as a deduction from equity:

   (i) it shall not recognise that goodwill in its opening IFRS balance sheet. Furthermore, it shall not transfer that goodwill to the income statement if it disposes of the subsidiary or if the investment in the subsidiary becomes impaired.

   (ii) adjustments resulting from the subsequent resolution of a contingency affecting the purchase consideration shall be recognised in retained earnings.

(j) Under its previous GAAP, the first-time adopter may not have consolidated a subsidiary acquired in a past business combination (for example, because the parent did not regard it as a subsidiary under previous GAAP or did not prepare consolidated financial statements). The first-time adopter shall adjust the carrying amounts of the subsidiary's assets and liabilities to the amounts that IFRSs would require in the subsidiary's balance sheet. The deemed cost of goodwill equals the difference at the date of transition to IFRSs between:

  (i) the parent's interest in those adjusted carrying amounts; and

  (ii) the cost in the parent's separate financial statements of its investment in the subsidiary.

(k) The measurement of minority interests and deferred tax follows from the measurement of other assets and liabilities. Therefore, the above adjustments to recognised assets and liabilities affect minority interests and deferred tax.

B3 The exemption for past business combinations also applies to past acquisitions of investments in associates and of interests in joint ventures. Furthermore, the date selected for paragraph B1 applies equally for all such acquisitions.

Appendix C
Amendments to other IFRSs

The amendments in this appendix become effective for annual financial statements covering periods beginning on or after 1 January 2004. If an entity applies this IFRS for an earlier period, these amendments become effective for that earlier period.

* * * * *

The amendments contained in this appendix when this Standard was issued in 2003 have been incorporated into the relevant pronouncements published in this volume.

Approval of IFRS 1 by the Board

International Financial Reporting Standard 1 *First-time Adoption of International Financial Reporting Standards* was approved for issue by the fourteen members of the International Accounting Standards Board.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Hans-Georg Bruns	
Anthony T Cope	
Robert P Garnett	
Gilbert Gélard	
James J Leisenring	
Warren J McGregor	
Patricia L O'Malley	
Harry K Schmid	
John T Smith	
Geoffrey Whittington	
Tatsumi Yamada	

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CONTENTS

Basis for Conclusions on IFRS 1 First-time Adoption of International Financial Reporting Standards

This Basis for Conclusions accompanies, but is not part of, IFRS 1.

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in IFRS 1 *First-time Adoption of International Financial Reporting Standards*. Individual Board members gave greater weight to some factors than to others.

BC2 SIC-8 *First-time Application of IASs as the Primary Basis of Accounting*, issued in 1998, dealt with matters that arose when an entity first adopted IASs. In 2001, the Board began a project to review SIC-8. In July 2002, the Board published ED 1 *First-time Application of International Financial Reporting Standards*, with a comment deadline of 31 October 2002. The Board received 83 comment letters on ED 1.

BC3 This project took on added significance because of the requirement that listed European Union companies should adopt International Financial Reporting Standards (IFRSs) in their consolidated financial statements from 2005. Several other countries have announced that they will permit or require entities to adopt IFRSs in the next few years. Nevertheless, the Board's aim in developing the IFRS was to find solutions that will be appropriate for any entity, in any part of the world, regardless of whether adoption occurs in 2005 or at a different time.

Scope

BC4 The IFRS applies to an entity that presents its first IFRS financial statements (a first-time adopter). Some suggested that an entity should not be regarded as a first-time adopter if its previous financial statements contained an explicit statement of compliance with IFRSs, except for specified (and explicit) departures. They argued that an explicit statement of compliance establishes that an entity regards IFRSs as its basis of accounting, even if the entity does not comply with every requirement of every IFRS. Some regarded this argument as especially strong if an entity previously complied with all recognition and measurement requirements of IFRSs, but did not give some required disclosures—for example, segmental disclosures that IAS 14 *Segment Reporting* requires or the explicit statement of compliance with IFRSs that IAS 1 *Presentation of Financial Statements* requires.

BC5 To implement that approach, it would be necessary to establish how many departures are needed—and how serious they must be—before an entity would conclude that it has not adopted IFRSs. In the Board's view, this would lead to complexity and uncertainty. Also, an entity should not be regarded as having adopted IFRSs if it does not give all disclosures required by IFRSs, because that approach would diminish the importance of disclosures and undermine efforts to promote full compliance with IFRSs. Therefore, the IFRS contains a simple test that gives an unambiguous answer: an entity has adopted IFRSs if, and only if, its financial statements contain an explicit and unreserved statement of compliance with IFRSs (paragraph 3 of the IFRS).

BC6 If an entity's financial statements in previous years contained that statement, any material disclosed or undisclosed departures from IFRSs are errors. The entity applies IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in correcting them.

Basic concepts

Useful information for users

BC7 In developing recognition and measurement requirements for an entity's opening IFRS balance sheet, the Board referred to the objective of financial statements, as set out in the *Framework for the Preparation and Presentation of Financial Statements*. The *Framework* states that the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

BC8 The *Framework* identifies four qualitative characteristics that make information in financial statements useful to users. In summary, the information should be:

(a) readily understandable by users.

(b) relevant to the decision-making needs of users.

(c) reliable, in other words financial statements should:

  (i) represent faithfully the transactions and other events they either purport to represent or could reasonably be expected to represent;

  (ii) represent transactions and other events in accordance with their substance and economic reality and not merely their legal form;

  (iii) be neutral, that is to say, free from bias;

  (iv) contend with the uncertainties that inevitably surround many events and circumstances by the exercise of prudence; and

  (v) be complete within the bounds of materiality and cost.

(d) comparable with information provided by the entity in its financial statements through time and with information provided in the financial statements of other entities.

Comparability

BC9 The previous paragraph notes the need for comparability. Ideally, a regime for first-time adoption of IFRSs would achieve comparability:

(a) within an entity over time;

(b) between different first-time adopters; and

(c) between first-time adopters and entities that already apply IFRSs.

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BC10 SIC-8 gave priority to ensuring comparability between a first-time adopter and entities that already applied IASs. It was based on the principle that a first-time adopter should comply with the same Standards as an entity that already applied IASs. However, the Board decided that it is more important to achieve comparability over time within a first-time adopter's first IFRS financial statements and between different entities adopting IFRSs for the first time at a given date; achieving comparability between first-time adopters and entities that already apply IFRSs is a secondary objective.

Current version of IFRSs

BC11 Paragraphs 7–9 of the IFRS require a first-time adopter to apply the current version of IFRSs, without considering superseded or amended versions. This:

(a) enhances comparability, because the information in a first-time adopter's first IFRS financial statements is prepared on a consistent basis over time;

(b) gives users comparative information prepared using later versions of IFRSs that the Board regards as superior to superseded versions; and

(c) avoids unnecessary costs.

BC12 In general, the transitional provisions in other IFRSs do not apply to a first-time adopter (paragraph 9 of the IFRS). Some of these transitional provisions require or permit an entity already reporting under IFRSs to apply a new requirement prospectively. These provisions generally reflect a conclusion that one or both of the following factors are present in a particular case:

(a) Retrospective application may be difficult or involve costs exceeding the likely benefits. The IFRS permits prospective application in specific cases where this could occur (paragraphs BC30–BC73).

(b) There is a danger of abuse if retrospective application would require judgements by management about past conditions after the outcome of a particular transaction is already known. The IFRS prohibits retrospective application in some areas where this could occur (paragraphs BC74–BC84).

BC13 Some have suggested three further reasons for permitting or requiring prospective application in some cases:

(a) to alleviate unforeseen consequences of a new IFRS if another party uses financial statements to monitor compliance with a contract or agreement. However, in the Board's view, it is up to the parties to an agreement to determine whether to insulate the agreement from the effects of a future IFRS and, if not, how they might renegotiate it so that it reflects changes in the underlying financial condition rather than changes in reporting (paragraph 21 of the *Preface to International Financial Reporting Standards*).

(b) to give a first-time adopter the same accounting options as an entity that already applies IFRSs. However, permitting prospective application by a first-time adopter would conflict with the Board's primary objective of comparability within an entity's first IFRS financial statements (paragraph BC10). Therefore, the Board did not adopt a general policy of giving first-time adopters the same accounting options of prospective application that existing IFRSs give to entities that already apply IFRSs. Paragraphs BC20–BC23 discuss one specific case, namely derecognition of financial assets and financial liabilities.

(c) to avoid difficult distinctions between changes in estimates and changes in the basis for making estimates. However, a first-time adopter need not make this distinction in preparing its opening IFRS balance sheet, so the IFRS does not include exemptions on these grounds. If an entity becomes aware of errors made under previous GAAP, the IFRS requires it to disclose the correction of the errors (paragraph 41 of the IFRS).

BC14 The Board will consider case by case when it issues a new IFRS whether a first-time adopter should apply that IFRS retrospectively or prospectively. The Board expects that retrospective application will be appropriate in most cases, given its primary objective of comparability over time within a first-time adopter's first IFRS financial statements. However, if the Board concludes in a particular case that prospective application by a first-time adopter is justified, it will amend the IFRS on first-time adoption of IFRSs. As a result, IFRS 1 will contain all material on first-time adoption of IFRSs and other IFRSs will not refer to first-time adopters (except, when needed, in the Basis for Conclusions and consequential amendments).

BC15 Under the proposals in ED 1, a first-time adopter could have elected to apply IFRSs as if it had always applied IFRSs. This alternative approach was intended mainly to help an entity that did not wish to use any of the exemptions proposed in ED 1 because it had already been accumulating information under IFRSs without presenting IFRS financial statements. To enable an entity using this approach to use the information it had already accumulated, ED 1 would have required it to consider superseded versions of IFRSs if more recent versions required prospective application. However, as explained in paragraphs BC28 and BC29, the Board abandoned ED 1's all-or-nothing approach to exemptions. Because this eliminated the reason for the alternative approach, the Board deleted it in finalising the IFRS.

Opening IFRS balance sheet

BC16 An entity's opening IFRS balance sheet is the starting point for its accounting under IFRSs. The following paragraphs explain how the Board used the *Framework* in developing recognition and measurement requirements for the opening IFRS balance sheet.

Recognition

BC17 The Board considered a suggestion that the IFRS should not require a first-time adopter to investigate transactions that occurred before the beginning of a 'look back' period of, say, three to five years before the date of transition to IFRSs. Some argued that this would be a practical way for a first-time adopter to give a high level of transparency and comparability, without incurring the cost of investigating very old transactions. They noted two particular precedents for transitional provisions that have permitted an entity to omit some assets and liabilities from its balance sheet:

(a) A previous version of IAS 39 *Financial Instruments: Recognition and Measurement* prohibited restatement of securitisation, transfer or other derecognition transactions entered into before the beginning of the financial year in which it was initially applied.

(b) Some national accounting standards and IAS 17 *Accounting for Leases* (superseded in 1997 by IAS 17 *Leases*) permitted prospective application of a requirement for lessees to capitalise finance leases. Under this approach, a lessee would not be required to recognise finance lease obligations and the related leased assets for leases that began before a specified date.

BC18 However, limiting the look back period could lead to the omission of material assets or liabilities from an entity's opening IFRS balance sheet. Material omissions would undermine the understandability, relevance, reliability and comparability of an entity's first IFRS financial statements. Therefore, the Board concluded that an entity's opening IFRS balance sheet should:

(a) include all assets and liabilities whose recognition is required by IFRSs, except:

  (i) some financial assets or financial liabilities derecognised under previous GAAP before the date of transition to IFRSs (paragraphs BC20–BC23); and

  (ii) goodwill and other assets acquired, and liabilities assumed, in a past business combination that were not recognised in the acquirer's consolidated balance sheet under previous GAAP and also would not qualify for recognition under IFRSs in the balance sheet of the acquiree (paragraphs BC31–BC40).

(b) not report items as assets or liabilities if they do not qualify for recognition under IFRSs.

BC19 Some financial instruments may be classified as equity under previous GAAP but as financial liabilities under IAS 32 *Financial Instruments: Disclosure and Presentation*. Some respondents to ED 1 requested an extended transitional period to enable the issuer of such instruments to renegotiate contracts that refer to debt-equity ratios. However, although a new IFRS may have unforeseen consequences if another party uses financial statements to monitor compliance with a contract or agreement, that possibility does not, in the Board's view, justify prospective application (paragraph BC13(a)).

Derecognition under previous GAAP

BC20 An entity may have derecognised financial assets or financial liabilities under its previous GAAP that do not qualify for derecognition under IAS 39. ED 1 proposed that a first-time adopter should recognise those assets and liabilities in its opening IFRS balance sheet. Some respondents to ED 1 requested the Board to permit or require a first-time adopter not to restate past derecognition transactions, on the following grounds:

(a) Restating past derecognition transactions would be costly, especially if restatement involves determining the fair value of retained servicing assets and liabilities and other components retained in a complex securitisation.

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Furthermore, it may be difficult to obtain information on financial assets held by transferees that are not under the transferor's control.

(b) Restatement undermines the legal certainty expected by parties who entered into transactions on the basis of the accounting rules in effect at the time.

(c) IAS 39 did not, before the improvements proposed in June 2002, require (or even permit) entities to restate past derecognition transactions. Without a similar exemption, first-time adopters would be unfairly disadvantaged.

(d) Retrospective application would not result in consistent measurement, as entities would need to recreate information about past transactions with the benefit of hindsight.

BC21 The Board had considered these arguments in developing ED 1. The Board's reasons for the proposal in ED 1 were as follows:

(a) The omission of material assets or liabilities would undermine the understandability, relevance, reliability and comparability of an entity's financial statements. Many of the transactions under discussion are large and will have effects for many years.

(b) Such an exemption would be inconsistent with the June 2002 Exposure Draft of improvements to IAS 39.

(c) The Board's primary objective is to achieve comparability over time within an entity's first IFRS financial statements. Prospective application by a first-time adopter would conflict with that primary objective, even if prospective application were available to entities already applying IFRSs.

(d) Although a new IFRS may have unforeseen consequences if another party uses financial statements to monitor compliance with a contract or agreement, that possibility does not justify prospective application (paragraph BC13(a)).

