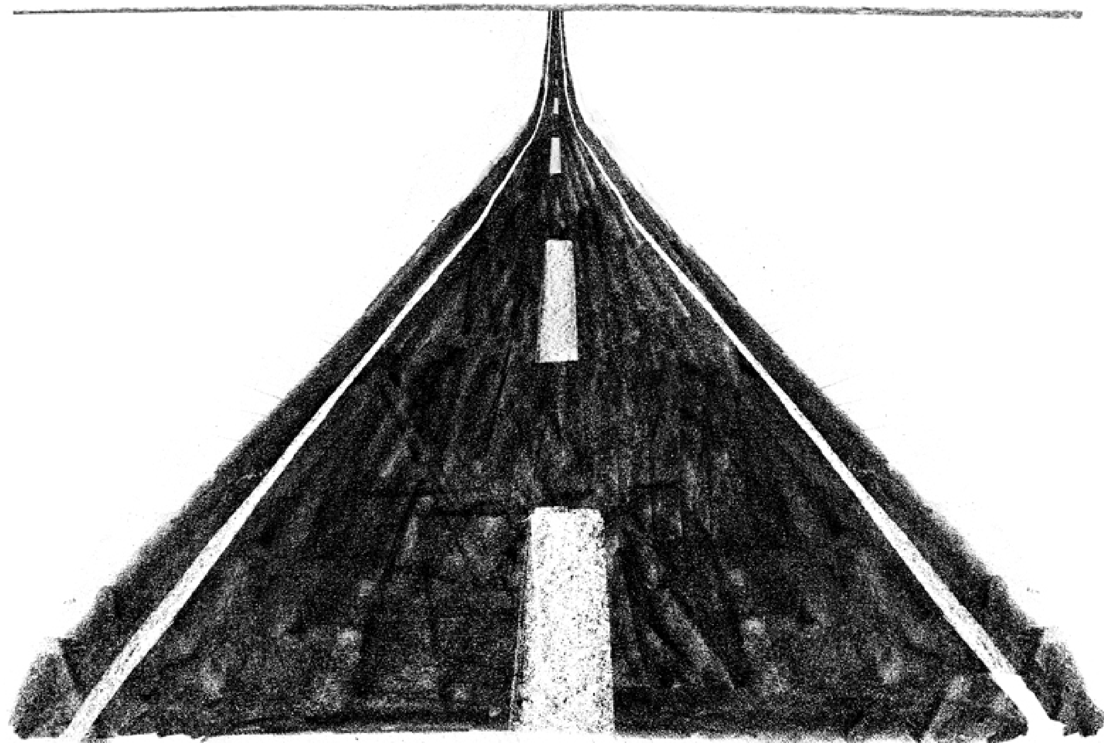
Grant Thornton

The Road to IFRS

A practical guide to IFRS 1 and first-time adoption
May 2009



Introduction

The Road to IFRS

International Financial Reporting Standards (IFRS) is fast becoming the global accounting language. Over 100 countries have now adopted IFRS and many more have committed to make the transition in the next few years. The benefits of global standards are widely acknowledged. For companies, however, the conversion to IFRS is a major change both for the finance function and for the wider business.

The International Accounting Standards Board (IASB) has recognised the need for guidance. In 2003 it published IFRS 1 *First-time adoption of International Financial Reporting Standards* (IFRS 1). IFRS 1 covers the application of IFRS in a company's first IFRS financial statements. It starts with the basic premise that an entity applies IFRS for the first time on a fully retrospective basis. However, acknowledging the cost and complexity of that approach, it then establishes various exemptions in areas where retrospective application would be too burdensome or impractical. In planning the conversion, management must develop a detailed and specific understanding of IFRS 1's implications on their business. Questions to consider include:

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

The member firms of Grant Thornton International Ltd (Grant Thornton International) - one of the world's leading organisations of independently owned and managed accounting and consulting firms - have gained extensive insights into the more problematic aspects of first-time adoption of IFRS. Grant Thornton International, through its IFRS team, develops general guidance that supports its member firms' commitment to high quality, consistent application of IFRS. We are pleased to share these insights by publishing this guide *The Road to IFRS - A practical guide to IFRS 1 and first-time adoption*. The guide reflects the collective experience of Grant Thornton International's IFRS team and member firm IFRS experts. It explains IFRS 1's key implementation issues and includes interpretational guidance in the more problematic areas. The guide also includes several examples illustrating the standard's disclosure and presentation requirements.

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Latest version of IFRS 1

IFRS 1 has been amended many times since its first publication, to accommodate changes to other IFRSs. As a result its structure became increasingly complex and unwieldy. In November 2008, the IASB issued a new version of IFRS 1 that simplifies the structure while retaining the previous technical content. For example, IFRS 1's exemptions have been moved to an appendix to facilitate future changes. The new version also contains the changes made as a consequence of IAS 1 *Presentation of Financial Statements* (revised 2007). It is effective for reporting periods beginning on or after 1 July 2009 with earlier application permitted.

In this guide, all references and examples are based on application of the November 2008 version of IFRS 1 (including examples that refer to periods prior to 1 July 2009 - the mandatory effective date). As the technical content of IFRS 1 was not changed in the 2008 restructuring, the guide is also relevant to entities applying the previous version.

Using this guide

The guide is organised as follows:

- **Section A** addresses the scope and objectives of IFRS 1 and summarises its main principles.
- **Section B** discusses the implications of preparing an IFRS opening statement of financial position, focusing on recognition and measurement principles (IFRS accounting policies) and the date of transition.
- **Section C** discusses the exemptions to full retrospective application of IFRS illustrating the practical implications with several examples.
- **Section D** addresses the disclosure requirements of IFRS 1.
- A list of mandatory and optional exemptions from full retrospective application of IFRS is included in **Appendix I.**
- **Appendix II** provides further application guidance.

We have not attempted to cover all potential challenges for a first-time adopter. The process of adopting IFRS involves many stages, such as for example changing the accounting systems and communication to investors and other stakeholders. Although such issues are very important, and must be considered by management at an early stage, these issues are not covered in this guide.

The focus of this guide is on the accounting aspects of first-time adoption. The guide is intended to assist companies and auditors in applying the challenging aspects of IFRS 1, and provides several examples of practical application. It is not possible to cover every possible transaction that may arise in practice, however, we believe that you will find the guide useful.

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May 2009

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A. IFRS 1 principles in brief

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

IFRS 1 at a glance

A. The main principle of IFRS 1 is to present the first IFRS financial statements using the accounting policies effective at the end of the first IFRS reporting period throughout all periods presented. For example, a company using IFRS for the first time in 2009 with a December year-end would use the accounting policies in force at 31 December 2009 and apply those policies retrospectively. Therefore the financial statements are presented as if the first-time adopter had always presented IFRS financial statements (important exemptions apply).

B. The first-time adopter establishes its date of transition, which is defined as the beginning of the earliest period for which an entity presents full comparative information under IFRS in its first IFRS financial statements.

C. At the date of transition the first-time adopter prepares an opening statement of financial position. This is the starting point for its accounting under IFRS.

D. In the opening statement of financial position, the first-time adopter applies its IFRS accounting policies in recognising and measuring all assets and liabilities, and if appropriate reclassifies items recognised under previous generally accepted accounting principles (GAAP) as another type of asset, liability or component of equity. The accounting policies are based on IFRSs effective at the end of its first IFRS reporting period (important exemptions apply).

E. In preparing the opening statement of financial position, the first-time adopter may choose the optional exemptions from retrospective application. The first-time adopter applies the mandatory exemptions in all applicable cases.

F. A first-time adopter prepares reconciliations between previous GAAP and IFRS, and discloses these reconciliations in its first IFRS financial statements (and interim report, if applicable). The entity complies with other note disclosures in IFRS 1 in addition to those required by other IFRSs.

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1 Background and objectives

IFRS 1 was published by the IASB in June 2003. It sets out most of the transitional requirements that an entity applies when it first adopts IFRS and also specifies various disclosures to explain the effects of transition to IFRS.

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

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

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

2 When does IFRS 1 apply?

IFRS 1.2 states that:

"An entity shall apply this IFRS in:
(a) its first IFRS financial statements; and
(b) each interim financial report, if any, that it presents in accordance with IAS 34 *Interim Financial Reporting* for part of the period covered by its first IFRS financial statements."