BC22 Nevertheless, in finalising the IFRS, the Board concluded that it would be premature to require a treatment different from the current version of IAS 39 before completing the proposed improvements to IAS 39. Accordingly, the IFRS originally required the same treatment as the then current version of IAS 39 for derecognition transactions before the effective date of the then current version of IAS 39, namely that any financial assets or financial liabilities derecognised under previous GAAP before financial years beginning on 1 January 2001 remain derecognised. The Board agreed that when it completed the improvements to IAS 39, it might amend or delete this exemption.

BC22A The Board reconsidered this issue in completing the revision of IAS 39 in 2003. The Board decided to retain the transition requirements as set out in IFRS 1, for the reasons given in paragraph BC20. However, the Board amended the date from which prospective application was required to transactions that occur on or after 1 January 2004 in order to overcome the practical difficulties of restating transactions that had been derecognised before that date.

BC22B The Board also noted that financial statements that include financial assets and financial liabilities that would otherwise be omitted under the provisions of the IFRS would be more complete and therefore more useful to users of financial

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statements. The Board therefore decided to permit retrospective application of the derecognition requirements. It also decided that retrospective application should be limited to cases when the information needed to apply the IFRS to past transactions was obtained at the time of initially accounting for those transactions. This limitation prevents the unacceptable use of hindsight.

BC23 The Board removed from IAS 39 the following consequential amendments to IAS 39 made when IFRS 1 was issued, because, for first-time adopters, these clarifications are clear in paragraphs IG26–IG31 and IG53 of the guidance on implementing IFRS 1. These were:

(a) the clarification that an entity is required to apply IAS 39 to all derivatives or other interests retained after a derecognition transaction, even if the transaction occurred before the effective date of IAS 39; and

(b) the confirmation that there are no exemptions for special purpose entities that existed before the date of transition to IFRSs.

Measurement

BC24 The Board considered whether it should require a first-time adopter to measure all assets and liabilities at fair value in the opening IFRS balance sheet. Some argued that this would result in more relevant information than an aggregation of costs incurred at different dates, or of costs and fair values. However, the Board concluded that a requirement to measure all assets and liabilities at fair value at the date of transition to IFRSs would be unreasonable, given that an entity may use an IFRS-compliant cost-based measurement before and after that date for some items.

BC25 The Board decided as a general principle that a first-time adopter should measure all assets and liabilities recognised in its opening IFRS balance sheet on the basis required by the relevant IFRSs. This is needed for an entity's first IFRS financial statements to present understandable, relevant, reliable and comparable information.

Benefits and costs

BC26 The *Framework* acknowledges that the need for a balance between the benefits of information and the cost of providing it may constrain the provision of relevant and reliable information. The Board considered these cost-benefit constraints and developed targeted exemptions from the general principle described in paragraph BC25. SIC-8 did not include specific exemptions of this kind, although it provided general exemptions from:

(a) retrospective adjustments to the opening balance of retained earnings 'when the amount of the adjustment relating to prior periods cannot be reasonably determined'.

(b) provision of comparative information when it is 'impracticable' to provide such information.

BC27 The Board expects that most first-time adopters will begin planning on a timely basis for the transition to IFRSs. Accordingly, in balancing benefits and costs, the Board took as its benchmark an entity that plans the transition well in advance and can collect most information needed for its opening IFRS balance sheet at, or very soon after, the date of transition to IFRSs.

BC28 ED 1 proposed that a first-time adopter should use either all the exemptions in ED 1 or none. However, some respondents disagreed with this all-or-nothing approach for the following reasons:

(a) Many of the exemptions are not interdependent, so there is no conceptual reason to condition use of one exemption on use of other exemptions.

(b) Although it is necessary to permit some exemptions on pragmatic grounds, entities should be encouraged to use as few exemptions as possible.

(c) Some of the exemptions proposed in ED 1 were implicit options because they relied on the entity's own judgement of undue cost or effort and some others were explicit options. Only a few exemptions were really mandatory.

(d) Unlike the other exceptions to retrospective application, the requirement to apply hedge accounting prospectively was not intended as a pragmatic concession on cost-benefit grounds. Retrospective application in an area that relies on designation by management would not be acceptable, even if an entity applied all other aspects of IFRSs retrospectively.

BC29 The Board found these comments persuasive. In finalising the IFRS, the Board grouped the exceptions to retrospective application into two categories:

(a) Some exceptions consist of optional exemptions (paragraphs BC30–BC63).

(b) The other exceptions prohibit full retrospective application of IFRSs to some aspects of derecognition (paragraphs BC20–BC23), hedge accounting (paragraphs BC75–BC80), and estimates (paragraph BC84).

Exemptions from other IFRSs

BC30 An entity may elect to use one or more of the following exemptions:

(a) business combinations (paragraphs BC31–BC40);

(b) fair value or revaluations as deemed cost (paragraphs BC41–BC47);

(c) employee benefits (paragraphs BC48–BC52);

(d) cumulative translation differences (paragraphs BC53–BC55);

(e) compound financial instruments (paragraphs BC56–BC58);

(f) assets and liabilities of subsidiaries, associates and joint ventures (paragraphs BC59–BC63);

(g) designation of previously recognised financial instruments (paragraph BC63A); and

(h) share-based payment transactions (paragraph 63B).

Business combinations

BC31 The following paragraphs discuss various aspects of accounting for business combinations that an entity recognised under previous GAAP before the date of transition to IFRSs:

(a) whether retrospective restatement of past business combinations should be prohibited, permitted or required (paragraphs BC32–BC34).

(b) whether an entity should recognise assets acquired and liabilities assumed in a past business combination if it did not recognise them under previous GAAP (paragraph BC35).

(c) whether an entity should restate amounts assigned to the assets and liabilities of the combining entities if previous GAAP brought forward unchanged their pre-combination carrying amounts (paragraph BC36).

(d) whether an entity should restate goodwill for adjustments made in its opening IFRS balance sheet to the carrying amounts of assets acquired and liabilities assumed in past business combinations (paragraphs BC37–BC40).

BC32 Retrospective application of IFRS 3 *Business Combinations* could require an entity to recreate data that it did not capture at the date of a past business combination and make subjective estimates about conditions that existed at that date. These factors could reduce the relevance and reliability of the entity's first IFRS financial statements. Therefore, ED 1 would have prohibited restatement of past business combinations (unless an entity used the proposed alternative approach, discussed in paragraph BC15, of applying IFRSs as if it had always applied IFRSs). Some respondents agreed, arguing that restatement of past business combinations would involve subjective, and potentially selective, use of hindsight that would diminish the relevance and reliability of financial statements.

BC33 Other respondents disagreed. They argued that:

(a) effects of business combination accounting can last for many years. Previous GAAP may differ significantly from IFRSs, and in some countries there are no accounting requirements at all for business combinations. Previous GAAP balances might not result in decision-useful information in these countries.

(b) restatement is preferable and may not involve as much cost or effort for more recent business combinations.

BC34 In the light of these comments, the Board concluded that restatement of past business combinations is conceptually preferable, although for cost-benefit reasons this should be permitted but not required. The Board decided to place some limits on this election and noted that information is more likely to be available for more recent business combinations. Therefore, if a first-time adopter restates any business combination, the IFRS requires it to restate all later business combinations (paragraph B1 of Appendix B of the IFRS).

BC35 If an entity did not recognise a particular asset or liability under previous GAAP at the date of the business combination, ED 1 proposed that its deemed cost under IFRSs would be zero. As a result, the entity's opening IFRS balance sheet would not have included that asset or liability if IFRSs permit or require a cost-based measurement. Some respondents to ED 1 argued that this would be an unjustifiable departure from the principle that the opening IFRS balance sheet should include all assets and liabilities. The Board agreed with that conclusion. Therefore, paragraph B2(f) of Appendix B of the IFRS requires that the acquirer should recognise those assets and liabilities and measure them on the basis that IFRSs would require in the separate balance sheet of the acquiree.

BC36 Under previous GAAP, an entity might have brought forward unchanged the pre-combination carrying amounts of the combining entities' assets and liabilities. Some argued that it would be inconsistent to use these carrying amounts as deemed cost under IFRSs, given that the IFRS does not permit the use of similar carrying amounts as deemed cost for assets and liabilities that were not acquired in a business combination. However, the Board identified no specific form of past business combination, and no specific form of accounting for past business combinations, for which it would not be acceptable to bring forward cost-based measurements made under previous GAAP.

BC37 Although the IFRS treats amounts assigned under previous GAAP to goodwill and other assets acquired and liabilities assumed in a past business combination as their deemed cost under IFRSs at the date of the business combination, an entity needs to adjust their carrying amounts in its opening IFRS balance sheet, as follows.

(a) Assets and liabilities measured under IFRSs at fair value or other forms of current value: remeasure to fair value or that other current value.

(b) Assets (other than goodwill) and liabilities for which IFRSs apply a cost-based measurement: adjust the accumulated depreciation or amortisation since the date of the business combination if it does not comply with IFRSs. Depreciation is based on deemed cost, which is the carrying amount under previous GAAP immediately following the business combination.

(c) Assets (other than goodwill) and liabilities not recognised under previous GAAP: measure on the basis that IFRSs would require in the separate balance sheet of the acquiree.

(d) Items that do not qualify for recognition as assets and liabilities under IFRSs: eliminate from the opening IFRS balance sheet.

BC38 The Board considered whether a first-time adopter should recognise the resulting adjustments by restating goodwill. Because intangible assets and goodwill are closely related, the Board decided that a first-time adopter should restate goodwill when it:

(a) eliminates an item that was recognised under previous GAAP as an intangible asset but does not qualify for separate recognition under IFRSs; or

(b) recognises an intangible asset that was subsumed within goodwill under previous GAAP.

However, to avoid costs that would exceed the likely benefits to users, the IFRS prohibits restatement of goodwill for most other adjustments reflected in the opening IFRS balance sheet, unless a first-time adopter elects to apply IFRS 3 retrospectively (paragraph B2(g) of the IFRS).

BC39 To minimise the possibility of double-counting an item that was included in goodwill under previous GAAP, and is included under IFRSs either within the measurement of another asset or as a deduction from a liability, the IFRS requires an entity to test goodwill recognised in its opening IFRS balance sheet for impairment (paragraph B2(g)(iii) of the IFRS). This does not prevent the implicit recognition of internally generated goodwill that arose after the date of the business combination. However, the Board concluded that an attempt to exclude such internally generated goodwill would be costly and lead to arbitrary results.

BC40 Some respondents to ED 1 suggested that a formal impairment test should be required only if there is a possibility of double-counting—ie when additional, previously unrecognised, assets relating to a past business combination are recognised in the opening IFRS balance sheet (or an indicator of impairment is present). However, the Board decided that a first-time adopter should carry out a formal impairment test of all goodwill recognised in its opening IFRS balance sheet, as previous GAAP might not have required a test of comparable rigour.

Fair value or revaluation as deemed cost

BC41 Some measurements under IFRSs are based on an accumulation of past costs or other transaction data. If an entity has not previously collected the necessary information, collecting or estimating it retrospectively may be costly. To avoid excessive cost, ED 1 proposed that an entity could use the fair value of an item of property, plant and equipment at the date of transition to IFRSs as its deemed cost at that date if determining a cost-based measurement under IFRSs would involve undue cost or effort.

BC42 In finalising the IFRS, the Board noted that reconstructed cost data might be less relevant to users, and less reliable, than current fair value data. Furthermore, the Board concluded that balancing costs and benefits was a task for the Board when it sets accounting requirements rather than for entities when they apply those requirements. Therefore, the IFRS permits an entity to use fair value as deemed cost in some cases without any need to demonstrate undue cost or effort.

BC43 Some expressed concerns that the use of fair value would lead to lack of comparability. However, cost is generally equivalent to fair value at the date of acquisition. Therefore, the use of fair value as the deemed cost of an asset means that an entity will report the same cost data as if it had acquired an asset with the same remaining service potential at the date of transition to IFRSs. If there is any lack of comparability, it arises from the aggregation of costs incurred at different dates, rather than from the targeted use of fair value as deemed cost for some assets. The Board regarded this approach as justified to solve the unique problem of introducing IFRSs in a cost-effective way without damaging transparency.

BC44 The IFRS restricts the use of fair value as deemed cost to those assets for which reconstructing costs is likely to be of limited benefit to users and particularly onerous: property, plant and equipment, investment property (if an entity elects to use the cost method in IAS 40 *Investment Property*) and intangible assets that meet restrictive criteria (paragraphs 16 and 18 of the IFRS).

BC45 Under the revaluation model in IAS 16 *Property, Plant and Equipment*, if an entity revalues an asset, it must revalue all assets in that class. This restriction prevents selective revaluation of only those assets whose revaluation would lead to a particular result. Some suggested a similar restriction on the use of fair value as deemed cost. However, IAS 36 *Impairment of Assets* requires an impairment test if there is any indication that an asset is impaired. Thus, if an entity uses fair value as deemed cost for assets whose fair value is above cost, it cannot ignore indications that the recoverable amount of other assets may have fallen below their carrying amount. Therefore, the IFRS does not restrict the use of fair value as deemed cost to entire classes of asset.

BC46 Some revaluations under previous GAAP might be more relevant to users than original cost. If so, it would not be reasonable to require time-consuming and expensive reconstruction of a cost that complies with IFRSs. In consequence, the IFRS permits an entity to use amounts determined using previous GAAP as deemed cost for IFRSs in the following cases:

(a) if an entity revalued one of the assets described in paragraph BC44 using its previous GAAP and the revaluation met specified criteria (paragraphs 17 and 18 of the IFRS).

(b) if an entity established a deemed cost under previous GAAP for some or all assets and liabilities by measuring them at their fair value at one particular date because of an event such as a privatisation or initial public offering (paragraph 19 of the IFRS).

BC47 Paragraph 17 of the IFRS refers to revaluations that are broadly comparable to fair value or reflect an index applied to a cost that is broadly comparable to cost determined under IFRSs. It may not always be clear whether a previous revaluation was intended as a measure of fair value or differs materially from fair value. The flexibility in this area permits a cost-effective solution for the unique problem of transition to IFRSs. It allows a first-time adopter to establish a deemed cost using a measurement that is already available and is a reasonable starting point for a cost-based measurement.

Employee benefits

BC48 If an entity elects to use the 'corridor' approach in IAS 19 *Employee Benefits*, full retrospective application of IAS 19 would require the entity to determine actuarial gains or losses for each year since the inception of the plan in order to determine the net cumulative unrecognised gains or losses at the date of transition to IFRSs. The Board concluded that this would not benefit users and would be costly. Therefore, the IFRS permits a first-time adopter to recognise all actuarial gains or losses up to the date of transition to IFRSs, even if its accounting policy under IAS 19 involves leaving some later actuarial gains and losses unrecognised (paragraph 20 of the IFRS).

BC49 The revision of IAS 19 in 1998 increased the reported employee benefit liabilities of some entities. IAS 19 permitted entities to amortise that increase over up to five years. Some suggested a similar transitional treatment for first-time adopters. However, the Board has no general policy of exempting transactions occurring before a specific date from the requirements of new IFRSs (paragraph 21 of the *Preface to International Financial Reporting Standards*). Therefore, the Board did not include a similar transitional provision for first-time adopters.

BC50 An entity's first IFRS financial statements may reflect measurements of pension liabilities at three dates: the reporting date, the end of the comparative year and the date of transition to IFRSs. Some suggested that obtaining three separate actuarial valuations for a single set of financial statements would be costly. Therefore, they proposed that the Board should permit an entity to use a single actuarial valuation, based, for example, on assumptions valid at the reporting date, with service costs and interest costs based on those assumptions for each of the periods presented.

BC51 However, the Board concluded that a general exemption from the principle of measurement at each date would conflict with the objective of providing understandable, relevant, reliable and comparable information for users. If an entity obtains a full actuarial valuation at one or two of these dates and rolls that (those) valuation(s) forward or back to the other date(s), any such roll forward or roll back needs to reflect material transactions and other material events (including changes in market prices and interest rates) between those dates (IAS 19, paragraph 57).

BC52 Some suggested that the Board should exempt a first-time adopter from the requirement to identify and amortise the unvested portion of past service cost at the date of transition to IFRSs. However, this requirement is less onerous than the retrospective application of the corridor for actuarial gains and losses because it does not require the recreation of data since the inception of the plan. The Board concluded that no exemption was justified for past service cost.

Cumulative translation differences

BC53 IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires an entity to classify some cumulative translation differences (CTDs) relating to a net investment in a foreign operation as a separate component of equity. The entity transfers the CTDs to the income statement on subsequent disposal of the foreign operation. The proposals in ED 1 would have permitted a first-time adopter to use the CTDs under previous GAAP as the deemed CTDs under IFRSs if reconstructing CTDs would have involved undue cost or effort.

BC54 Some respondents to ED 1 argued that it would be more transparent and comparable to exempt an entity from the requirement to identify CTDs at the date of transition to IFRSs, for the following reasons:

(a) An entity might know the aggregate CTDs, but might not know the amount for each subsidiary. If so, it could not transfer that amount to the income statement on disposal of that subsidiary. This would defeat the objective of identifying CTDs as a separate component of equity.

(b) The amount of CTDs under previous GAAP might be inappropriate as it might be affected by adjustments made on transition to IFRSs to assets and liabilities of foreign entities.

BC55 The Board found these arguments persuasive. Therefore, a first-time adopter need not identify the CTDs at the date of transition to IFRSs (paragraphs 21 and 22 of the IFRS). The first-time adopter need not show that identifying the CTDs would involve undue cost or effort.

Compound financial instruments

BC56 IAS 32 *Financial Instruments: Disclosure and Presentation* requires an entity to split a compound financial instrument at inception into separate liability and equity components. Even if the liability component is no longer outstanding, retrospective application of IAS 32 would involve separating two portions of equity. The first portion is in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component of the instrument.

BC57 Some respondents to ED 1 argued that separating these two portions would be costly if the liability component of the compound instrument is no longer outstanding at the date of transition to IFRSs. The Board agreed with those comments. Therefore, if the liability component is no longer outstanding at the date of transition to IFRSs, a first-time adopter need not separate the cumulative interest on the liability component from the equity component (paragraph 23 of the IFRS).

BC58 Some respondents requested an exemption for compound instruments even if still outstanding at the date of transition to IFRSs. One possible approach would be to use the fair value of the components at the date of transition to IFRSs as deemed cost. However, as the IFRS does not include any exemptions for financial liabilities, the Board concluded that it would be inconsistent to create such an exemption for the liability component of a compound instrument.

Assets and liabilities of subsidiaries, associates and joint ventures

BC59 A subsidiary may have reported to its parent in the previous period using IFRSs without presenting a full set of financial statements under IFRSs. If the subsidiary subsequently begins to present financial statements that contain an explicit and unreserved statement of compliance with IFRSs, it becomes a first-time adopter at that time. This might compel the subsidiary to keep two parallel sets of accounting records based on different dates of transition to IFRSs, because some measurements under the IFRS depend on the date of transition to IFRSs.

BC60 In developing ED 1, the Board concluded that a requirement to keep two parallel sets of records would be burdensome and not be beneficial to users. Therefore, ED 1 proposed that a subsidiary would not be treated as a first-time adopter for recognition and measurement purposes if the subsidiary was consolidated in IFRS financial statements for the previous period and all owners of the minority interests consented.

BC61 Some respondents to ED 1 opposed the exemption, on the following grounds:

(a) The exemption would not eliminate all differences between the group reporting package and the subsidiary's own financial statements. The reporting package does not constitute a full set of financial statements, the parent may have made adjustments to the reported numbers (for example, if pension cost adjustments were made centrally), and the group materiality threshold may be higher than for the subsidiary.

(b) The Board's objective of comparability between different entities adopting IFRSs for the first time at the same date (paragraph BC10) should apply equally to any entity, including subsidiaries, particularly if the subsidiary's debt or equity securities are publicly traded.

BC62 However, the Board retained the exemption because it will ease some practical problems. Although the exemption does not eliminate all differences between the subsidiary's financial statements and a group reporting package, it does reduce them. Furthermore, the exemption does not diminish the relevance and reliability of the subsidiary's financial statements because it permits a measurement that is already acceptable under IFRSs in the consolidated financial statements of the parent. Therefore, the Board also eliminated the proposal in ED 1 that the exemption should be conditional on the consent of minorities.

BC63 In finalising the IFRS, the Board simplified the description of the exemption for a subsidiary that adopts IFRSs after its parent. Under the IFRS, the subsidiary may measure its assets and liabilities at the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary. Alternatively, it may elect to measure them at the carrying amounts required by the rest of the IFRS, based on the subsidiary's date of transition to IFRSs. The Board also extended the exemption 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 (paragraph 24 of the IFRS). However, if a parent adopts IFRSs later than a subsidiary, the parent cannot, in its consolidated financial statements, elect to change IFRS measurements that the subsidiary has already used in its financial statements, except to adjust for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary (paragraph 25 of the IFRS).

Designation of previously recognised financial instruments

BC63A IAS 39 (as revised in 2003) permits an entity to designate, on initial recognition only, a financial instrument as (a) a financial asset or financial liability at fair value through profit or loss or (b) available for sale. Despite this requirement, an entity that had already applied IFRSs before the effective date of IAS 39 (as revised in 2003) may, on initial application of IAS 39 (as revised in 2003), so designate a previously recognised financial instrument. The Board decided to treat first-time adopters in the same way as entities that already apply IFRSs. Accordingly, a first-time adopter of IFRSs may similarly designate a previously recognised financial instrument at the date of transition to IFRSs. Such an entity is required to disclose the amount of previously recognised financial instruments that it so designates.

Share-based payment transactions

BC63B IFRS 2 *Share-based Payment* contains various transitional provisions. For example, for equity-settled share-based payment arrangements, IFRS 2 requires an entity to apply IFRS 2 to shares, share options or other equity instruments that were granted after 7 November 2002 and had not vested at the effective date of IFRS 2. IFRS 2 is effective for annual periods beginning on or after 1 January 2005. There are also transitional arrangements for liabilities arising from cash-settled share-based payment transactions, and for modifications of the terms or conditions of a grant of equity instruments to which IFRS 2 has not been applied, if the modification occurs after the effective date of IFRS 2. The Board decided that, in general, first-time adopters should be treated in the same way as entities that already apply IFRSs. For example, a first-time adopter should not be required to apply IFRS 2 to equity instruments that were granted on or before 7 November 2002. Similarly, a first-time adopter should not be required to apply IFRS 2 to equity instruments that were granted after 7 November 2002 if those equity instruments vested before 1 January 2005. In addition, the Board decided that a first-time adopter should not be required to apply IFRS 2 to equity instruments that were granted after 7 November 2002 if those equity instruments vested before the date of transition to IFRSs. Similarly, the Board decided that a first-time adopter should not be required to apply IFRS 2 to liabilities arising from cash-settled share-based payment transactions if those liabilities were settled before 1 January 2005, or before the date of transition to IFRSs.

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

BC63C IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* requires specified changes in decommissioning, restoration and similar liabilities to be added to, or deducted from, the cost of the assets to which they relate, and the adjusted depreciable amount to be depreciated prospectively over the remaining useful life of those assets. Retrospective application of this requirement at the date of transition would require an entity to construct a historical record of all such adjustments that would have been made in the past. In many cases this will not be practicable. The Board agreed that, as an alternative to complying with this requirement, an entity should be permitted to include in the depreciated cost of the asset, at the date of transition to IFRSs, an amount calculated by discounting the liability at that date back to, and depreciating it from, when the liability was first incurred.

Leases

BC63D IFRIC 4 *Determining whether an Arrangement contains a Lease* contains transitional provisions because the IFRIC acknowledged the practical difficulties raised by full retrospective application of the Interpretation, in particular the difficulty of going back potentially many years and making a meaningful assessment of whether the arrangement satisfied the criteria at that time. The Board decided to treat first–time adopters in the same way as entities that already apply IFRSs.

Other possible exemptions rejected

BC64 The Board considered and rejected suggestions for other exemptions. Each such exemption would have moved the IFRS away from a principles-based approach, diminished transparency for users, decreased comparability over time within an entity's first IFRS financial statements and created additional complexity. In the Board's view, any cost savings generated would not have outweighed these disadvantages. Paragraphs BC65–BC73 discuss some of the specific suggestions the Board considered, for embedded derivatives, hyperinflation, intangible assets and transaction costs on financial instruments.

Embedded derivatives

BC65 IAS 39 *Financial Instruments: Recognition and Measurement* requires an entity to account separately for some embedded derivatives at fair value. Some respondents to ED 1 argued that retrospective application of this requirement would be costly. Some suggested either an exemption from retrospective application of this requirement, or a requirement or option to use the fair value of the host instrument at the date of transition to IFRSs as its deemed cost at that date.

BC66 The Board noted that US GAAP provides an option in this area. Under the transitional provisions of SFAS 133 *Accounting for Derivative Instruments and Hedging Activities*, an entity need not account separately for some pre-existing embedded derivatives. Nevertheless, the Board concluded that the failure to measure embedded derivatives at fair value would diminish the relevance and reliability of an entity's first IFRS financial statements. The Board also observed that IAS 39 addresses an inability to measure an embedded derivative and the host contract separately. In such cases, IAS 39 requires an entity to measure the entire combined contract at fair value.

Hyperinflation

BC67 Some argued that the cost of restating financial statements for the effects of hyperinflation in periods before the date of transition to IFRSs would exceed the benefits, particularly if the currency is no longer hyperinflationary. However, the Board concluded that such restatement should be required, because hyperinflation can make unadjusted financial statements meaningless or misleading.

Intangible assets

BC68 For the following reasons, some proposed that a first-time adopter's opening IFRS balance sheet should exclude intangible assets that it did not recognise under previous GAAP:

(a) Using hindsight to assess retrospectively when the recognition criteria for intangible assets were met could be subjective, open up possibilities for manipulation and involve costs that might exceed the benefits to users.

(b) The benefits expected from intangible assets are often not related directly to the costs incurred. Therefore, capitalising the costs incurred is of limited benefit to users, particularly if the costs were incurred in the distant past.

(c) Such an exclusion would be consistent with the transitional provisions in IAS 38 *Intangible Assets*. These encourage (but do not require) the recognition of intangible assets acquired in a previous business combination that was an acquisition and prohibit the recognition of all other previously unrecognised intangible assets.

BC69 In many cases, internally generated intangible assets do not qualify for recognition under IAS 38 at the date of transition to IFRSs because an entity did not, under previous GAAP, accumulate cost information or did not carry out contemporaneous assessments of future economic benefits. In these cases, there is no need for a specific requirement to exclude those assets. Furthermore, when these assets do not qualify for recognition, first-time adopters will not generally, in the Board's view, need to perform extensive work to reach this conclusion.

BC70 In other cases, an entity may have accumulated and retained sufficient information about costs and future economic benefits to determine which intangible assets (whether internally generated or acquired in a business combination or separately) qualify under IAS 38 for recognition in its opening IFRS balance sheet. If that information is available, no exclusion is justified.

BC71 Some argued that fair value should be used as deemed cost for intangible assets in the opening IFRS balance sheet (by analogy with a business combination). ED 1 would not have permitted this. However, in finalising the IFRS, the Board concluded that this approach should be available for those intangible assets for which IFRSs already permit fair value measurements. Therefore, under the IFRS, a first-time adopter may elect to use fair value or some previous GAAP revaluations of intangible assets as deemed cost for IFRSs, but only if the intangible assets meet:

(a) the recognition criteria in IAS 38 (including reliable measurement of original cost); and

(b) the criteria in IAS 38 for revaluation (including the existence of an active market) (paragraph 18 of the IFRS).

Transaction costs: financial instruments

BC72 To determine the amortised cost of a financial asset or financial liability using the effective interest method, it is necessary to determine the transaction costs incurred when the asset or liability was originated. Some respondents to ED 1 argued that determining these transaction costs could involve undue cost or effort for financial assets or financial liabilities originated long before the date of transition to IFRSs. They suggested that the Board should permit a first-time adopter:

(a) to use the fair value of the financial asset or financial liability at the date of transition to IFRSs as its deemed cost at that date; or

(b) to determine amortised cost without considering transaction costs.