2.1 First IFRS financial statements

An entity only applies IFRS 1 in its first IFRS financial statements (and each interim financial report that covers part of the period of those first IFRS financial statements). It is therefore essential to identify those financial statements, which are defined as "The first **annual** financial statements in which the entity adopts International Financial Reporting Standards (IFRSs), by an explicit and unreserved statement of compliance with IFRSs." (IFRS 1.Appendix A) [emphasis added].

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

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

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Example A.1: First IFRS financial statements

A. Entity A did not present financial statements for previous periods. Entity A's annual financial statements include an explicit and unreserved statement of compliance with IFRS. The financial statements of Entity A are the entity's first IFRS financial statements, and Entity A applies IFRS 1. (IFRS 1.3(d))

B. Entity B's previous financial statements contained an explicit statement of compliance with some, but not all, IFRSs. The financial statements of Entity B for the year contain an explicit and unreserved statement of compliance with all IFRSs. The financial statements for the year are the entity's first IFRS financial statements and the entity applies IFRS 1. (IFRS 1.3(a)(iii))

C. Entity C's financial statements for the previous year contained an explicit and unreserved statement of compliance with IFRS, but the auditors presented a qualified audit report. The financial statements of Entity C for this year are not the entity's first IFRS financial statements, and IFRS 1 does not apply. (IFRS 1.4(c))

D. Entity D presented its prior year financial statements under national requirements and those financial statements contained an explicit and unreserved statement of compliance with IFRS. This year's financial statements also contain an explicit and unreserved statement of compliance with IFRS. The financial statements of Entity D for this year are not the entity's first IFRS financial statements, and IFRS 1 does not apply. (IFRS 1.4(b))

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

2.2 Interim financial reports

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

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B. Opening statement of financial position

Summary of requirements

A. The first-time adopter establishes its date of transition to IFRSs, which is defined as the beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements.

B. At the date of transition the first-time adopter prepares an opening statement of financial position. This is the starting point for its accounting under IFRS.

C. In the opening statement of financial position, the first-time adopter applies its IFRS accounting policies in recognising and measuring all assets and liabilities, and if appropriate reclassifies items recognised under previous GAAP as another type of asset, liability or component of equity. The accounting policies are based on IFRSs effective at the end of its first IFRS reporting period (important exemptions apply). For interim reports, we believe the effective standards at the date of authorisation of those interim reports should be applied.

1 Preparing an opening statement of financial position

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

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

This opening statement of financial position is prepared based on IFRS in force at the end of the first reporting period under IFRS, except where IFRS 1 permits or requires otherwise.

1.1 The date of transition

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

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

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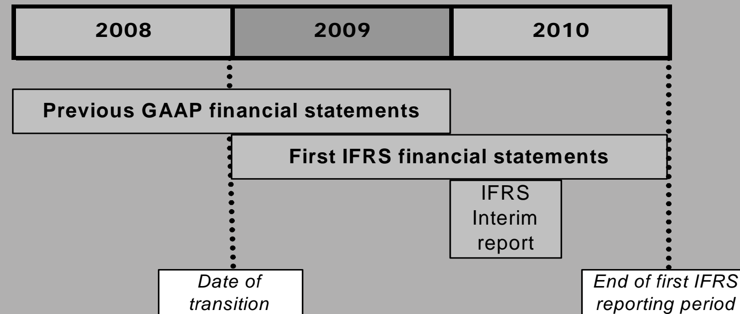
For companies presenting only one year of full comparative information, the date of transition will be the beginning of the (only) full comparative period. Consider the following example:

Example B.1: The date of transition



The first-time adopter prepares its first IFRS financial statements at 31 December 2010 (the end of its first IFRS reporting period). For the 2009 and previous annual periods the first-time adopter presented its financial statements under national GAAP. The first-time adopter prepares one year of full comparative information in accordance with stock exchange and IFRS requirements. The date of transition is determined as 1 January 2009 (the beginning of the earliest comparative period for which an entity presents full comparative information). Under stock exchange requirements the first-time adopter is required to present an interim report under IFRS at least every 6 months. The first-time adopter presents its interim report for the period 1 January 2010 to 30 June 2010, which is part of the period for its first IFRS financial statements. This interim report is prepared under IAS 34 *Interim Financial Reporting*. To comply with IFRS 1, the first-time adopter presents additional information to that required in IAS 34 for each interim report of the first year presented under IFRS (IFRS 1.32 and IFRS 1.33).

Presenting one year of full comparative information is the norm under IFRS. It should however be noted that IAS 1 *Presentation of Financial Statements* (as revised in 2007) (IAS 1R) now requires an additional statement of financial position in a regular set of IFRS financial statements at the beginning of the earliest comparative period presented when an entity makes a retrospective restatement. In first IFRS financial statements, IFRS 1.21 now requires presentation of at least two comparative statements of financial position, and one comparative period of other primary financial statements.

IFRS 1 paragraph 21

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

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

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

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

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

Entity C is presenting its first IFRS financial statements in 2009 with a reporting date of 31 December 2009. The entity is required by national law to present full comparative information under IFRS for two annual periods. The date of transition is 1 January 2007, which is the beginning of the earliest period where an entity presents full comparative information under IFRS. In this situation, the transition date is 3 years before the reporting date because of the requirement by national law for two full comparative periods.

1.2 Recognition and measurement in the opening statement of financial position

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

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

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

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

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2 Accounting policies

In preparing the opening statement of financial position a first-time adopter applies accounting policies that comply with all IFRSs effective at the end of its first IFRS reporting period, which is the end of the latest period covered by the financial statements. It uses these accounting policies throughout all periods presented in the first IFRS financial statements (IFRS 1.7). In other words, a first-time adopter is not permitted to apply different versions of IFRS that were effective at earlier dates (IFRS 1.8).

2.1 Transitional provisions of other standards do not apply

Transitional and effective date provisions in other IFRSs

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

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

The transitional provisions in other IFRSs do not apply to a first-time adopter except where specified in IFRS 1 (IFRS 1.9). The transitional provisions in other IFRSs therefore apply only to entities that already apply IFRS. However, there are exceptions to this general rule for insurance contracts, leases, service concession arrangements and borrowing costs. For these items, the transitional provisions of the relevant standards apply as specified in IFRS 1.9.

2.2 Changes to IFRS effective later than the first reporting date

In many cases, a first-time adopter will find that more than one standard (or version thereof) is available at the end of the first IFRS reporting period. This occurs when the IASB has issued a new or revised standard which is not yet mandatory at that date but which permits early application. In this situation, a first-time adopter is permitted to develop its accounting policies using either the previous or the latest version. For example, IAS 23 *Borrowing Costs* was revised in 2007 to remove the option to expense rather than capitalise certain borrowing costs. Those changes take mandatory effect for annual periods beginning on or after 1 January 2009, but earlier application is permitted. If a first-time adopter presents its first IFRS financial statements at 30 June 2009 (ie for an annual period beginning on 1 July 2008), it can apply the former version of IAS 23. Alternatively, it can apply the 2007 changes to IAS 23. IFRS 1.8 confirms that a first-time adopter may apply a new IFRS that is not yet mandatory if that IFRS permits early application.

In practice, a first-time adopter will often find it more convenient to apply the new version of a standard to avoid having an accounting policy change in the following year, but there may be

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circumstances favouring the use of the older version. The options are illustrated further by the following example:

Example B.3: Impact of new standards

Entity F is a first-time adopter and its first IFRS reporting period ends on 31 December 2009. Entity F presents full comparative information in those financial statements for one year. Therefore, its date of transition to IFRS is 1 January 2008. Entity F presented financial statements under its previous GAAP annually to 31 December each year up to, and including, 31 December 2008.

Entity F is required to apply the IFRS effective for periods ending on 31 December 2009 in:
(a) preparing and presenting its opening IFRS statement of financial position at 1 January 2008, and
(b) preparing and presenting its statement of financial position for 31 December 2009 (including comparative amounts for 2008), statement of comprehensive income, statement of changes in equity and statement of cash flows for the year to 31 December 2009 (including comparative amounts for 2008) and related notes.

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

Determining effective standards:

The first-time adopter applies all of those IFRS that are effective on 31 December 2009.

IAS 1R becomes effective for annual periods beginning on or after 1 January 2009. The annual period in which Entity F presents its first IFRS financial statements begins 1 January 2009. Therefore, IAS 1R is effective at 31 December 2009 and must be applied.