BC73 In the Board's view, the unamortised portion of transaction costs at the date of transition to IFRSs is unlikely to be material for most financial assets and financial liabilities. Even when the unamortised portion is material, reasonable estimates should be possible. Therefore, the Board created no exemption in this area.

Retrospective designation

BC74 The Board considered practical implementation difficulties that could arise from the retrospective application of aspects of IAS 39 *Financial Instruments: Recognition and Measurement*:

(a) hedge accounting (paragraphs BC75–BC80);

(b) the treatment of cumulative fair value changes on available-for-sale financial assets at the date of transition to IFRSs (paragraphs BC81–BC83); and

(c) 'day 1' gain or loss recognition (paragraph BC83A).

Hedge accounting

BC75 Before beginning their preparations for adopting IAS 39 (or a local standard based on IAS 39), it is unlikely that most entities would have adopted IAS 39's criteria for (a) documenting hedges at their inception and (b) testing the hedges for effectiveness, even if they intended to continue the same hedging strategies after adopting IAS 39. Furthermore, retrospective designation of hedges (or retrospective reversal of their designation) could lead to selective designation of some hedges to report a particular result.

BC76 To overcome these problems, the transitional requirements in IAS 39 require an entity already applying IFRSs to apply the hedging requirements prospectively when it adopts IAS 39. As the same problems arise for a first-time adopter, the IFRS requires prospective application by a first-time adopter.

BC77 ED 1 included a redrafted version of the transitional provisions in IAS 39 and related *Questions and Answers* (Q&As) developed by the IAS 39 Implementation Guidance Committee. The Board confirmed in the Basis for Conclusions published with ED 1 that it did not intend the redrafting to create substantive changes. However, in the light of responses to ED 1, the Board decided in finalising IFRS 1 that the redrafting would not make it easier for first-time adopters and others to understand and apply the transitional provisions and Q&As. However, the project to improve IAS 32 and IAS 39 resulted in certain amendments to the transition requirements. In addition, this project incorporated selected other Q&As (ie not on transition) into IAS 39. The Board therefore took this opportunity to consolidate all the guidance for first-time adopters in one place, by incorporating the Q&As on transition into IFRS 1.

BC78 Some respondents to ED 1 asked the Board to clarify what would happen if hedge accounting under previous GAAP involved hedging relationships of a type that does not qualify for hedge accounting under IAS 39. The problem can be seen most clearly for a hedge of a net position (macro hedge). If a first-time adopter were to use hedge accounting in its opening IFRS balance sheet for a hedge of a net position, this would involve either:

(a) recognising deferred debits and credits that are not assets and liabilities (for a fair value hedge); or

(b) deferring gains or losses in equity when there is, at best, a weak link to an underlying item that defines when they should be transferred to the income statement (for a cash flow hedge).

BC79 As either of these treatments would diminish the relevance and reliability of an entity's first IFRS financial statements, the Board decided that an entity should not apply hedge accounting in its opening IFRS balance sheet to a hedge of a net position that does not qualify as a hedged item under IAS 39. However, the Board concluded that it would be reasonable (and consistent with IAS 39, paragraph 133) to permit a first-time adopter to designate an individual item as a hedged item within the net position, provided that it does so no later than the date of transition to IFRSs, to prevent selective designation. For similar reasons, the Board prohibited hedge accounting in the opening IFRS balance sheet for any hedging relationship of a type that does not qualify for hedge accounting under IAS 39 (see paragraph 29 of the IFRS).

BC80 Some respondents to ED 1 suggested that an entity adopting IFRSs for the first time in 2005 could not meet IAS 39's documentation and effectiveness criteria by the date of transition to IFRSs (1 January 2004 for many entities). Some requested an exemption from these criteria until the beginning of the latest period covered by the first IFRS financial statements (1 January 2005 for many entities). However, for the following reasons, the Board did not create an exemption in this area:

(a) The Board's primary objective is comparability within a first-time adopter's first IFRS financial statements and between different first-time adopters switching to IFRSs at the same time (paragraph BC10).

(b) The continuation of previous GAAP hedge accounting practices could permit the non-recognition of derivatives or the recognition of deferred debits and credits that are not assets and liabilities.

(c) The Board's benchmark for cost-benefit assessments was an entity that has planned the transition to IFRSs and is able to collect the necessary information at, or very soon after, the date of transition to IFRSs (paragraph BC27). Entities should not be 'rewarded' by concessions if they failed to plan for transition, nor should that failure be allowed to undermine the integrity of their opening IFRS balance sheet. Entities switching to IFRSs in 2005 need to have their hedge accounting systems in place by the beginning of 2004. In the Board's view, that is a challenging but achievable timetable. Entities preparing to switch to IFRSs in 2004 should have been aware of the implications of IAS 39 already and the Exposure Draft of improvements to IAS 39, published in June 2002, proposed very few changes in this area, so delayed transition is not justified for these entities either.

Available-for-sale financial assets

BC81 Retrospective application of IAS 39 to available-for-sale financial assets requires a first-time adopter to recognise the cumulative fair value changes in a separate component of equity in the opening IFRS balance sheet, and transfer those fair value changes to the income statement on subsequent disposal or impairment of the asset. This could allow, for example, selective classification of assets with cumulative gains as available for sale (with subsequent transfers to the income statement on disposal) and assets with cumulative losses as held for trading (with no transfers on disposal).

BC82 IAS 39 confirmed the proposal in the Exposure Draft of June 2002 to give an entity that already applies IFRSs an option to designate any financial asset as at fair value through profit or loss when it first applies the proposed improvements. Although this requirement could increase the risk of selective classification by first-time adopters of the kind discussed in the previous paragraph, the Board noted that an entity could achieve a similar result by selective disposal of some assets before the date of transition to IFRSs. Therefore, the Board concluded that it should treat first-time adopters in the same way as entities that already apply IFRSs by requiring retrospective application.

BC83 Some respondents to ED 1 commented that the cost of determining the amount to be included in a separate component of equity would exceed the benefits. However, the Board noted that these costs would be minimal if a first-time adopter carried the available-for-sale financial assets under previous GAAP at cost or the lower of cost and market value. These costs might be more significant if it carried them at fair value, but in that case it might well classify the assets as held for trading. Therefore, the Board made no changes to ED 1's proposal that a first-time adopter should apply IAS 39 retrospectively to available-for-sale financial assets.

BC83A IFRS 1 originally required retrospective application of the 'day 1' gain or loss recognition requirements in IAS 39, paragraph AG76. After the revised IAS 39 was issued, constituents raised concerns that retrospective application would diverge from the requirements of US GAAP, would be difficult and expensive to implement, and might require subjective assumptions about what was observable and what was not. In response to these concerns, the Board decided to permit entities to apply the requirements in the last sentence of IAS 39 paragraph AG76, and paragraph AG76A, in any one of the following ways:

(a) retrospectively;

(b) prospectively to transactions entered into after 25 October 2002; or

(c) prospectively to transactions entered into after 1 January 2004.

Estimates

BC84 An entity will have made estimates under previous GAAP at the date of transition to IFRSs. Events between that date and the reporting date for the entity's first IFRS financial statements might suggest a need to change those estimates. Some of those events might qualify as adjusting events under IAS 10 *Events after the Balance Sheet Date*. However, if the entity made those estimates on a basis consistent with IFRSs, the Board concluded that it would be more helpful to users—and more consistent with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*—to recognise the revision of those estimates as income or expense in the period when the entity made the revision, rather than in preparing the opening IFRS balance sheet (paragraphs 31–34 of the IFRS).

Presentation and disclosure

Comparative information

BC85 IAS 1 *Presentation of Financial Statements* requires an entity to disclose comparative information (under IFRSs) for the previous period. Some suggested that a first-time adopter should disclose comparative information for more than one previous period. For entities that already apply IFRSs, users normally have access to financial statements prepared on a comparable basis for several years. However, this is not the case for a first-time adopter.

BC86 Nevertheless, the Board did not require a first-time adopter to present more comparative information than IAS 1 requires, because such a requirement would impose costs out of proportion to the benefits to users, and increase the risk that preparers might need to make arbitrary assumptions in applying hindsight.

BC87 ED 1 proposed that if the first IFRS financial statements include more than one year of comparative information, the additional comparative information should comply with IFRSs. Some respondents to ED 1 noted that some regulators require entities to prepare more than two years of comparatives. They argued the following:

(a) A requirement to restate two years of comparatives would impose excessive costs and lead to arbitrary restatements that might be biased by hindsight.

(b) Consider an entity adopting IFRSs in 2005 and required by its regulator to give two years of comparatives. Its date of transition to IFRSs would be 1 January 2003—several months before the publication of the IFRS and of the standards resulting from the Improvements project. This could contradict the Board's assertion in paragraph BC27 above that most preparers could gather most information they need for their opening IFRS balance sheet at, or soon after, the date of transition to IFRSs.

BC88 In response to these comments, the Board deleted this proposal. Instead, if a first-time adopter elects to give more than one year of comparative information, the additional comparative information need not comply with IFRSs, but the IFRS requires the entity:

(a) to label previous GAAP information prominently as not being prepared under IFRSs.

(b) to disclose the nature of the main adjustments that would make it comply with IFRSs (paragraph 37 of the IFRS).

BC89 Some respondents to ED 1 suggested that it would be onerous to prepare comparative information under IAS 32 and IAS 39 about financial instruments. They suggested that an entity should be able to apply IAS 39 prospectively from the beginning of the year of its first IFRS financial statements (eg 1 January 2005 for many first-time adopters). They noted that US companies were not required to restate comparatives on the introduction of SFAS 133 *Accounting for Derivative Instruments and Hedging Activities*. However, given the Board's emphasis on comparability within the first IFRS financial statements (paragraph BC10) and the assumption of timely planning (paragraph BC27), the Board introduced no general exemption in this area.

BC89A Nevertheless, the Board noted that the revised IAS 32 and IAS 39 were not issued until December 2003. Additionally, the Board's decision to re-expose its proposals for portfolio hedges of interest rate risk had the effect that some of the requirements will not be finalised until early 2004. The Board was sympathetic to concerns that entities that will be required to comply with IFRSs for the first time in 2005 could not make a timely transition to IFRSs because IAS 39 will not be issued in final form until after the start of 2004. Therefore, the Board decided to exempt entities adopting IFRSs for the first time before 1 January 2006 from producing comparative information that complies with IAS 32 and IAS 39, as revised in 2003, in their first IFRS financial statements. The disclosures in paragraph 36A inform users of the lack of comparability.

Historical summaries

BC90 Some entities choose, or are required, to present in their financial statements historical summaries of selected data covering periods before the first period for which they present full comparative information. Some argued that an entity should present this information under IFRSs, to ensure comparability over time. However, the Board concluded that such a requirement would cause costs out of proportion to the benefit to users. The IFRS requires disclosure of the nature of the main adjustments needed to make historical summaries included in financial statements or interim financial reports comply with IFRSs (paragraph 37 of the IFRS). Historical summaries published outside financial statements or interim financial reports are beyond the scope of the IFRS.

Explanation of transition to IFRSs

BC91 The IFRS requires disclosures about the effect of the transition from previous GAAP to IFRSs. The Board concluded that such disclosures are essential, in the first (annual) IFRS financial statements as well as in interim financial reports (if any), because they help users understand the effect and implications of the transition to IFRSs and how they need to change their analytical models to make the best use of information presented using IFRSs. The required disclosures relate to both:

(a) the most recent information published under previous GAAP, so that users have the most up-to-date information; and

(b) the date of transition to IFRSs. This is an important focus of attention for users, preparers and auditors because the opening IFRS balance sheet is the starting point for accounting under IFRSs.

BC92 Paragraph 39(a) and (b) of the IFRS requires reconciliations of equity and profit or loss. The Board concluded that users would also find it helpful to have information about the other adjustments that affect the opening IFRS balance sheet but do not appear in these reconciliations. Because a reconciliation could be voluminous, the IFRS requires disclosure of narrative information about these adjustments, as well as about adjustments to the cash flow statement (paragraph 40 of the IFRS).

BC93 Paragraph 41 of the IFRS states that the reconciliations should distinguish changes in accounting policies from the correction of errors. Some respondents to ED 1 argued that complying with this requirement could be difficult or costly. However, the Board concluded that both components are important and their disclosure should be required because:

(a) information about changes in accounting policies helps explain the transition to IFRSs.

(b) information about errors helps users assess the reliability of financial information. Furthermore, a failure to disclose the effect of material errors would obscure the 'results of the stewardship of management, or the accountability of management for the resources entrusted to it' (*Framework*, paragraph 14).

BC94 For impairment losses (and reversals) recognised in preparing the opening IFRS balance sheet, paragraph 39(c) of the IFRS requires the disclosures that IAS 36 *Impairment of Assets* would require if those impairment losses (and reversals) were recognised during the period beginning with the date of transition to IFRSs. The rationale for this requirement is that there is inevitably subjectivity about impairment losses. This disclosure provides transparency about impairment losses recognised on transition to IFRSs. These losses might otherwise receive less attention than impairment losses recognised in earlier or later periods.

BC95 Paragraph 44 of the IFRS requires disclosures about the use of fair value as deemed cost. Although the adjustment arising from the use of this exemption appears in the reconciliations discussed above, this more specific disclosure highlights it. Furthermore, this exemption differs from the other exemptions that might apply for property, plant and equipment (previous GAAP revaluation or event-driven fair value measurement). The latter two exemptions do not lead to a restatement on transition to IFRSs because they apply only if the measurement was already used in previous GAAP financial statements.

Interim financial reports

BC96 IAS 34 *Interim Financial Reporting* states that the interim financial report is 'intended to provide an update on the latest complete set of annual financial statements' (paragraph 6). Thus, IAS 34 requires less disclosure in interim financial statements than IFRSs require in annual financial statements. However, an entity's interim financial report under IAS 34 is less helpful to users if the entity's latest annual financial statements were prepared using previous GAAP than if they were prepared under IFRSs. Therefore, the Board concluded that a first-time adopter's first interim financial report under IAS 34 should include sufficient information to enable users to understand how the transition to IFRSs affected previously reported annual, as well as interim, figures (paragraphs 45 and 46 of the IFRS).