IFRS 3 *Business Combinations* (Revised 2008) (IFRS 3R) becomes effective for annual periods beginning on or after 1 July 2009. The annual period in which Entity F presents its first IFRS financial statements begins 1 January 2009. Therefore, IFRS 3R is not effective at 31 December 2009, however, Entity F may elect to adopt the standard early, as early adoption is permitted (IAS 27 revised must be adopted at the same time).

2.3 Interim financial reports

When publishing interim financial reports, which cover part of the period of the first IFRS financial statements, a first-time adopter may not always be able to identify the IFRSs effective at the end of the reporting period. This may occur as a result of the IASB making one of its occasional 'fast-track' changes to IFRS after publication of the interim report but before the end of the first IFRS reporting period. Management may also decide to change an accounting policy after release of the interim report, for example by early application of a new IFRS.

We consider that the accounting policies used in an interim report should reflect the IFRS effective at the date of authorisation of that interim financial report. An entity should not use an exposure draft it expects to be approved before year-end as the basis for an accounting policy in its interim report. In the absence of an IFRS that specifically applies to a transaction, the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for selection of accounting policies applies both for the interim report and for the annual financial statements. The selection of accounting policies for interim financial reports can be illustrated with the following example:

Example B.4: Interim financial reports

The facts are the same as in example B.3 above. The first-time adopter uses the standards that are effective at the date of authorisation of the interim report.

IAS 1R becomes effective for annual periods beginning on or after 1 January 2009. The annual period in which Entity F presents its first IFRS interim financial reports begins 1 January 2009. Therefore, IAS 1R is effective at 31 December 2009 and shall be applied.

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As noted above, the accounting policies used for the first annual IFRS financial statements should comply with each IFRS effective at the end of the first IFRS reporting period, except when an exemption is applied.

3 Where does the adjustment entry go?

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

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

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

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C. Exemptions from full retrospective application

Summary of requirements

A. In preparing the opening statement of financial position the first-time adopter applies the IFRS accounting policies effective at the end of the first IFRS reporting period. The general principle is to apply the IFRS accounting policies retrospectively in the opening statement of financial position.

B. IFRS 1, however, establishes important exemptions from full retrospective application in areas where the IASB acknowledged that the costs of retrospective application exceed the benefits to users and where retrospective application may be impracticable. These are divided into:

  a. Mandatory exemptions

  b. Optional exemptions

C. The first-time adopter may choose any of the optional exemptions from retrospective application in IFRS 1. The first-time adopter applies the mandatory exemptions in all cases.

1 Prospective application

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

[1] The Institute of Chartered Accountants in England and Wales (ICAEW): "EU implementation of IFRS and the fair value directive - A report for the European Commission", Executive summary p.11. In this Publication the survey is referred to as the 'ICAEW survey'. The survey describes the use of IFRS 1 exemptions by some European first-time adopters.

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

Mandatory and optional exemptions from full retrospective application	
Mandatory exemptions	***Optional exemptions***
Derecognition of financial assets and financial liabilities (3.1)	Business combinations (2.1 and 2.2)
Hedge accounting (3.2)	Fair value or revaluation as deemed cost(2.3)
Estimates (3.3)	Employee benefits (2.4)
Some aspects of accounting for non-controlling interests (3.5)	Cumulative translation differences (2.5)
	Compound financial instruments (2.6)
	Assets and liabilities of subsidiaries, associates and joint ventures (2.7)
	Designation of previously recognised financial instruments (2.8)
	Share-based payment transactions (2.9)
	Insurance contracts (2.10)
	Decommissioning liabilities included in the cost of property, plant and equipment (2.11)
	Leases (2.12)
	Fair value measurement of financial assets or financial liabilities at initial recognition (2.13)
	A financial asset or an intangible asset accounted for in accordance with IFRIC 12 *Service Concession Arrangements* (2.14)
	Borrowing costs (2.15)
	Investments in subsidiaries, jointly controlled entities and associates (2.16)

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

2 Optional exemptions

IFRS 1.18 permits a first-time adopter to elect one or more exemptions from full retrospective application. These exemptions are specific and complete - a first-time adopter cannot avail itself of further exemptions by analogy to those set out. If taking the exemption, a first time adopter uses an alternative accounting method specified in IFRS 1 rather than applying the 'normal' IFRS requirement retrospectively. This assists the first-time adopter because applying the 'normal' IFRS requirement retrospectively might be unduly costly or impracticable. Management should therefore carefully consider the impact of the optional exemptions in IFRS 1. The exemptions are discussed in the following paragraphs. In the new version of IFRS 1 issued in November 2008, these exemptions were moved to Appendices C-E.

Some of the exemptions refer to fair value. IFRS 1 does not contain any guidance on determination of fair values - first-time adopters should apply the specific guidance in other IFRSs. Fair values shall reflect the conditions that existed at the date for which they were determined (IFRS 1.19).

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2.1 Past business combinations

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

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

Limited restatement approach

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

The exemption - which is widely applied in practice - is necessary because many first-time adopters do not have all the information necessary to apply IFRS 3 to past business combinations.[2]

According to IFRS 1.C1 a first-time adopter has the following options:

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

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

To illustrate the options (assuming the first-time adopter does not wish to restate all past business combinations), consider a first-time adopter with a reporting date of 31 December 2010 and a date of transition of 1 January 2009:

- the first-time adopter may elect not to apply IFRS 3 to past business combinations that occurred before 1 January 2009. In that case the first-time adopter follows the requirements set out in Appendix C to IFRS 1 which can be described as a limited restatement approach (IFRS 1.C1),
- the first-time adopter may elect to restate an earlier business combination to comply with IFRS 3. In that case it must also restate all business combinations that took place after the date of that business combination. For example, the first-time adopter may elect to restate a business combination occurring at 1 February 2008 and accordingly it must also restate every other business combination from 1 February 2008 to the date of transition (IFRS 1.C1).[3] In effect 1 February 2008 becomes the designated effective date of IFRS 3. The first-time adopter follows the limited restatement approach set out in Appendix C to IFRS 1 for all business combinations that occurred before 1 February 2008.

[2] In the ICAEW survey, the option proved to be popular as all first-time adopters used the exemption for business combinations where applicable. (ICAEW survey, Executive summary p. 11)
[3] Where the revised version of IFRS 3 is used, an entity shall also apply IAS 27 (Revised) from that date.

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IFRS 3 *Business Combinations* (Revised 2008)

In order to decide whether to take up the past business combination exemption, it is advisable to determine which version of IFRS 3 would otherwise apply. A revised version of IFRS 3 (IFRS 3R) was published in January 2008 and made consequential amendments to IFRS 1 and several other standards (notably IAS 27 *Consolidated and Separate Financial Statements*). Early adoption of IFRS 3R by a first-time adopter also triggers early adoption of the consequential amendments.

IFRS 3R and its consequential amendments are effective for business combinations in annual periods beginning on or after 1 July 2009. To illustrate:

- for an entity whose annual reporting period begins on 1 July, IFRS 3R is effective for first-time adopters if the end of the first IFRS reporting period is on 30 June 2010.
- for an entity whose annual reporting period begins on 1 January, IFRS 3R is effective for first-time adopters if the end of the first IFRS reporting period is 31 December 2010.

Earlier application is permitted, however IAS 27 (Revised) must also be applied at the same time. IFRS 3R cannot be applied prior to the beginning of an annual period beginning on or after 30 June 2007. Therefore, an entity whose annual period begins on 1 January may early adopt IFRS 3R for the year beginning 1 January 2008 but not for the year beginning 1 January 2007.

In this section it is assumed that the entity applies IFRS 3R. Therefore, this section reflects the requirements of the revised standard and the resulting amendments to IFRS 1. First-time adopters that do not apply IFRS 3R must use the preceding versions of IFRS 1 and IFRS 3. A first-time adopter must apply the same version of IFRS 3 in its first IFRS financial statements (including the restatement of past business combinations if applicable.)

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

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

In our view, a first-time adopter can only apply the exemption to transactions that meet IFRS 3's definition of a business combination.[4] The exemption is not therefore applicable to acquisitions of assets (including entities holding one or more assets) that do not constitute a business.

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

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

[4] IFRS 3 (Revised) made some (minor) changes to the definition of a business combination compared to the former version.