BC97 [Deleted]

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Guidance on implementing IFRS 1 *First-time Adoption of International Financial Reporting Standards*

This guidance accompanies, but is not part of, IFRS 1.

Introduction

IG1 This implementation guidance:

(a) explains how the requirements of the IFRS interact with the requirements of some other IFRSs (paragraphs IG2–IG62, IG64 and IG65). This explanation addresses those IFRSs that are most likely to involve questions that are specific to first-time adopters.

(b) includes an illustrative example to show how a first-time adopter might disclose how the transition to IFRSs affected its reported financial position, financial performance and cash flows, as required by paragraphs 39(a) and (b), 40 and 41 of the IFRS (paragraph IG63).

IAS 10 *Events after the Balance Sheet Date*

IG2 Except as described in paragraph IG3, an entity applies IAS 10 in determining whether:

(a) its opening IFRS balance sheet reflects an event that occurred after the date of transition to IFRSs; and

(b) comparative balance sheet amounts in its first IFRS financial statements reflect an event that occurred after the end of that comparative period.

IG3 Paragraphs 31–34 of the IFRS require some modifications to the principles in IAS 10 when a first-time adopter determines whether changes in estimates are adjusting or non-adjusting events at the date of transition to IFRSs (or, when applicable, the end of the comparative period). Cases 1 and 2 below illustrate those modifications. In case 3 below, paragraphs 31-34 of the IFRS do not require modifications to the principles in IAS 10.

(a) Case 1—Previous GAAP required estimates of similar items for the date of transition to IFRSs, using an accounting policy that is consistent with IFRSs. In this case, the estimates under IFRSs need to be consistent with estimates made for that date under previous GAAP, unless there is objective evidence that those estimates were in error (see IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*). The entity reports later revisions to those estimates as events of the period in which it makes the revisions, rather than as adjusting events resulting from the receipt of further evidence about conditions that existed at the date of transition to IFRSs.

(b) Case 2—Previous GAAP required estimates of similar items for the date of transition to IFRSs, but the entity made those estimates using accounting policies that are not consistent with its accounting policies under IFRSs. In this case, the estimates under IFRSs need to be consistent with the estimates required under previous GAAP for that date (unless there is objective evidence that those estimates were in error), after adjusting for the difference in accounting policies. The opening IFRS balance sheet reflects those adjustments for the difference in accounting policies. As in case 1, the entity reports later revisions to those estimates as events of the period in which it makes the revisions.

For example, previous GAAP may have required an entity to recognise and measure provisions on a basis consistent with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, except that the previous GAAP measurement was on an undiscounted basis. In this example, the entity uses the estimates under previous GAAP as inputs in making the discounted measurement required by IAS 37.

(c) Case 3—Previous GAAP did not require estimates of similar items for the date of transition to IFRSs. Estimates under IFRSs for that date reflect conditions existing at that date. In particular, estimates of market prices, interest rates or foreign exchange rates at the date of transition to IFRSs reflect market conditions at that date. This is consistent with the distinction in IAS 10 between adjusting events after the balance sheet date and non-adjusting events after the balance sheet date.

IG Example 1 Estimates

Background

Entity A's first IFRS financial statements have a reporting date of 31 December 2005 and include comparative information for one year. In its previous GAAP financial statements for 31 December 2003 and 2004, entity A:

(a) made estimates of accrued expenses and provisions at those dates;

(b) accounted on a cash basis for a defined benefit pension plan; and

(c) did not recognise a provision for a court case arising from events that occurred in September 2004. When the court case was concluded on 30 June 2005, entity A was required to pay 1,000 and paid this on 10 July 2005.

In preparing its first IFRS financial statements, entity A concludes that its estimates under previous GAAP of accrued expenses and provisions at 31 December 2003 and 2004 were made on a basis consistent with its accounting policies under IFRSs. Although some of the accruals and provisions turned out to be overestimates and others to be underestimates, entity A concludes that its estimates were reasonable and that, therefore, no error had occurred. As a result, accounting for those over- and underestimates involves the routine adjustment of estimates under IAS 8.

Continued from previous page

IG Example 1 Estimates

Application of requirements

In preparing its opening IFRS balance sheet at 1 January 2004 and in its comparative balance sheet at 31 December 2004, entity A:

(a) does not adjust the previous estimates for accrued expenses and provisions; and

(b) makes estimates (in the form of actuarial assumptions) necessary to account for the pension plan under IAS 19 *Employee Benefits*. Entity A's actuarial assumptions at 1 January 2004 and 31 December 2004 do not reflect conditions that arose after those dates. For example, entity A's:

   (i) discount rates at 1 January 2004 and 31 December 2004 for the pension plan and for provisions reflect market conditions at those dates; and

   (ii) actuarial assumptions at 1 January 2004 and 31 December 2004 about future employee turnover rates do not reflect conditions that arose after those dates—such as a significant increase in estimated employee turnover rates as a result of a curtailment of the pension plan in 2005.

The treatment of the court case at 31 December 2004 depends on the reason why entity A did not recognise a provision under previous GAAP at that date.

Assumption 1 – Previous GAAP was consistent with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Entity A concluded that the recognition criteria were not met. In this case, entity A's assumptions under IFRSs are consistent with its assumptions under previous GAAP. Therefore, entity A does not recognise a provision at 31 December 2004.

Assumption 2 – Previous GAAP was not consistent with IAS 37. Therefore, entity A develops estimates under IAS 37. Under IAS 37, an entity determines whether an obligation exists at the balance sheet date by taking account of all available evidence, including any additional evidence provided by events after the balance sheet date. Similarly, under IAS 10 *Events after the Balance Sheet Date*, the resolution of a court case after the balance sheet date is an adjusting event after the balance sheet date if it confirms that the entity had a present obligation at that date. In this instance, the resolution of the court case confirms that entity A had a liability in September 2004 (when the events occurred that gave rise to the court case). Therefore, entity A recognises a provision at 31 December 2004. Entity A measures that provision by discounting the 1,000 paid on 10 July 2005 to its present value, using a discount rate that complies with IAS 37 and reflects market conditions at 31 December 2004.

IG4 Paragraphs 31–34 of the IFRS do not override requirements in other IFRSs that base classifications or measurements on circumstances existing at a particular date. Examples include:

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(a) the distinction between finance leases and operating leases (see IAS 17 *Leases*);

(b) the restrictions in IAS 38 *Intangible Assets* that prohibit capitalisation of expenditure on an internally generated intangible asset if the asset did not qualify for recognition when the expenditure was incurred; and

(c) the distinction between financial liabilities and equity instruments (see IAS 32 *Financial Instruments: Disclosure and Presentation*).

IAS 12 *Income Taxes*

IG5 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.

IG6 Under IAS 12, the measurement of current and deferred tax reflects tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date. An entity accounts for the effect of changes in tax rates and tax laws when those changes are enacted or substantively enacted.

IAS 16 *Property, Plant and Equipment*[*]

IG7 If an entity's depreciation methods and rates under previous GAAP are acceptable under IFRSs, it accounts for any change in estimated useful life or depreciation pattern prospectively from when it makes that change in estimate (paragraphs 31 and 32 of the IFRS and paragraph 61 of IAS 16). However, in some cases, an entity's depreciation methods and rates under previous GAAP may differ from those that would be acceptable under IFRSs (for example, if they were adopted solely for tax purposes and do not reflect a reasonable estimate of the asset's useful life). If those differences have a material effect on the financial statements, the entity adjusts accumulated depreciation in its opening IFRS balance sheet retrospectively so that it complies with IFRSs.

IG8 An entity may elect to use one of the following amounts as the deemed cost of an item of property, plant and equipment:

(a) fair value at the date of transition to IFRSs (paragraph 16 of the IFRS), in which case the entity gives the disclosures required by paragraph 44 of the IFRS;

(b) a revaluation under previous GAAP that meets the criteria in paragraph 17 of the IFRS; or

(c) fair value at the date of an event such as a privatisation or initial public offering (paragraph 19 of the IFRS).

IG9 Subsequent depreciation is based on that deemed cost and starts from the date for which the entity established the fair value measurement or revaluation.

IG10 If an entity chooses as its accounting policy the revaluation model in IAS 16 for some or all classes of property, plant and equipment, it presents the cumulative revaluation surplus as a separate component of equity. The revaluation surplus at the date of transition to IFRSs is based on a comparison of the carrying amount of

[*] as revised in 2003

the asset at that date with its cost or deemed cost. If the deemed cost is the fair value at the date of transition to IFRSs, the entity gives the disclosures required by paragraph 44 of the IFRS.

IG11 If revaluations under previous GAAP did not satisfy the criteria in paragraph 17 or 19 of the IFRS, an entity measures the revalued assets in its opening balance sheet on one of the following bases:

(a) cost (or deemed cost) less any accumulated depreciation and any accumulated impairment losses under the cost model in IAS 16;

(b) deemed cost, being the fair value at the date of transition to IFRSs (paragraph 16 of the IFRS); or

(c) revalued amount, if the entity adopts the revaluation model in IAS 16 as its accounting policy under IFRSs for all items of property, plant and equipment in the same class.

IG12 IAS 16 requires each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item to be depreciated separately. However, IAS 16 does not prescribe the unit of measure for recognition of an asset, ie what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances (see IAS 16, paragraphs 9 and 43).

IG13 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 on which the asset stands. An entity applies IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* in recognising and measuring any resulting provision. The entity applies IAS 16 in determining the resulting amount included in the cost of the asset, before depreciation and impairment losses. Items such as depreciation and, when applicable, impairment losses cause differences between the carrying amount of the liability and the amount included in the carrying amount of the asset. An entity accounts for changes in such liabilities in accordance with IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*. However, paragraph 25E of IFRS 1 provides an exemption for changes that occurred before the date of transition to IFRSs, and prescribes an alternative treatment where the exemption is used. An example of the first-time adoption of IFRIC 1, which illustrates the use of this exemption, is given at paragraphs IG201–IG203.

IAS 17 *Leases**

IG14 At the date of transition to IFRSs, a lessee or lessor classifies leases as operating leases or finance leases on the basis of circumstances existing at the inception of the lease (IAS 17, paragraph 13). 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 in accordance with 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 economic life or of

* as revised in 2003

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.

IG15 When IAS 17 was revised in 1997, the net cash investment method for recognising finance income of lessors was eliminated. IAS 17 permits finance lessors to eliminate this method prospectively. However, the transitional provisions in IAS 17 do not apply to an entity's opening IFRS balance sheet (paragraph 9 of the IFRS). Therefore, a finance lessor measures finance lease receivables in its opening IFRS balance sheet as if the net cash investment method had never been permitted.

IG16 SIC-15 *Operating Leases—Incentives* applies to lease terms beginning on or after 1 January 1999. However, a first-time adopter applies SIC-15 to all leases, whether they started before or after that date.

IAS 18 *Revenue*

IG17 If an entity has received amounts that do not yet qualify for recognition as revenue under IAS 18 (for example, the proceeds of a sale that does not qualify for revenue recognition), the entity recognises the amounts received as a liability in its opening IFRS balance sheet and measures that liability at the amount received.

IAS 19 *Employee Benefits*

IG18 At the date of transition to IFRSs, an entity applies IAS 19 in measuring net employee benefit assets or liabilities under defined benefit plans, but it may elect to recognise all cumulative actuarial gains or losses from the inception of the plan until the date of transition to IFRSs even if its accounting policy under IAS 19 will involve leaving some later actuarial gains and losses unrecognised (paragraph 20 of the IFRS). The transitional provisions in IAS 19 do not apply to an entity's opening IFRS balance sheet (paragraph 9 of the IFRS).

IG19 An entity's actuarial assumptions at the date of transition to IFRSs are consistent with actuarial assumptions made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 31 of the IFRS). The impact of any later revisions to those assumptions is an actuarial gain or loss of the period in which the entity makes the revisions.

IG20 An entity may need to make actuarial assumptions at the date of transition to IFRSs that were not necessary under its previous GAAP. Such actuarial assumptions do not reflect conditions that arose after the date of transition to IFRSs. In particular, discount rates and the fair value of plan assets at the date of transition to IFRSs reflect market conditions at that date. Similarly, the entity's actuarial assumptions at the date of transition to IFRSs about future employee turnover rates do not reflect a significant increase in estimated employee turnover rates as a result of a curtailment of the pension plan that occurred after the date of transition to IFRSs (paragraph 32 of the IFRS).

IG21 In many cases, an entity's first IFRS financial statements will reflect measurements of employee benefit obligations at three dates: the reporting date, the date of the comparative balance sheet and the date of transition to IFRSs. IAS 19 encourages an entity to involve a qualified actuary in the measurement of all material post-employment benefit obligations. To minimise costs, an entity may request a qualified actuary to carry out a detailed actuarial valuation at one or two of these dates and roll the valuation(s) forward or back to the other date(s). Any such roll forward or roll back reflects any material transactions and other material events (including changes in market prices and interest rates) between those dates (IAS 19, paragraph 57).

IAS 21 *The Effects of Changes in Foreign Exchange Rates*[*]

IG21A An entity may, under previous GAAP, have treated goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation as assets and liabilities of the entity rather than as assets and liabilities of the foreign operation. If so, the entity is permitted to apply prospectively the requirements of paragraph 47 of IAS 21 to all acquisitions occurring after the date of transition to IFRSs.

IFRS 3 *Business Combinations*

IG22 The following examples illustrate the effect of Appendix B of the IFRS, assuming that a first-time adopter uses the exemption.

IG Example 2 Business combination

Background

Entity B's first IFRS financial statements have a reporting date of 31 December 2005 and include comparative information for 2004 only. On 1 July 2001, entity B acquired 100 per cent of subsidiary C. Under its previous GAAP, entity B:

(a) classified the business combination as an acquisition by entity B.

(b) measured the assets acquired and liabilities assumed at the following amounts under previous GAAP at 31 December 2003 (date of transition to IFRSs):

  (i) identifiable assets less liabilities for which IFRSs require cost-based measurement at a date after the business combination: 200 (with a tax base of 150 and an applicable tax rate of 30 per cent).