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Business combinations outside the scope of IFRS 3

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

2.1.3 Accounting for past business combinations to which IFRS 3 is not applied

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

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

2.1.4 Classification of past business combinations

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

2.1.5 Recognition or derecognition in the opening statement of financial position

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

- some items **recognised** under previous GAAP may need to be derecognised under IFRS, and
- some items **not recognised** under previous GAAP may need to be recognised under IFRS.

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

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

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2.1.5.1 Items that were recognised under previous GAAP

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

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

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

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

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

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

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

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

Under previous GAAP the first-time adopter recognised:
(a) a restructuring provision that does not qualify for recognition under IFRS. This increased goodwill.
(b) an intangible asset that does not qualify for recognition under IFRS. This reduced goodwill.

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

(a) does not recognise a restructuring provision. The change is recognised in retained earnings (IFRS1.C4(c)(ii)),

(b) does not recognise the intangible asset. The item is reclassified to goodwill (IFRS 1.C4(c)(i)),

(c) tests the goodwill for impairment under IAS 36 (IFRS 1.C4(g)(ii)).

Appendix II.8.2 includes further discussion on the treatment of intangible assets acquired in a past business combination.

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2.1.5.2 Items that were not recognised under previous GAAP

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

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

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

This is illustrated in Example C.3.

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

Background
First-time adopter F's date of transition to IFRSs is 1 January 2008. F acquired subsidiary M before the date of transition. Under its previous GAAP Entity F did not capitalise subsidiary M's finance leases. In accordance with IFRS, the subsidiary M is required to recognise the finance leases in its separate financial statements. At the date of transition the carrying amount of finance leased assets of Entity M is CU 2,000. The carrying amount of finance lease obligations is CU 2,200.

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

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

The effects are illustrated in the following example:

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

Background
First-time adopter F's date of transition to IFRSs is 1 January 2008. F acquired subsidiary M before the date of transition.

Under previous GAAP the first-time adopter did not recognise in its consolidated financial statements:
(a) a contingent liability, and
(b) internally generated trademarks.

These items were subsumed within goodwill under previous GAAP.

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

(a) Contingent liabilities are not recognised from the acquiree's perspective in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* Accordingly, the contingent liability is not recognised in the first-time adopter's opening statement of financial position.

(b) Internally generated trademarks cannot be recognised in accordance with IAS 38 *Intangible Assets.* Accordingly, the first-time adopter does not recognise this item in the opening statement of financial position.

The practical implications of IFRS 1.C4(b)(ii) for internally generated intangible assets are discussed further in Appendix II.8.2.

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

2.1.6 Measurement

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

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

For assets and liabilities that are not measured based on original cost under normal IFRS (for example, those measured at fair value) a first-time adopter applies the measurement basis required by IFRS in its opening statement of financial position. The resulting change is recognised by

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adjusting retained earnings or another appropriate category of equity (for example, in the case of available-for-sale financial assets), IFRS 1.C4(d).

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

Under previous GAAP, a first-time adopter may not have consolidated a subsidiary that should be consolidated under IFRS and which it acquired in a past business combination. At the date of transition the first-time adopter in its opening consolidated statement of financial position:[5]

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

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

[5] IG Example 6 provides an example of such a situation.

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2.2 Goodwill

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

- when a first-time adopter derecognises an intangible asset acquired in a past business combination that does not qualify for recognition under IAS 38 *Intangible Assets* it reclassifies this amount to goodwill, including the related deferred tax or non-controlling interests, if any (see IFRS 1.C4(c)(i) and IFRS 1.IG example 4),[6]
- if a first-time adopter recognises an intangible asset that was subsumed in goodwill under previous GAAP because previous GAAP did not permit recognition of such an intangible asset, the carrying amount of goodwill is decreased accordingly (and deferred tax and non-controlling interests adjusted, if applicable) (see IFRS 1.C4(f) and IFRS 1.C4(g)(i)),[7]
- regardless of whether there is any indication that the goodwill may be impaired, the first-time adopter applies IAS 36 *Impairment of Assets* in testing the goodwill for impairment at the date of transition to IFRS. Any resulting impairment loss is recognised in retained earnings (or, if so required by IAS 36, in revaluation surplus). The impairment test is based on conditions at the date of transition to IFRS (IFRS 1.C4(g)(ii)).

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

Contingent consideration

Prior to IFRS 3R, IFRS 1 included another possible adjustment to goodwill, relating to contingent consideration (paragraph B2(g)(ii) in prior version of IFRS 1). This stated that if a contingency affecting the amount of the purchase consideration for a past business combination had been resolved before the date of transition to IFRSs and if a reliable estimate of the contingent adjustment could be made and its payment is probable, the first-time adopter shall adjust the goodwill by that amount. Similarly, the first-time adopter should in accordance with this paragraph 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.

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

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

[7] If goodwill under previous GAAP was recognised as a deduction from equity, then the adjustment shall be made to retained earnings (see IFRS 1.IG Example 5).

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If the first-time adopter under previous GAAP recognised goodwill as a deduction from equity, paragraph C4(i) of the standard applies. The above rules would not apply because no goodwill was recognised under previous GAAP. The standard prescribes that goodwill shall not be reclassified from equity at the date of transition and that goodwill shall not be reclassified to profit or loss on disposal or impairment of the investment in the subsidiary. Adjustments resulting from a subsequent resolution of contingencies affecting the purchase consideration shall be recognised in retained earnings.[8] Where the first-time adopter records adjustments to intangible assets, the adjustment shall likewise be made to retained earnings (IFRS 1.IG Example 5).

2.3 Fair value or revaluation as deemed cost

2.3.1 Property, plant and equipment

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

IFRS 1's deemed cost exemption may be elected for a single item of property, plant and equipment - it need not be applied to an entire class of assets.[9] A first-time adopter may elect to use one of the following amounts as the deemed cost of an item of property, plant and equipment:

- fair value at the date of transition (IFRS 1.D5),
- the amount determined under a previous GAAP revaluation at, or before, the date of transition if the revaluation was broadly comparable to either fair value *or* cost or depreciated cost under IFRS (adjusted to reflect, for example, changes in a general or specific price index). This amount is the deemed cost at the date of revaluation (IFRS 1.D6),
- a deemed cost under previous GAAP established by measuring some or all assets and liabilities at fair value at one particular date because of an event such as a privatisation or initial public offering (IFRS 1.D8) - see 2.3.3. below.

At and after the date of transition, the accounting for items of property, plant and equipment depends on whether the first-time adopter adopts IAS 16's cost model or its revaluation model. At the date of transition under the **cost model,** depreciation (determined in accordance with IAS 16) is based on the deemed cost starting from the date for which the first-time adopter established the deemed cost (IFRS 1.IG9). If necessary the first-time adopter adjusts accumulated depreciation under previous GAAP (IFRS 1.IG7). If deemed cost was established at the date of transition (for example the fair value at that date), then the item is measured at that amount at the date of transition. The adjustment to previous GAAP should be made to retained earnings (not revaluation reserve) (IFRS 1.IG10). After the date of transition the IAS 16 cost model continues to be applied based on the transition date carrying values.

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[8] Refer to IG example 5 as an example of the accounting for such a business combination.
[9] 31 out of 151 first-time adopters used fair value or revaluations as deemed cost of property, plant or equipment or investment property. (ICAEW survey, Executive summary p. 11)

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

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

Entity A is transitioning to IFRS and adopts IAS 16's revaluation model as its accounting policy for its own-use land. The date of transition is 1 January 2008. Under previous GAAP the entity used a similar principle for its land and fair value of the land was measured at 31 December 2007. The entity elects to use the fair value at this date as deemed cost at the date of transition. In the opening statement of financial position the land is measured at the fair value, which in this case equals deemed cost. Therefore, no revaluation reserve is recognised within equity. Entity A also gives the disclosures required by IFRS 1.30.

2.3.2 Investment property and intangible assets

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

- investment property, where the first-time adopter uses the cost model in IAS 40 *Investment Property,* and
- intangible assets, that qualify for recognition in accordance with IAS 38 (including reliable measurement of original cost), *and* satisfy the criteria in IAS 38 for revaluation (including the existence of an active market).[10]

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

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

If, and only if, an intangible asset meets both the recognition criteria in IAS 38 (including reliable measurement of original cost) and the criteria in IAS 38 for revaluation (including the existence of an active market), a first-time adopter may elect to use either fair value or revaluation as deemed cost. These criteria are strict and have the effect that the deemed cost elections will not be available for most intangible assets. When available, the deemed cost elections apply whether or not the revaluation method in IAS 38 is applied (see also IFRS 1.IG50 and IG51).

[10] No first-time adopters in the ICAEW survey used fair value or revaluation as deemed cost for intangible assets (ICAEW survey, executive summary, p.11).

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2.3.3 Event-driven fair value as deemed cost under IFRS

Paragraph D8 of IFRS 1 states:

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

The paragraph explains that event-driven fair value measurements can be used in general for all assets and liabilities as a substitute for cost (deemed cost). It does not apply only to property, plant and equipment, intangible assets or investment property.

The event-driven deemed cost under previous GAAP can be used as deemed cost under IFRS at the date of that measurement. The subsequent measurement requirements under IFRS apply after that date. To illustrate, consider this example:

Example C.6: Event-driven fair value

An entity has established an event-driven deemed cost under previous GAAP for an item of property, plant and equipment. The deemed cost was established at 1 January 2006 and the date of transition is 1 January 2008. At the date of transition, the entity elects to use the 'event-driven fair value' exemption in IFRS 1.D8. Therefore the cost of the item under IFRS is the deemed cost established under previous GAAP. If the item is measured at cost less accumulated depreciation and impairment under IFRS, at the date of transition the entity measures the item at deemed cost at 1 January 2006 less subsequent depreciation until 1 January 2008.

2.4 Employee benefits

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 into a recognised portion and an unrecognised portion from the inception of the plan. This exercise can be costly and sometimes impracticable.

IFRS 1.D10 states that a first-time adopter may elect to recognise all cumulative actuarial gains and losses at the date of transition to IFRS. This election is available even if it uses the corridor approach for subsequent actuarial gains and losses. If this election is applied, it must be applied to all plans.[11] This means that all actuarial gains and losses from the inception of the plan until the date of transition are recognised in the opening statement of financial position.

The actuarial assumptions used by the first-time adopter at the date of transition reflect circumstances at this date (market conditions, discount rates, fair value of plan assets etc). This is important for a first-time adopter which did not use actuarial assumptions under previous GAAP. IAS 19 encourages entities to involve a qualified actuary in measuring post-employment benefit plans (IFRS 1.IG20 and 21).

2.5 Cumulative translation differences

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

[11] This exemption was well-liked by first-time adopters. Where applicable, all first-time adopters elected to recognise all gains and losses on transition date. (ICAEW survey, Executive summary p.11)

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

This option is useful in practice and has been taken up by many first-time adopters.[12] Often entities will not have calculated translation differences under previous GAAP. Furthermore, full retrospective application would require a first-time adopter to prepare (or reconstruct) IFRS based financial statements for foreign operations for periods before transition to IFRS. In many cases this would be costly or impracticable.

2.6 Compound financial instruments

The issuer of a so-called compound financial instrument is required at inception to allocate the instrument into a liability and equity component in accordance with IAS 32 *Financial Instruments: Presentation* (IAS 32). IFRS 1.D18 exempts the first-time adopter from separating the equity and liability components at the date of transition if the liability is no longer outstanding at that date.[13]

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

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

2.7 Assets and liabilities of subsidiaries, associates and joint ventures

Entities in the same group may adopt IFRS at different dates. For example, a subsidiary may have reported IFRS figures to its parent without publishing its own full IFRS financial statements. When entities within a group adopt IFRS at different dates, each entity has its own date of transition and applies IFRS 1 accordingly. The exemptions in IFRS 1.D16 and D17 deal with first-time adoption in these situations. Three scenarios are addressed: (i) a subsidiary becomes a first-time adopter later than its parent, (ii) a parent becomes a first-time adopter later than its subsidiary, and (iii) a parent becomes a first-time adopter for its separate financial statements at an earlier or later date than for its consolidated financial statements.

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

2.7.1 Subsidiary adopts IFRS later than its parent

A subsidiary may become a first-time adopter later than its parent due to local law or regulation, or because the entity voluntarily applies IFRS at a different date. IFRS 1.D16 states that the subsidiary

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[12] Where applicable, the option was chosen by all first-time adopters (ICAEW survey, Executive summary p.11).
[13] This exemption was applied by all first-time adopters where applicable (ICAEW survey, Executive summary p. 11).

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has two options for measuring assets and liabilities at the date of transition in its first IFRS financial statements. It measures its assets and liabilities at either:

- the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRS, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary (IFRS 1.D16(a)); or
- the carrying amounts required by IFRS based on the subsidiary's own date of transition. (IFRS 1.D16(b)).

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

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

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

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

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

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Example C.7: Subsidiary adopts IFRS later than its parent

A parent entity (P) presents its first IFRS consolidated financial statements in 2005. A foreign subsidiary (S) is not permitted under local law to present IFRS financial statements until 2008. However, a reporting package under IFRS is prepared for the purpose of the consolidated financial statements of parent Entity P.

Application of paragraph D16(a)

Subsidiary S applies paragraph D16(a), ie it chooses to use the carrying amounts that would be included in P's consolidated financial statements. Its date of transition is 1 January 2007. At the date of transition S's assets and liabilities in its opening statement of financial position are the same as in P's consolidated financial statements, adjusted for consolidation adjustments and the effects of the business combination in which P acquired S. These figures are based on P's date of transition to IFRS and are acceptable because they already comply with IFRS. S may however adopt its own IFRS accounting policies, in which case it changes the amounts to conform with those policies as necessary.

Application of paragraph D16(b)

Instead, subsidiary S applies paragraph D16(b). At the date of transition (1 January 2007), S measures all of its assets and liabilities based on its own date of transition. S makes its own IFRS 1 elections which may differ from those made by P. S continues to prepare a reporting package to P, however, these numbers are based on P's date of transition and they are not changed due to the fact that S becomes a first-time adopter later than its parent. In effect, S prepares two sets of accounts.

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

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

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

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

The rules are not optional

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

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

The effect of IFRS 1.D17 is that the parent entity's selection of IFRS 1 exemptions is restricted. The parent may not make elections which would restate the subsidiary's assets or liabilities. This may significantly limit the exemptions available. For example, the parent cannot elect to use the 'fair

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value or revaluation as deemed cost' exemption for a specific asset of a subsidiary that has already adopted IFRS if that subsidiary measures the asset at its depreciated original cost.

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

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

2.7.3 Interaction with past business combination requirements

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

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

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

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

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

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Example C.8: Group adopts IFRS later than its subsidiary

Parent (P) moves to IFRS in 2008. Its date of transition is 1 January 2007. Previously the parent has prepared consolidated financial statements under local GAAP. Its foreign subsidiary (S) has prepared IFRS financial statements since 2005. For consolidation purposes these accounts have been adjusted to the parent's local GAAP.

In the opening (consolidated) statement of financial position at 1 January 2007 the parent (P) uses the carrying amounts of S's assets and liabilities in subsidiary S' financial statements at that date, adjusted for consolidation procedures and the effects of the business combination in which P acquires S.

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

2.7.4 Separate financial statements of parent

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

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

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

2.8 Designation of previously recognised financial instruments

In accordance with IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) an entity is permitted to designate a financial asset upon initial recognition as available-for-sale or at fair value through profit or loss in specified circumstances. A financial liability can, likewise, be designated at fair value through profit or loss upon initial recognition if conditions are met. In IAS 39 itself, these optional designations are usually available only on initial recognition of the instrument. The exemption in IFRS 1.D19 allows a first-time adopter to designate eligible financial assets as available-for-sale at the date of transition. Similarly, financial assets and financial liabilities can be designated at fair value through profit or loss provided the applicable IAS 39 conditions are met at the date of transition.[14] If the first-time adopter applies these rules it makes the note disclosures in IFRS 1.29 (see section D).

2.9 Share-based payment transactions

IFRS 2 *Share-based Payment* addresses the accounting for transactions in which an entity uses equity instruments to purchase goods and services (including employee services). IFRS 1 includes options that limit the extent to which a first-time adopter is required to apply IFRS 2 to certain share-based

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

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payment awards granted in previous periods.[15] The various options, which are similar to those available to an ongoing IFRS entity in IFRS 2 itself, are described in this section.