  (ii) pension liability (for which the present value of the defined benefit obligation measured under IAS 19 *Employee Benefits* is 130 and the fair value of plan assets is 100): nil (because entity B used a pay-as-you-go cash method of accounting for pensions under its previous GAAP). The tax base of the pension liability is also nil.

  (iii) goodwill: 180.

(c) did not, at the date of acquisition, recognise deferred tax arising from temporary differences associated with the identifiable assets acquired and liabilities assumed.

[*] as revised in 2003

Continued from previous page

IG Example 2 Business combination

Application of requirements

In its opening (consolidated) IFRS balance sheet, entity B:

(a) classifies the business combination as an acquisition by entity B even if the business combination would have qualified under IFRS 3 as a reverse acquisition by subsidiary C (paragraph B2(a) of the IFRS).

(b) does not adjust the accumulated amortisation of goodwill. Entity B tests the 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 to IFRSs. If no impairment exists, the carrying amount of the goodwill remains at 180 (paragraph B2(g)).

(c) for those net identifiable assets acquired for which IFRSs require cost-based measurement at a date after the business combination, treats their carrying amount under previous GAAP immediately after the business combination as their deemed cost at that date (paragraph B2(e)).

(d) does not restate the accumulated depreciation and amortisation of the net identifiable assets in (c), unless the depreciation methods and rates under previous GAAP result in amounts that differ materially from those required under IFRSs (for example, if they were adopted solely for tax purposes and do not reflect a reasonable estimate of the asset's useful life under IFRSs). If no such restatement is made, the carrying amount of those assets in the opening IFRS balance sheet equals their carrying amount under previous GAAP at the date of transition to IFRSs (200) (paragraph IG7).

(e) if there is any indication that identifiable assets are impaired, tests those assets for impairment, based on conditions that existed at the date of transition to IFRSs (see IAS 36).

(f) recognises the pension liability, and measures it, at the present value of the defined benefit obligation 130 less the fair value of the plan assets (100), giving a carrying amount of 30, with a corresponding debit of 30 to retained earnings (paragraph B2(d)). However, if subsidiary C had already adopted IFRSs in an earlier period, entity B would measure the pension liability at the same amount as in subsidiary C's financial statements (paragraph 25 of the IFRS and IG Example 9).

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IG Example 2 Business combination

(g) recognises a net deferred tax liability of 6 (20 at 30 per cent) arising from:

 (i) the taxable temporary difference of 50 (200 less 150) associated with the identifiable assets acquired and non-pension liabilities assumed, less

 (ii) the deductible temporary difference of 30 (30 less nil) associated with the pension liability.

 The entity recognises the resulting increase in the deferred tax liability as a deduction from retained earnings (paragraph B2(k) of the IFRS). If a taxable temporary difference arises from the initial recognition of the goodwill, entity B does not recognise the resulting deferred tax liability (paragraph 15(a) of IAS 12 *Income Taxes*).

IG Example 3 Business combination—restructuring provision

Background

Entity D's first IFRS financial statements have a reporting date of 31 December 2005 and include comparative information for 2004 only. On 1 July 2003, entity D acquired 100 per cent of subsidiary E. Under its previous GAAP, entity D recognised an (undiscounted) restructuring provision of 100 that would not have qualified as an identifiable liability under IFRS 3. The recognition of this restructuring provision increased goodwill by 100. At 31 December 2003 (date of transition to IFRSs), entity D:

(a) had paid restructuring costs of 60; and

(b) estimated that it would pay further costs of 40 in 2004, and that the effects of discounting were immaterial. At 31 December 2003, those further costs did not qualify for recognition as a provision under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Application of requirements

In its opening IFRS balance sheet, entity D:

(a) does not recognise a restructuring provision (paragraph B2(c) of the IFRS).

(b) does not adjust the amount assigned to goodwill. However, entity D tests the goodwill for impairment under IAS 36 *Impairment of Assets*, and recognises any resulting impairment loss (paragraph B2(g)).

(c) as a result of (a) and (b), reports retained earnings in its opening IFRS balance sheet that are higher by 40 (before income taxes, and before recognising any impairment loss) than in the balance sheet at the same date under previous GAAP.

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IG Example 4 Business combination—intangible assets

Background

Entity F's first IFRS financial statements have a reporting date of 31 December 2005 and include comparative information for 2004 only. On 1 July 2001, entity F acquired 75 per cent of subsidiary G. Under its previous GAAP, entity F assigned an initial carrying amount of 200 to intangible assets that would not have qualified for recognition under IAS 38 *Intangible Assets*. The tax base of the intangible assets was nil, giving rise to a deferred tax liability (at 30 per cent) of 60.

On 31 December 2003 (the date of transition to IFRSs), the carrying amount of the intangible assets under previous GAAP was 160, and the carrying amount of the related deferred tax liability was 48 (30 per cent of 160).

Application of requirements

Because the intangible assets do not qualify for recognition as separate assets under IAS 38, entity F transfers them to goodwill, together with the related deferred tax liability (48) and minority interests (paragraph B2(g)(i) of the IFRS). The related minority interests amount to 28 (25 per cent of [160 − 48 = 112]). Thus, the increase in goodwill is 84—intangible assets (160) less deferred tax liability (48) less minority interests (28.)

Entity F tests the 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 to IFRSs (paragraph B2(g)(iii) of the IFRS).

IG Example 5 Business combination—goodwill deducted from equity and treatment of related intangible assets

Background

Entity H acquired a subsidiary before the date of transition to IFRSs. Under its previous GAAP, entity H:

(a) recognised goodwill as an immediate deduction from equity;

(b) recognised an intangible asset of the subsidiary that does not qualify for recognition as an asset under IAS 38; and

(c) did not recognise an intangible asset of the subsidiary that would qualify under IAS 38 *Intangible Assets* for recognition as an asset in the financial statements of the subsidiary. The subsidiary held the asset at the date of its acquisition by entity H.

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IG Example 5 Business combination—goodwill deducted from equity and treatment of related intangible assets

Application of requirements

In its opening IFRS balance sheet, entity H:

(a) does not recognise the goodwill, as it did not recognise the goodwill as an asset under previous GAAP (paragraph B2(g)–B2(i)).

(b) does not recognise the intangible asset that does not qualify for recognition as an asset under IAS 38. Because entity H deducted goodwill from equity under its previous GAAP, the elimination of this intangible asset reduces retained earnings (paragraph B2(c)(ii)).

(c) recognises the intangible asset that qualifies under IAS 38 for recognition as an asset in the financial statements of the subsidiary, even though the amount assigned to it under previous GAAP in entity H's consolidated financial statements was nil (paragraph B2(f)). The recognition criteria in IAS 38 include the availability of a reliable measurement of cost (paragraphs IG45–IG48) and entity H measures the asset at cost less accumulated depreciation and less any impairment losses identified under IAS 36. Because entity H deducted goodwill from equity under its previous GAAP, the recognition of this intangible asset increases retained earnings (paragraph B2(c)(ii)). However, if this intangible asset had been subsumed in goodwill recognised as an asset under previous GAAP, entity H would have decreased the carrying amount of that goodwill accordingly (and, if applicable, adjusted deferred tax and minority interests) (paragraph B2(g)(i)).

IG Example 6 Business combination—subsidiary not consolidated under previous GAAP

Background

Parent J's date of transition to IFRSs is 1 January 2004. Under its previous GAAP, parent J did not consolidate its 75 per cent subsidiary K, acquired in a business combination on 15 July 2001. On 1 January 2004:

(a) the cost of parent J's investment in subsidiary K is 180.

(b) under IFRSs, subsidiary K would measure its assets at 500 and its liabilities (including deferred tax under IAS 12) at 300. On this basis, subsidiary K's net assets are 200 under IFRSs.

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IG Example 6 Business combination—subsidiary not consolidated under previous GAAP

Application of requirements

Parent J consolidates subsidiary K. The consolidated balance sheet at 1 January 2004 includes:

(a) subsidiary K's assets at 500 and liabilities at 300;

(b) minority interests of 50 (25 per cent of [500 – 300]); and

(c) goodwill of 30 (cost of 180 less 75 per cent of [500 – 300]) (paragraph B2(j)). Parent J tests the 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 to IFRSs (paragraph B2(g)(iii)).

IG Example 7 Business combination—finance lease not capitalised under previous GAAP

Background

Parent L's date of transition to IFRSs is 1 January 2004. Parent L acquired subsidiary M on 15 January 2001 and did not capitalise subsidiary M's finance leases. If subsidiary M prepared financial statements under IFRSs, it would recognise finance lease obligations of 300 and leased assets of 250 at 1 January 2004.

Application of requirements

In its consolidated opening IFRS balance sheet, parent L recognises finance lease obligations of 300 and leased assets of 250, and charges 50 to retained earnings (paragraph B2(f)).

IAS 23 *Borrowing Costs*

IG23 On first adopting IFRSs, an entity adopts a policy of capitalising borrowing costs (IAS 23 allowed alternative treatment) or not capitalising them (IAS 23 benchmark treatment). The entity applies that policy consistently in its opening IFRS balance sheet and in all periods presented in its first IFRS financial statements. However, if the entity established a deemed cost for an asset, the entity does not capitalise borrowing costs incurred before the date of the measurement that established the deemed cost.

IG24 Under the allowed alternative treatment, IAS 23 requires disclosure of interest capitalised during the period. Neither IAS 23 nor the IFRS requires disclosure of the cumulative amount capitalised.

IG25 IAS 23 contains transitional provisions that encourage retrospective application, but permit an entity that adopts the allowed alternative treatment to capitalise (prospectively) only those borrowing costs incurred after the effective date of IAS 23 that meet the criteria for capitalisation. However, if a first-time adopter adopts the IAS 23 allowed alternative treatment, the IFRS requires retrospective application of that treatment, even for periods before the effective date of IAS 23 (paragraph 9 of the IFRS).

IAS 27 *Consolidated and Separate Financial Statements*

IG26 A first-time adopter consolidates all subsidiaries that it controls, unless IAS 27 requires otherwise.

IG27 If a first-time adopter did not consolidate a subsidiary under previous GAAP, then:

(a) in its consolidated financial statements, the first-time adopter measures the subsidiary's assets and liabilities at the same carrying amounts as in the IFRS financial statements of the subsidiary, after adjusting for consolidation procedures and for the effects of the business combination in which it acquired the subsidiary (paragraph 25 of the IFRS). If the subsidiary has not adopted IFRSs in its financial statements, the carrying amounts described in the previous sentence are those that IFRSs would require in those financial statements (paragraph B2(j) of the IFRS).

(b) if the parent acquired the subsidiary in a business combination before the date of transition to IFRS, the parent recognises goodwill, as explained in IG Example 6.

(c) if the parent did not acquire the subsidiary in a business combination because it created the subsidiary, the parent does not recognise goodwill.

IG28 When a first-time adopter adjusts the carrying amounts of assets and liabilities of its subsidiaries in preparing its opening IFRS balance sheet, this may affect minority interests and deferred tax.

IG29 IG Examples 8 and 9 illustrate paragraphs 24 and 25 of the IFRS, which address cases where a parent and its subsidiary become first-time adopters at different dates.

IG Example 8 Parent adopts IFRSs before subsidiary

Background

Parent N presents its (consolidated) first IFRS financial statements in 2005. Its foreign subsidiary O, wholly owned by parent N since formation, prepares information under IFRSs for internal consolidation purposes from that date, but subsidiary O does not present its first IFRS financial statements until 2007.

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IG Example 8 Parent adopts IFRSs before subsidiary

Application of requirements

If subsidiary O applies paragraph 24(a) of the IFRS, the carrying amounts of its assets and liabilities are the same in both its opening IFRS balance sheet at 1 January 2006 and parent N's consolidated balance sheet (except for adjustments for consolidation procedures) and are based on parent N's date of transition to IFRSs.

Alternatively, subsidiary O may, under paragraph 24(b) of the IFRS, measure all its assets or liabilities based on its own date of transition to IFRSs (1 January 2006). However, the fact that subsidiary O becomes a first-time adopter in 2007 does not change the carrying amounts of its assets and liabilities in parent N's consolidated financial statements.

IG Example 9 Subsidiary adopts IFRSs before parent

Background

Parent P presents its (consolidated) first IFRS financial statements in 2007. Its foreign subsidiary Q, wholly owned by parent P since formation, presented its first IFRS financial statements in 2005. Until 2007, subsidiary Q prepared information for internal consolidation purposes under parent P's previous GAAP.

Application of requirements

The carrying amounts of subsidiary Q's assets and liabilities at 1 January 2006 are the same in both parent P's (consolidated) opening IFRS balance sheet and subsidiary Q's financial statements (except for adjustments for consolidation procedures) and are based on subsidiary Q's date of transition to IFRSs. The fact that parent P becomes a first-time adopter in 2007 does not change those carrying amounts (paragraph 25 of the IFRS).

IG30 Paragraphs 24 and 25 of the IFRS do not override the following requirements:

(a) to apply Appendix B of the IFRS to assets acquired, and liabilities assumed, in a business combination that occurred before the acquirer's date of transition to IFRSs. However, the acquirer applies paragraph 25 to new assets acquired, and liabilities assumed, by the acquiree after that business combination and still held at the acquirer's date of transition to IFRSs.

(b) to apply the rest of the IFRS in measuring all assets and liabilities for which paragraphs 24 and 25 are not relevant.

(c) to give all disclosures required by the IFRS as of the first-time adopter's own date of transition to IFRSs.

IG31 Paragraph 24 of the IFRS applies if a subsidiary becomes a first-time adopter later than its parent, for example if the subsidiary previously prepared a reporting package under IFRSs for consolidation purposes but did not present a full set of financial statements under IFRSs. This may be relevant not only when a subsidiary's reporting package complies fully with the recognition and measurement requirements of IFRSs, but also when it is adjusted centrally for matters such as post-balance sheet events review and central allocation of pension costs. For the disclosure required by paragraph 41 of the IFRS, adjustments made centrally to an unpublished reporting package are not corrections of errors. However, paragraph 24 does not permit a subsidiary to ignore misstatements that are immaterial to the consolidated financial statements of its parent but material to its own financial statements.