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

2.9.1 Equity-settled share-based payment transactions

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

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

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

The exemptions mean that a first-time adopter is not required to apply IFRS 2 to any equity instruments that vested before the date of transition. The IASB noted that this is sensible because no expense would be presented in the first IFRS financial statements even if IFRS 2 was to be applied. In addition, IFRS 2 need not be applied to equity instruments granted on or before 7 November 2002 even if they vest after the date of transition. However, the relevance of this exemption is of course decreasing over time. If IFRS 2 is not applied to equity instruments, a first-time adopter nevertheless discloses information on arrangements that exist during the reporting period as required by IFRS 2 paragraphs 44 and 45. These disclosures can be extensive.

If a first-time adopter modifies the terms or conditions of a grant of equity instruments to which IFRS 2 has not been applied, the first-time adopter is not required to apply paragraphs 26–29 of IFRS 2 if the modification occurred before the date of transition to IFRS (or 1 January 2005 if later).

Example C.9: Application of IFRS 2 on first-time adoption

A first-time adopter prepares its first IFRS financial statements for the period ending 31 December 2009. The date of transition is 1 January 2008. The first-time adopter need not apply IFRS 2 for equity instruments that vested before the date of transition.

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

[15] The reliefs granted for share-based payments were used by all 151 first-time adopters in the sample, where applicable. (ICAEW survey, Executive summary p.11). However, in practice it has also been seen that some companies have chosen to adopt IFRS 2 in full at the date of transition.

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As noted, applying IFRS 2 retrospectively to some previous awards of equity instruments is conditional on having disclosed publicly the fair value of the instruments determined at the IFRS 2 measurement date. In practice, this often prohibits application of IFRS 2 to past awards. IFRS 1 does not elaborate on 'disclosed publicly'. However, an example is given in IFRS 2.IG8. The standard mentions equity instruments for which the entity has disclosed in the notes to its financial statements (under previous GAAP) the information required by SFAS 123 *Accounting for Stock-Based Compensation* in the United States. Although disclosure in previous financial statements may not be the only way to meet the requirement, it is the most common and unambiguous method in practice.

2.9.2 Cash-settled share-based payment transactions

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

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

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

2.10 Insurance contracts

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

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

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

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

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

IFRS 1 recognises the difficulty of constructing an historical record of adjustments in previous years. IFRS 1 therefore includes an exemption to retrospective application of this Interpretation. A first-time adopter need not comply with these requirements for changes in such liabilities that

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occurred before the date of transition. If this option is chosen, IFRS 1.D21 requires that the first-time adopter measures the liability at the date of transition in accordance with the requirements in IAS 37. The first-time adopter includes in the depreciated cost of the asset an amount calculated by discounting the liability at the date of transition back to when the liability was first incurred (using its best estimate of the historical risk-adjusted discount rate that would have applied for that liability over the intervening period) and depreciating this adjustment from that date. IFRS 1.IG Example 201 illustrates the effect of this exemption.

2.12 Leases

A first-time adopter may apply the transitional provisions in IFRIC 4 *Determining whether an Arrangement Contains a Lease* (IFRIC 4). This Interpretation generally requires an entity to determine whether an arrangement contains a lease at the inception of the contract. However, an ongoing IFRS entity is permitted to make the assessment at the beginning of the earliest comparative period presented when first applying the Interpretation (IFRIC 4.17).

A first-time adopter may determine whether an arrangement existing at the date of transition to IFRS contains a lease on the basis of facts and circumstances existing at the transition date (IFRS 1.D9). IFRIC 4 deals with arrangements, such as a transaction or a series of related transactions that does not take the legal form of a lease but conveys a right to use an asset in return for a payment or series of payments. The IFRS 1.D9 exemption is useful because it may be very difficult to assess transactions and arrangements that commenced in the distant past.

If the first-time adopter does not apply IFRS 1.D9, it instead determines whether an arrangement existing at the date of transition to IFRS contains a lease on the basis of facts and circumstances existing at the inception of the arrangement (IFRIC 4.10).

It is important to note that all extant arrangements within the scope of IFRIC 4 need to be assessed - the IFRS 1 relief addresses only the date at which the facts and circumstances are assessed.

If the arrangement is determined to contain a lease, the first-time adopter must measure the relevant amounts retrospectively. This applies equally to 'IFRIC 4 leases' and 'free-standing leases'. For example, if the lease is an operating lease the minimum lease payments are (in most cases) recognised on a straight-line basis over the entire lease term (not the remaining lease term after the date of transition). Some limited additional requirements are included in IFRS 1.IG14-16 (IFRS 1.IG Example 202). These requirements are described in Appendix II.

2.13 Fair value measurement of financial assets and liabilities

IFRS 1.D20 contains an optional exemption from full retrospective application aimed at the (minor) amendments made to IAS 39 in 2004 regarding measurement of financial instruments at initial recognition (commonly referred to as the 'day 1 gains or losses' amendment). In summary, these amendments restrict an entity's ability to record a profit or loss when first recognising financial assets or liabilities to situations in which the fair value it ascribes to the instruments is based entirely on observable market data (IAS 39.AG76 and AG76A).

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IFRS 1 recognises that it may be difficult and expensive to determine retrospectively what is observable market data. Therefore, an exemption was granted to allow entities to apply the applicable IAS 39 requirements either:

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

Given the dates prescribed, the relevance of these reliefs is diminishing over time.

2.14 Service concession arrangements

Service concession arrangements are dealt with in IFRIC 12 *Service Concession Arrangements* (IFRIC 12). IFRS 1.D22 permits the transitional provisions of this Interpretation to be applied by a first-time adopter.

IFRIC 12 deals with contracts where a private sector entity participates in infrastructure for public sector services, such as financing, development, maintenance or operation of the infrastructure. It is effective for annual periods beginning on or after 1 January 2008 (IFRIC 12.28). Accordingly, the exemption in IFRS 1 is effective from the same date. Therefore, the Interpretation and option in IFRS 1 will be applicable to many current first-time adopters (for example, a first-time adopter whose first IFRS reporting period ends on 31 December 2008).

The transitional provisions in IFRIC 12 state that the Interpretation shall be applied retrospectively (IFRIC 12.29), unless it is impracticable. Where it is impracticable, the first-time adopter shall:

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

2.15 Borrowing costs

In March 2007 the IASB revised its standard on borrowing costs, IAS 23 *Borrowing Costs* (IAS 23). The revision eliminated the option to expense borrowing costs that are directly attributable to a qualifying asset.

IAS 23's amendments require prospective application. The transition rules of IAS 23 itself require that entities that formerly used the 'expensing' option must start capitalising borrowing costs relating to all qualifying assets for which the 'commencement date' is on or after the effective date of the standard (1 January 2009). However, an entity may choose to designate any date before 1 January 2009 as its effective date. Borrowing costs will then be capitalised for all qualifying assets for which the commencement date is on or after this earlier 'designated effective date'.

Commencement date under IAS 23

The commencement date for a particular asset is the date when the entity meets all the following conditions:
(a) incurs expenditures for the qualifying asset;
(b) incurs borrowing costs; and
(c) undertakes activities that are necessary to prepare the asset for its intended use or sale (IAS 23.17).

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IFRS 1 has been amended to allow first-time adopters to apply the same transitional provisions as existing preparers (IFRS 1.D23 and IFRS 1.IG23). In applying this exemption first-time adopters may:

- capitalise borrowing costs relating to all qualifying assets for which the commencement date for capitalisation is on or after 1 July 2009 (based on the latest version of IFRS 1) or the date of transition to IFRS, whichever is the later; or
- designate an earlier date as the effective date, which may be part way through an accounting period.

Whichever date is determined as the effective date, the first-time adopter capitalises borrowing costs relating to all qualifying assets for which the commencement date for capitalisation is on or after that date (see also IFRS 1.IG23). Neither IFRS 1 nor IAS 23 require disclosure of the cumulative amount capitalised (IFRS 1.IG24) although this might be disclosed indirectly in the explanation of transition to IFRS.

First-time adopters shall apply the amendments in IFRS 1.D1(n) and D23 for annual periods beginning on or after 1 July 2009 (based on the latest version of IFRS 1). If an entity applied IAS 23 (as revised in 2007) for an earlier period, the amendments shall be applied for that earlier period.

Example C.10: Capitalisation of borrowing costs

Entity B will prepare its first IFRS financial statements for the year ended 31 December 2009. Its date of transition to IFRS is 1 January 2008. IAS 23 (Revised) is effective as its first IFRS reporting period begins on 1 January 2009. The entity is engaged in the construction of various qualifying assets. Entity B's previous GAAP accounting policy was to expense borrowing costs as incurred. The entity has the following options:

(a) adopt IAS 23 (Revised) retrospectively. The entity would then in its opening IFRS statement of financial position restate all qualifying assets as if it had always applied IAS 23 (Revised) and apply this standard throughout its first IFRS financial statements.

(b) apply the IFRS 1.D23 option of prospective application. Entity B's relevant effective date for application of IAS 23 (Revised) is 1 January 2009 as this is later than the transition date. The entity capitalises borrowing costs prospectively only for new qualifying assets with a commencement date on or after 1 January 2009.

(c) Designate an earlier effective date. For example, the entity designates 1 September 2007 as the effective date for adoption of IAS 23 (Revised) as a larger construction project commenced on that date. The entity capitalises borrowing costs for all qualifying assets for which the commencement date is on or after 1 September 2007. This is reflected in its opening IFRS statement of financial position at 1 January 2008, where only qualifying assets with a commencement date after 1 September 2007 would include borrowing costs. For assets with a commencement date before this date, all borrowing costs are recognised in profit or loss.

2.15.1 IFRS 1 deemed cost option

Independently of its choices under IFRS 1.D23 and its previous GAAP policy for borrowing costs, the first-time adopter may apply the exemptions in IFRS 1.D5 - D7. This allows the first-time adopter to measure items of property, plant and equipment or investment properties (provided the entity has elected to use the cost model in IAS 40 *Investment Property*) at fair value or a previous GAAP revaluation. These amounts are treated as the 'deemed cost' of the asset(s). If the first-time adopter decides to do this, it effectively ignores the treatment of borrowing costs incurred on the applicable assets up to the transition date (or the date of the measurement that established the deemed cost if earlier) (IFRS 1.IG23). After the transition date, borrowing costs are accounted for in accordance with IAS 23 subject to the first-time adopter's elections under IFRS 1.D23. The IFRS

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1.D5 - D7 exemptions are not however available for some qualifying assets such as inventories, development properties, and intangible assets that do not meet the IAS 38 *Intangible Assets* criteria for revaluation (eg expenditure on internally developed software).

2.16 Investments in subsidiaries, jointly controlled entities and associates

This exemption is relevant only for a first-time adopter that is: (i) a parent or investor; and (ii) presents separate financial statements. Separate financial statements are not consolidated financial statements but are those financial statements presented by a parent, an investor in an associate or a venturer in a jointly controlled entity in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.

In accordance with IAS 27 *Consolidated and Separate Financial Statements* (IAS 27) a parent entity records investments in subsidiaries in separate financial statements either at cost or in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 27.38). Similar requirements apply to the measurement of associates and jointly controlled entities in the separate financial statements.

IFRS 1.D14 and D15 allow a first-time adopter to use a 'deemed cost' when measuring an investment in a subsidiary, jointly controlled entity or associate in the separate opening statement of financial position. This deemed cost can be determined using either fair value in accordance with IAS 39 at the entity's date of transition to IFRS or a previous GAAP carrying amount at that date. An entity is able to choose whether to use the deemed cost exemption on an investment-by-investment basis for each subsidiary, jointly controlled entity or associate.

Effective date of IFRS 1.D14 and D15

This exemption was inserted by an amendment to IFRS 1 and IAS 27 issued in May 2008. The amendment also removed IAS 27's previous reference to a 'cost method'. The effective date of the May 2008 amendments is annual periods beginning on or after 1 January 2009. Earlier application is permitted.

IAS 27 was also amended extensively in January 2008 as part of the IASB's wider business combinations project. The January 2008 changes mainly affect accounting for non-controlling interests and loss of control of subsidiaries in consolidated financial statements. They did not affect separate financial statements and are effective for annual periods beginning on or after 1 July 2009. Early application is permitted but is conditional on also adopting the 2008 version of IFRS 3.

In our view, the May 2008 amendments to IFRS 1 and IAS 27 can be early adopted by a first-time adopter without adopting the earlier January 2008 changes to IAS 27 (in respect of first IFRS reporting periods commencing before 1 July 2009). To illustrate:

- A first-time adopter with a reporting date of 31 December 2008 applies the effective standards at that date in its first IFRS financial statements. The entity can choose to early adopt the D14 and D15 (deemed cost) amendment to IFRS 1, without also early adopting the January 2008 amendments to IAS 27.
- A first-time adopter with a reporting date of 31 December 2009 applies the effective standards at that date in its first IFRS financial statements. The entity applies the amendment to IFRS 1 as this amendment is effective for annual periods beginning on or after 1 January 2009. However, the first-time adopter does not have to apply the January 2008 amendments to IAS 27 as they are effective for annual periods beginning on or after 1 July 2009.

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3 Mandatory exemptions

Some consequences of retrospective application by a first-time adopter are considered inappropriate by the IASB. Accordingly, IFRS 1 contains a prohibition of retrospective application in the following areas:

- derecognition of financial assets and financial liabilities,
- hedge accounting,
- estimates,
- assets classified as held for sale and discontinued operations, and
- some aspects of accounting for non-controlling interests.

The prohibition relates to some aspects in these areas. For example, derecognition of financial assets and liabilities is retrospectively applied under certain conditions. The prohibitions are included in paragraphs 13-17 and Appendix B of IFRS 1.

3.1 Derecognition of financial assets and financial liabilities

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

IFRS 1 exempts a first-time adopter from recognition of non-derivative financial assets and non-derivative financial liabilities that were derecognised under previous GAAP before 1 January 2004 (IFRS 1.B2). In effect, this means applying the derecognition requirements in IAS 39 prospectively to transfers occurring on or after that date.

However, the first-time adopter may, in accordance with IFRS 1.B3, apply the derecognition requirements of IAS 39 retrospectively from a date of its choosing provided that the information needed was obtained at the time of initially accounting for these transactions. In practice, this election permits the first-time adopter to apply IAS 39's derecognition requirements from a designated date prior to 1 January 2004. The condition in IFRS 1.B3 (on having obtained information) limits the ability to selectively 're-recognise' financial assets and liabilities, which would be an unacceptable use of hindsight.

The degree of relief provided by these exemptions is of course diminishing with the passage of time.

3.2 Hedge accounting

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

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

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

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

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

IFRS 1 also addresses situations in which the first-time adopter, before the date of transition, designated an arrangement for hedge accounting under previous GAAP but IAS 39's requirements are not met. In that case the first-time adopter discontinues hedge accounting under IFRS in accordance with IAS 39.91 and 101 (IFRS 1.B6). In effect, this means that all hedging relationships identified as such under previous GAAP must be examined for compliance with IAS 39 at the date of transition. If a hedge does not meet IAS 39's requirements for hedge accounting (i) the derivative is classified as held for trading at the date of transition and subsequently measured at fair value through profit or loss; and (ii) adjustments made to the hedged item in applying fair value hedging, and gains or losses deferred in equity under cash flow hedging, are dealt with in the same way as a designated IAS 39 hedge accounting relationship that ceases to meet the applicable conditions.

IFRS 1.B5 also includes one relaxation of this generally strict approach. If a first-time adopter has designated a net position as a hedged item under previous GAAP, it may designate an individual item within that net position as a hedged item under IFRS. This re-designation must be effected no later than the date of transition to IFRS.

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

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

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

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3.3 Estimates

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

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

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

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

If an entity was not required to make estimates under previous GAAP but IFRS requires estimates in the opening (or comparative) statement of financial position, then the entity uses information that existed at the date of transition or the date of the comparative period (market prices, interest rates, foreign exchange rates at that date) (IFRS 1.16). This is consistent with the approach in IAS 10 to non-adjusting and adjusting events after the reporting period (IFRS 1.IG3).

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

3.4 Assets classified as held for sale and discontinued operations

The previous version of IFRS 1 included an exemption for assets classified as held for sale and discontinued operations available for an entity with a date of transition to IFRS before 1 January 2005. The exemption is unlikely to be relevant to current first-time adopters, and was therefore removed in the 2008 version. In effect, the requirement for current first-time adopters is to apply IFRS 5 retrospectively.