IAS 29 *Financial Reporting in Hyperinflationary Economies*

IG32 An entity complies with IAS 21 *The Effects of Changes in Foreign Exchange Rates* in determining its functional currency and presentation currency. When the entity prepares its opening IFRS balance sheet, it applies IAS 29 to any periods during which the economy of the functional currency or presentation currency was hyperinflationary.

IG33 An entity may elect to use the fair value of an item of property, plant and equipment at the date of transition to IFRSs as its deemed cost at that date (paragraph 16 of the IFRS), in which case it gives the disclosures required by paragraph 44 of the IFRS.

IG34 If an entity elects to use the exemptions in paragraphs 16–19 of the IFRS, it applies IAS 29 to periods after the date for which the revalued amount or fair value was determined.

IAS 32 *Financial Instruments: Disclosure and Presentation*[*]

IG35 In its opening IFRS balance sheet, an entity applies the criteria in IAS 32 to classify financial instruments issued (or components of compound instruments issued) as either financial liabilities or equity instruments in accordance with the substance of the contractual arrangement when the instrument first satisfied the recognition criteria in IAS 32 (paragraphs 15 and 30), without considering events after that date (other than changes to the terms of the instruments).

IG36 For compound instruments outstanding at the date of transition to IFRSs, an entity determines the initial carrying amounts of the components on the basis of circumstances existing when the instrument was issued (IAS 32, paragraph 30). An entity determines those carrying amounts using the version of IAS 32 effective at the reporting date for its first IFRS financial statements. If the liability component is no longer outstanding at the date of transition to IFRSs, a first-time adopter need not separate the initial equity component of the instrument from the cumulative interest accreted on the liability component (paragraph 23 of the IFRS).

IAS 34 *Interim Financial Reporting*

IG37 IAS 34 applies if an entity is required, or elects, to present an interim financial report in accordance with IFRSs. Accordingly, neither IAS 34 nor the IFRS requires an entity:

(a) to present interim financial reports that comply with IAS 34; or

* as revised in 2003

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(b) to prepare new versions of interim financial reports presented under previous GAAP. However, if an entity does prepare an interim financial report under IAS 34 for part of the period covered by its first IFRS financial statements, the entity restates the comparative information presented in that report so that it complies with IFRSs.

IG38 An entity applies the IFRS in each interim financial report that it presents under IAS 34 for part of the period covered by its first IFRS financial statements. In particular, paragraph 45 of the IFRS requires an entity to disclose various reconciliations (see IG Example 10).

IG Example 10 Interim financial reporting

Background

Entity R's first IFRS financial statements have a reporting date of 31 December 2005, and its first interim financial report under IAS 34 is for the quarter ended 31 March 2005. Entity R prepared previous GAAP annual financial statements for the year ended 31 December 2004, and prepared quarterly reports throughout 2004.

Application of requirements

In each quarterly interim financial report for 2005, entity R includes reconciliations of:

(a) its equity under previous GAAP at the end of the comparable quarter of 2004 to its equity under IFRSs at that date; and

(b) its profit or loss under previous GAAP for the comparable quarter of 2004 (current and year-to-date) to its profit or loss under IFRSs.

In addition to the reconciliations required by (a) and (b) and the disclosures required by IAS 34, entity R's interim financial report for the first quarter of 2005 includes reconciliations of (or a cross-reference to another published document that includes these reconciliations):

(a) its equity under previous GAAP at 1 January 2004 and 31 December 2004 to its equity under IFRSs at those dates; and

(b) its profit or loss for 2004 under previous GAAP to its profit or loss for 2004 under IFRSs.

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IG Example 10 Interim financial reporting

Each of the above reconciliations gives sufficient detail to enable users to understand the material adjustments to the balance sheet and income statement. Entity R also explains the material adjustments to the cash flow statement.

If entity R becomes aware of errors made under previous GAAP, the reconciliations distinguish the correction of those errors from changes in accounting policies.

If entity R did not, in its most recent annual financial statements under previous GAAP, disclose information material to an understanding of the current interim period, its interim financial reports for 2005 disclose that information or include a cross-reference to another published document that includes it (paragraph 46 of the IFRS).

IAS 36 *Impairment of Assets* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

IG39 An entity applies IAS 36 in:

(a) determining whether any impairment loss exists at the date of transition to IFRSs; and

(b) measuring any impairment loss that exists at that date, and reversing any impairment loss that no longer exists at that date. An entity's first IFRS financial statements include 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 to IFRSs (paragraph 39(c) of the IFRS).

IG40 The estimates used to determine whether an entity recognises an impairment loss or provision (and to measure any such impairment loss or provision) at the date of transition to IFRSs are consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error (paragraphs 31 and 32 of the IFRS). The entity reports the impact of any later revisions to those estimates as an event of the period in which it makes the revisions.

IG41 In assessing whether it needs to recognise an impairment loss or provision (and in measuring any such impairment loss or provision) at the date of transition to IFRSs, an entity may need to make estimates for that date that were not necessary under its previous GAAP. Such estimates and assumptions do not reflect conditions that arose after the date of transition to IFRSs (paragraph 33 of the IFRS).

IG42 The transitional provisions in IAS 36 and IAS 37 do not apply to an entity's opening IFRS balance sheet (paragraph 9 of the IFRS).

IG43 IAS 36 requires the reversal of impairment losses in some cases. If an entity's opening IFRS balance sheet reflects impairment losses, the entity recognises any later reversal of those impairment losses in the income statement (except when IAS 36 requires the entity to treat that reversal as a revaluation). This applies to both impairment losses recognised under previous GAAP and additional impairment losses recognised on transition to IFRSs.

IAS 38 *Intangible Assets*[*]

IG44 An entity's opening IFRS balance sheet:

(a) excludes all intangible assets and other intangible items that do not meet the criteria for recognition under IAS 38 at the date of transition to IFRSs; and

(b) includes all intangible assets that meet the recognition criteria in IAS 38 at that date, except for intangible assets acquired in a business combination that were not recognised in the acquirer's consolidated balance sheet under previous GAAP and also would not qualify for recognition under IAS 38 in the separate balance sheet of the acquiree (see paragraph B2(f) of Appendix B of the IFRS).

IG45 The criteria in IAS 38 require an entity to recognise an intangible asset if, and only if:

(a) it is probable that the future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost of the asset can be measured reliably.

IAS 38 supplements these two criteria with further, more specific, criteria for internally generated intangible assets.

IG46 Under paragraphs 65 and 71 of IAS 38, an entity capitalises the costs of creating internally generated intangible assets prospectively from the date when the recognition criteria are met. IAS 38 does not permit an entity to use hindsight to conclude retrospectively that these recognition criteria are met. Therefore, even if an entity concludes retrospectively that a future inflow of economic benefits from an internally generated intangible asset is probable and the entity is able to reconstruct the costs reliably, IAS 38 prohibits it from capitalising the costs incurred before the date when the entity both:

(a) concludes, based on an assessment made and documented at the date of that conclusion, that it is probable that future economic benefits from the asset will flow to the entity; and

(b) has a reliable system for accumulating the costs of internally generated intangible assets when, or shortly after, they are incurred.

IG47 If an internally generated intangible asset qualifies for recognition at the date of transition to IFRSs, an entity recognises the asset in its opening IFRS balance sheet even if it had recognised the related expenditure as an expense under previous GAAP. If the asset does not qualify for recognition under IAS 38 until a later date, its cost is the sum of the expenditure incurred from that later date.

IG48 The criteria discussed in paragraph IG45 also apply to an intangible asset acquired separately. In many cases, contemporaneous documentation prepared to support

[*] as revised in 2004

the decision to acquire the asset will contain an assessment of the future economic benefits. Furthermore, as explained in paragraph 26 of IAS 38, the cost of a separately acquired intangible asset can usually be measured reliably.

IG49 For an intangible asset acquired in a business combination before the date of transition to IFRSs, its carrying amount under previous GAAP immediately after the business combination is its deemed cost under IFRSs at that date (paragraph B2(e) of the IFRS). If that carrying amount was zero, the acquirer does not recognise the intangible asset in its consolidated opening IFRS balance sheet, unless it would qualify under IAS 38, applying the criteria discussed in paragraphs IG45–IG48, for recognition at the date of transition to IFRSs in the balance sheet of the acquiree (paragraph B2(f) of the IFRS). If those recognition criteria are met, the acquirer measures the asset on the basis that IAS 38 would require in the balance sheet of the acquiree. The resulting adjustment affects goodwill (paragraph B2(g)(i) of the IFRS).

IG50 A first-time adopter may elect to use the fair value of an intangible asset at the date of an event such as a privatisation or initial public offering as its deemed cost at the date of that event (paragraph 19 of the IFRS), provided that the intangible asset qualifies for recognition under IAS 38 (paragraph 10 of the IFRS). In addition, if, and only if, an intangible asset meets both the recognition criteria in IAS 38 (including reliable measurement of original cost) and the criteria in IAS 38 for revaluation (including the existence of an active market), a first-time adopter may elect to use one of the following amounts as its deemed cost (paragraph 18 of the IFRS):

(a) fair value at the date of transition to IFRSs (paragraph 16 of the IFRS), in which case the entity gives the disclosures required by paragraph 44 of the IFRS; or

(b) a revaluation under previous GAAP that meets the criteria in paragraph 17 of the IFRS.

IG51 If an entity's amortisation methods and rates under previous GAAP would be acceptable under IFRSs, the entity does not restate the accumulated amortisation in its opening IFRS balance sheet. Instead, the entity accounts for any change in estimated useful life or amortisation pattern prospectively from the period when it makes that change in estimate (paragraph 31 of the IFRS and paragraph 104 of IAS 38). However, in some cases, an entity's amortisation methods and rates under previous GAAP may differ from those that would be acceptable under IFRSs (for example, if they were adopted solely for tax purposes and do not reflect a reasonable estimate of the asset's useful life). If those differences have a material effect on the financial statements, the entity adjusts the accumulated amortisation in its opening IFRS balance sheet retrospectively so that it complies with IFRSs (paragraph 31 of the IFRS).

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IAS 39 *Financial Instruments: Recognition and Measurement*[*]

IG52 An entity recognises and measures all financial assets and financial liabilities in its opening IFRS balance sheet in accordance with IAS 39, except as specified in paragraphs 27–30 of the IFRS, which address derecognition and hedge accounting, and paragraph 36A, which permits an exemption from restating comparative information.

Recognition

IG53 An entity recognises all financial assets and financial liabilities (including all derivatives) that qualify for recognition under IAS 39 and have not yet qualified for derecognition under IAS 39, except non-derivative financial assets and non-derivative financial liabilities derecognised under previous GAAP before 1 January 2004, to which the entity does not choose to apply paragraph 27A (see paragraphs 27 and 27A of the IFRS). For example, an entity that does not apply paragraph 27A does not recognise assets transferred in a securitisation, transfer or other derecognition transaction that occurred before 1 January 2004 if those transactions qualified for derecognition under previous GAAP. However, if the entity uses the same securitisation arrangement or other derecognition arrangement for further transfers after 1 January 2004, those further transfers qualify for derecognition only if they meet the derecognition criteria of IAS 39.

IG54 An entity does not recognise financial assets and financial liabilities that do not qualify for recognition under IAS 39, or have already qualified for derecognition under IAS 39.

Embedded derivatives

IG55 When IAS 39 requires an entity to separate an embedded derivative from a host contract, the initial carrying amounts of the components at the date when the instrument first satisfies the recognition criteria in IAS 39 reflect circumstances at that date (IAS 39, paragraph 11). If the entity cannot determine the initial carrying amounts of the embedded derivative and host contract reliably, it treats the entire combined contract as a financial instrument held for trading (IAS 39, paragraph 12). This results in fair value measurement (except when the entity cannot determine a reliable fair value, see IAS 39, paragraph 46(c)), with changes in fair value recognised in profit or loss.

Measurement

IG56 In preparing its opening IFRS balance sheet, an entity applies the criteria in IAS 39 to identify those financial assets and financial liabilities that are measured at fair value and those that are measured at amortised cost. In particular:

(a) to comply with IAS 39, paragraph 51, classification of financial assets as held-to-maturity investments relies on a designation made by the entity in applying IAS 39 reflecting the entity's intention and ability at the date of transition to IFRSs. It follows that sales or transfers of held-to-maturity investments before the date of transition to IFRSs do not trigger the 'tainting' rules in IAS 39, paragraph 9.

[*] as revised in 2003

(b) to comply with IAS 39, paragraph 9, the category of 'loans and receivables' refers to the circumstances when the financial asset first satisfied the recognition criteria in IAS 39.

(c) under IAS 39, paragraph 9, derivative financial assets and derivative financial liabilities are always deemed held for trading (except for a derivative that is a designated and effective hedging instrument). The result is that an entity measures all derivative financial assets and derivative financial liabilities at fair value.

(d) to comply with IAS 39, paragraph 50, an entity classifies a non-derivative financial asset or non-derivative financial liability in its opening IFRS balance sheet as at fair value through profit or loss if, and only if, the asset or liability was:

  (i) acquired or incurred principally for the purpose of selling or repurchasing it in the near term;

  (ii) at the date of transition to IFRSs, part of a portfolio of identified financial instruments that were managed together and for which there was evidence of a recent actual pattern of short-term profit-taking; or

  (iii) designated as at fair value through profit or loss at the date of transition to IFRSs.

(e) to comply with IAS 39, paragraph 9, available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale and those non-derivative financial assets that are not in any of the previous categories.

IG57 For those financial assets and financial liabilities measured at amortised cost in the opening IFRS balance sheet, an entity determines their cost on the basis of circumstances existing when the assets and liabilities first satisfied the recognition criteria in IAS 39. However, if the entity acquired those financial assets and financial liabilities in a past business combination, their carrying amount under previous GAAP immediately following the business combination is their deemed cost under IFRSs at that date (paragraph B2(e) of the IFRS).

IG58 An entity's estimates of loan impairments at the date of transition to IFRSs are consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 31 of the IFRS). The entity treats the impact of any later revisions to those estimates as impairment losses (or, if the criteria in IAS 39 are met, reversals of impairment losses) of the period in which it makes the revisions.

Transition adjustments

IG58A An entity shall treat an adjustment to the carrying amount of a financial asset or financial liability as a transition adjustment to be recognised in the opening balance of retained earnings at the date of transition to IFRSs only to the extent that it results from adopting IAS 39. Because all derivatives, other than those that are designated and effective hedging instruments, are classified as held for trading, the differences between the previous carrying amount (which may have been zero) and the fair value of the derivatives are recognised as an adjustment of the balance of retained earnings at the beginning of the financial year in which IAS 39 is initially applied (other than for a derivative that is a designated and effective hedging instrument).

IG58B IAS 8 (as revised in 2003) applies to adjustments resulting from changes in estimates. If an entity is unable to determine whether a particular portion of the adjustment is a transition adjustment or a change in estimate, it treats that portion as a change in accounting estimate under IAS 8, with appropriate disclosures (IAS 8, paragraphs 32–40).

IG59 An entity may, under its previous GAAP, have measured investments at fair value and recognised the revaluation gain directly in equity. If an investment is classified as at fair value through profit or loss, the pre-IAS 39 revaluation gain that had been recognised in equity is reclassified into retained earnings on initial application of IAS 39. If, on initial application of IAS 39, an investment is classified as available for sale, then the pre-IAS 39 revaluation gain is recognised in a separate component of equity. Subsequently, the entity recognises gains and losses on the available-for-sale financial asset in that separate component of equity until the investment is impaired, sold, collected or otherwise disposed of. On subsequent derecognition or impairment of the available-for-sale financial asset, the entity transfers to profit or loss the cumulative gain or loss remaining in equity (IAS 39, paragraph 55(b)).

Hedge accounting

IG60 Paragraphs 28–30 of the IFRS deal with hedge accounting. The designation and documentation of a hedge relationship must be completed on or before the date of transition to IFRSs if the hedge relationship is to qualify for hedge accounting from that date. Hedge accounting can be applied prospectively only from the date that the hedge relationship is fully designated and documented.

IG60A An entity may, under its previous GAAP, have deferred or not recognised gains and losses on a fair value hedge of a hedged item that is not measured at fair value. For such a fair value hedge, an entity adjusts the carrying amount of the hedged item at the date of transition to IFRSs. The adjustment is the lower of:

(a) 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

(b) that portion of the cumulative change in the fair value of the hedging instrument that reflects the designated hedged risk and, under previous GAAP, was either (i) not recognised or (ii) deferred in the balance sheet as an asset or liability.

IG60B An entity may, under its previous GAAP, have deferred gains and losses on a cash flow hedge of a forecast transaction. If, at the date of transition to IFRSs, the hedged forecast transaction is not highly probable, but is expected to occur, the entire deferred gain or loss is recognised in equity. Any net cumulative gain or loss that has been reclassified to equity on initial application of IAS 39 remains in equity until (a) the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, (b) the forecast transaction affects

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profit or loss or (c) subsequently circumstances change and the forecast transaction is no longer expected to occur, in which case any related net cumulative gain or loss that had been recognised directly in equity is recognised in profit or loss. If the hedging instrument is still held, but the hedge does not qualify as a cash flow hedge under IAS 39, hedge accounting is no longer appropriate starting from the date of transition to IFRSs.

IAS 40 *Investment Property*

IG61 An entity that adopts the fair value model in IAS 40 measures its investment property at fair value at the date of transition to IFRSs. The transitional requirements of IAS 40 do not apply (paragraph 9 of the IFRS).

IG62 An entity that adopts the cost model in IAS 40 applies paragraphs IG7–IG13 on property, plant and equipment.

Explanation of transition to IFRSs

IG63 Paragraphs 39(a) and (b), 40 and 41 of the IFRS require a first-time adopter to disclose reconciliations that give sufficient detail to enable users to understand the material adjustments to the balance sheet, income statement and, if applicable, cash flow statement. Paragraph 39(a) and (b) requires specific reconciliations of equity and profit or loss. IG Example 11 shows one way of satisfying these requirements.

IG Example 11 Reconciliation of equity and profit or loss

Background

An entity first adopted IFRSs in 2005, with a date of transition to IFRSs of 1 January 2004. Its last financial statements under previous GAAP were for the year ended 31 December 2004.

Application of requirements

The entity's first IFRS financial statements include the reconciliations and related notes shown below.

Among other things, this example includes a reconciliation of equity at the date of transition to IFRSs (1 January 2004). The IFRS also requires a reconciliation at the end of the last period presented under previous GAAP (not included in this example).

In practice, it may be helpful to include cross-references to accounting policies and supporting analyses that give further explanation of the adjustments shown in the reconciliations below.

If a first-time adopter becomes aware of errors made under previous GAAP, the reconciliations distinguish the correction of those errors from changes in accounting policies (paragraph 41 of the IFRS). This example does not illustrate disclosure of a correction of an error.

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IG Example 11 Reconciliation of equity and profit or loss

Reconciliation of equity at 1 January 2004 (date of transition to IFRSs)

Note		*Previous GAAP*	*Effect of transition to IFRSs*	*IFRSs*
1	Property, plant and equipment	8,299	100	8,399
2	Goodwill	1,220	150	1,370
2	Intangible assets	208	(150)	58
3	Financial assets	3,471	420	3,891
	Total non-current assets	13,198	520	13,718
	Trade and other receivables	3,710	0	3,710
4	Inventories	2,962	400	3,362
5	Other receivables	333	431	764
	Cash and cash equivalents	748	0	748
	Total current assets	7,753	831	8,584
	Total assets	20,951	1,351	22,302
	Interest-bearing loans	9,396	0	9,396
	Trade and other payables	4,124	0	4,124
6	Employee benefits	0	66	66
7	Restructuring provision	250	(250)	0
	Current tax liability	42	0	42
8	Deferred tax liability	579	460	1,039
	Total liabilities	14,391	276	14,667
	Total assets less total liabilities	6,560	1,075	7,635
	Issued capital	1,500	0	1,500
3	Revaluation reserve	0	294	294
5	Hedging reserve	0	302	302
9	Retained earnings	5,060	479	5,539
	Total equity	6,560	1,075	7,635

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IG Example 11 Reconciliation of equity and profit or loss

Notes to the reconciliation of equity at 1 January 2004:

1 Depreciation was influenced by tax requirements under previous GAAP, but under IFRSs reflects the useful life of the assets. The cumulative adjustment increased the carrying amount of property, plant and equipment by 100.

2 Intangible assets under previous GAAP included 150 for items that are transferred to goodwill because they do not qualify for recognition as intangible assets under IFRSs.

3 Financial assets are all classified as available-for-sale under IFRSs and are carried at their fair value of 3,891. They were carried at cost of 3,471 under previous GAAP. The resulting gains of 294 (420, less related deferred tax of 126) are included in the revaluation reserve.

4 Inventories include fixed and variable production overhead of 400 under IFRSs, but this overhead was excluded under previous GAAP.

5 Unrealised gains of 431 on unmatured forward foreign exchange contracts are recognised under IFRSs, but were not recognised under previous GAAP. The resulting gains of 302 (431, less related deferred tax of 129) are included in the hedging reserve because the contracts hedge forecast sales.

6 A pension liability of 66 is recognised under IFRSs, but was not recognised under previous GAAP, which used a cash basis.

7 A restructuring provision of 250 relating to head office activities was recognised under previous GAAP, but does not qualify for recognition as a liability under IFRSs.

8 The above changes increased the deferred tax liability as follows:

Revaluation reserve (note 3)	126
Hedging reserve (note 5)	129
Retained earnings	205
Increase in deferred tax liability	460

Because the tax base at 1 January 2004 of the items reclassified from intangible assets to goodwill (note 2) equalled their carrying amount at that date, the reclassification did not affect deferred tax liabilities.

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IG Example 11 Reconciliation of equity and profit or loss

9 The adjustments to retained earnings are as follows:

Depreciation (note 1)	100
Production overhead (note 4)	400
Pension liability (note 6)	(66)
Restructuring provision (note 7)	250
Tax effect of the above	(205)
Total adjustment to retained earnings	479

Reconciliation of profit or loss for 2004

Note		*Previous GAAP*	*Effect of transition to IFRSs*	*IFRSs*
	Revenue	20,910	0	20,910
1,2,3	Cost of sales	(15,283)	(97)	(15,380)
	Gross profit	5,627	(97)	5,530
1	Distribution costs	(1,907)	(30)	(1,937)
1,4	Administrative expenses	(2,842)	(300)	(3,142)
	Finance income	1,446	0	1,446
	Finance costs	(1,902)	0	(1,902)
	Profit before tax	422	(427)	(5)
5	Tax expense	(158)	128	(30)
	Net profit (loss)	264	(299)	(35)

Notes to the reconciliation of profit or loss for 2004:

1 A pension liability is recognised under IFRSs, but was not recognised under previous GAAP. The pension liability increased by 130 during 2004, which caused increases in cost of sales (50), distribution costs (30) and administrative expenses (50).

2 Cost of sales is higher by 47 under IFRSs because inventories include fixed and variable production overhead under IFRSs but not under previous GAAP.

3 Depreciation was influenced by tax requirements under previous GAAP, but reflects the useful life of the assets under IFRSs. The effect on the profit for 2004 was not material.

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IG Example 11 Reconciliation of equity and profit or loss

4	A restructuring provision of 250 was recognised under previous GAAP at 1 January 2004, but did not qualify for recognition under IFRS until the year ended 31 December 2004. This increases administrative expenses for 2004 under IFRSs.
5	Adjustments 1–4 above lead to a reduction of 128 in deferred tax expense.

Explanation of material adjustments to the cash flow statement for 2004:

Income taxes of 133 paid during 2004 are classified as operating cash flows under IFRSs, but were included in a separate category of tax cash flows under previous GAAP. There are no other material differences between the cash flow statement presented under IFRSs and the cash flow statement presented under previous GAAP.

IFRS 2 *Share-based Payment*

IG64 A first-time adopter is encouraged, but not required, to apply IFRS 2 *Share-based Payment* to equity instruments that were granted after 7 November 2002 that vested before the later of (a) the date of transition to IFRSs and (b) 1 January 2005.

IG65 For example, if an entity's date of transition to IFRSs is 1 January 2004, the entity applies IFRS 2 to shares, share options or other equity instruments that were granted after 7 November 2002 and had not yet vested at 1 January 2005. Conversely, if an entity's date of transition to IFRSs is 1 January 2010, the entity applies IFRS 2 to shares, share options or other equity instruments that were granted after 7 November 2002 and had not yet vested at 1 January 2010.

[Paragraphs IG66–IG200 reserved for possible guidance on future standards]

IFRIC Interpretations

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

IG201 IAS 16 requires the cost of an item of property, plant and equipment to include the initial estimate of the costs of dismantling and removing the asset and restoring the site on which it is located. IAS 37 requires the liability, both initially and subsequently, to be measured at the amount required to settle the present obligation at the balance sheet date, reflecting a current market-based discount rate.

IG202 IFRIC 1 requires that, subject to specified conditions, changes in an existing decommissioning, restoration or similar liability are added to or deducted from the cost of the related asset. The resulting depreciable amount of the asset is depreciated over its useful life, and the periodic unwinding of the discount on the liability is recognised in profit or loss as it occurs.

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IG203 Paragraph 25E of IFRS 1 provides a transitional exemption. Instead of retrospectively accounting for changes in this way, entities can include in the depreciated cost of the asset an amount calculated by discounting the liability at the date of transition to IFRSs back to, and depreciating it from, when the liability was first incurred. IG Example 201 illustrates the effect of applying this exemption, assuming that the entity accounts for its property, plant and equipment using the cost model.

IG Example 201 Changes in existing decommissioning, restoration and similar liabilities

Background

An entity's first IFRS financial statements have a reporting date of 31 December 2005 and include comparative information for 2004 only. Its date of transition to IFRSs is therefore 1 January 2004.

The entity acquired an energy plant on 1 January 2001, with a life of 40 years.

As at the date of transition to IFRSs, the entity estimates the decommissioning cost in 37 years' time to be 470, and estimates that the appropriate risk-adjusted discount rate for the liability is 5 per cent. It judges that the appropriate discount rate has not changed since 1 January 2001.

Application of requirements

The decommissioning liability recognised at the transition date is 77 (470 discounted for 37 years at 5 per cent).

Discounting this liability back for a further three years to 1 January 2001 gives an estimated liability at acquisition, to be included in the cost of the asset, of 67. Accumulated depreciation on the asset is $67 \times 3/40 = 5$.

The amounts recognised in the opening IFRS balance sheet on the date of transition to IFRSs (1 January 2004) are, in summary:

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

IFRIC 4 *Determining whether an Arrangement contains a Lease*

IG204 IFRIC 4 specifies criteria for determining, at the inception of an arrangement, whether the arrangement contains a lease. It also specifies when an arrangement should be reassessed subsequently.

IG205 Paragraph 25F of IFRS 1 provides a transitional exemption. Instead of determining retrospectively whether an arrangement contains a lease at the inception of the arrangement and subsequently reassessing that arrangement as required in the periods before transition to IFRSs, entities may determine whether arrangements in existence on the date of transition to IFRSs contain leases by applying paragraphs 6–9 of IFRIC 4 to those arrangements on the basis of facts and circumstances existing on that date.

IG Example 202 Determining whether an arrangement contains a Lease

Background

An entity's first IFRS financial statements have a reporting date of 31 December 2007 and include comparative information for 2006 only. Its date of transition to IFRSs is therefore 1 January 2006.

On 1 January 1995, the entity entered into a take–or–pay arrangement to supply gas. On 1 January 2000, there was a change in the contractual terms of the arrangement.

Application of requirements

On 1 January 2006, the entity may determine whether the arrangement contains a lease by applying the criteria in paragraphs 6–9 of IFRIC 4 on the basis of facts and circumstances existing on that date. Alternatively, the entity applies those criteria on the basis of facts and circumstances existing on 1 January 1995 and reassesses the arrangement on 1 January 2000. If the arrangement is determined to contain a lease, the entity follows the guidance in paragraphs IG14–IG16.

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