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3.5 Non-controlling interests

In January 2008 the IASB issued IFRS 3R and IAS 27R. Among other changes, IAS 27R introduces important new requirements on accounting for non-controlling interests in subsidiaries. IFRS 1 has been amended to require that certain of these new IAS 27R requirements are applied prospectively from the date of transition to IFRS (IFRS 1.B7).

IFRS 1.B7 is applicable only for first-time adopters that apply IAS 27R in their first IFRS reporting period (ie either when IAS 27R is mandatory in that first period, or where IAS 27R is voluntarily adopted early).

IAS 27 *Consolidated and Separate Financial Statements* (Revised 2008)

The first-time adopter should establish whether paragraph B7 of IFRS 1 applies. IFRS 1.B7 is applied for annual periods beginning on or after 1 July 2009 (IFRS 1.37), which is the same as the 2008 changes to IAS 27R. Accordingly:

- an entity whose annual reporting period begins on 1 July applies IAS 27R and IFRS 1.B7 for the annual period ending 30 June 2010;
- an entity whose annual reporting period begins on 1 January applies IAS 27R and IFRS 1.B7 for the annual period ending 31 December 2010.

Earlier application of both IFRS 1.B7 and IAS 27R is permitted. However, IFRS 3R must then be applied at the same time. IFRS 3R and IAS 27R cannot be applied prior to the beginning of an annual period beginning on or after 30 June 2007. Therefore, an entity whose annual period begins on 1 January may early adopt for the year beginning 1 January 2008 but not for the year beginning 1 January 2007.

In this section it is assumed that the entity applies IAS 27R. Therefore, this section reflects the requirements of the revised standard of IAS 27R and the introduction of IFRS 1.B7.

First-time adopters that do not apply IAS 27R should use the previous versions of IFRS 1 and IAS 27.

In general, the first-time adopter applying IAS 27R does so retrospectively from the date of transition. IFRS 1.B7(a)-(c) set some exceptions to this general approach, specifying that certain requirements of IAS 27R are instead applied prospectively from the date of transition, unless IFRS 3R is applied retrospectively to past business combinations. The exceptions are:

- the amendment in paragraph 28 of IAS 27R requiring attribution of total comprehensive income to the owners of the parent and to the non-controlling interest even if this results in the non-controlling interests having a deficit balance,
- the requirements on accounting for changes in the parent's ownership interests in a subsidiary after control is obtained (IAS 27R.30-31), and
- the requirements on accounting for a loss of control of a subsidiary (IAS 27R.34-37) and the related requirements of IFRS 5.8A (to classify assets and liabilities of that subsidiary as held for sale when the criteria are met regardless of whether the first-time adopter will retain a non-controlling interest after the sale).

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If a first-time adopter elects to restate a pre-transition date business combination in accordance with IFRS 3R, this also brings forward the date when it applies IAS 27R. To illustrate, consider a first-time adopter with a date of transition at 1 July 2008. IFRS 3R and IAS 27R are effective for the entity as the first IFRS reporting period begins on 1 July 2009:

- if the first-time adopter does not restate past business combinations, the provisions in IFRS 1.B7(a)-(c) are applied prospectively from the date of transition (1 July 2008),
- the first-time adopter restates a business combination that occurred on 1 January 2008, it also restates all other business combinations that occurred from 1 January 2008 to its date of transition (IFRS 1.C1). IAS 27R is also applied from 1 January 2008.

4 Future developments

In September 2008 the IASB published an Exposure Draft of proposed amendments to IFRS 1 to address challenges likely to be faced by jurisdictions and companies that are adopting IFRS in the near future. The Exposure Draft proposes:

- to exempt companies from retrospective application of IFRS for oil and gas assets using the full cost method. The Exposure Draft proposes that an entity that used full cost accounting under its previous GAAP may elect at the date of transition to IFRS to measure exploration and evaluation assets at their previous GAAP amounts. It also proposes to measure oil and gas assets in the development or production phases by allocating the previous GAAP amount to the underlying assets pro rata using reserve volumes or values at the date of transition.
- to exempt companies from retrospective application of IFRS for operations subject to rate regulation. Companies whose pricing structure is subject to regulation could elect to use the carrying amount of items of property, plant and equipment held for use in such operations as their deemed cost at the date of transition to IFRS if both retrospective restatement and using fair value as deemed cost are impracticable.
- to exempt companies from reassessing the determination of lease contracts where the company has made the same determination under previous GAAP as that required by IFRIC 4 *Determining whether an Arrangement contains a Lease* but at a date other than required by IFRIC 4.

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D. Presentation and disclosure

Summary of requirements

A. In general the first-time adopter shall present at least the same disclosures as all other entities reporting under IFRS.

B. The disclosure requirements generally apply for comparative information as well.

C. Additional disclosure requirements apply for a first-time adopter. The entity shall prepare reconciliations between previous GAAP and IFRS and disclose these reconciliations in its first IFRS financial statements (and interim report, if applicable). These disclosures provide vital information about the transition to IFRS.

D. The requirement for reconciliations between previous GAAP and IFRS also applies in a first-time adopter's interim reports for part of the period covered by its first IFRS financial statements.

1 General requirements

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

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

In this section the specific disclosures for a first-time adopter included within IFRS 1 are discussed.

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Primary statement terminology and IAS 1 (as revised 2007)

IAS 1 *Presentation of Financial Statements* (Revised 2007) (IAS 1R) changed the terminology of the primary financial statements. This section explains the requirements under IAS 1R. First-time adopters that do not apply IAS 1R present a reconciliation of profit or loss instead of total comprehensive income (IFRS 1.24(b) and 32).

2 Primary statements and comparative information

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

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

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

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

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

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Old IFRS 1.36A-36C

IFRS 1.36A-36C were deleted by IAS 1R and have been removed from the latest version of IFRS 1. Previously, IFRS 1 granted relief in the following areas:

- IFRS 6 *Exploration for and Evaluation of Mineral Resources* comparative information in the first IFRS financial statements when IFRS 6 is adopted before 1 January 2006 (previously IFRS 1. 36B);
- IFRS 7 *Financial Instruments: Disclosures* comparative information in the first IFRS financial statements when IFRS 7 is adopted before 1 January 2006 (previously IFRS 1.36C);
- Comparative information for IAS 32, IAS 39 or IFRS 4 in the first IFRS financial statements where IFRS is adopted before 1 January 2006.

These reliefs are not available for a first-time adopter applying IAS 1R and the current version of IFRS 1 (as published in 2008). These reliefs are in any case not likely to be relevant to current first-time adopters and are referred to elsewhere in this publication.

2.1 Historical summaries

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

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

2.2 Related notes

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

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

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

A first-time adopter A presents its first IFRS financial statements for the year ended 31 December 2009. It presents only one full comparative period and its date of transition is 1 January 2008. In accordance with IFRS 1.21 the first-time adopter is required to present three statements of financial position and related notes.

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

In accordance with IAS 16.73(e) an entity presents a reconciliation of the carrying amount at the beginning and end of the reporting period. Is this reconciliation required for the year ended 31 December 2007? In our view, it is not. This is because the reconciliation relates to a reporting period and need not therefore be viewed as a related note for the statement of financial position at 31 December 2007. Accordingly, in our view it provides the information specified by IAS 16.73(e) for 2008 and 2009, but not for 2007.

In any case the entity will not be able to present the reconciliation for 2007 because it measures some items at fair value at the date of transition. The entity does not therefore determine IFRS-based amounts for those items prior to the date of transition.

3 Explanation of transition to IFRS

IFRS 1.23 states:

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

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

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

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

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

If an entity did not present financial statements for previous periods, the reconciliations cannot be prepared. Accordingly, an entity does not present the reconciliations and discloses that fact (IFRS 1.28).

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3.1 Reconciliations of equity

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

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

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

Consider the following example:

Example D.2: Reconciliations of equity

Entity C is a first-time adopter. Its first IFRS reporting period ends on 31 December 2009. It presents one year of full comparative information. Its date of transition is 1 January 2008. Entity C presented its last financial report under its previous GAAP as at 31 December 2008. The entity is required to present reconciliations between equity under previous GAAP and IFRS at:

(i) 1 January 2008 (date of transition)
(ii) 31 December 2008 (the end of the latest period presented under previous GAAP)

If Entity C presented two years of full comparative information the transition date would be 1 January 2007, which leaves a gap in the reconciliations. The standard is silent on this situation. Entities may choose to present an additional reconciliation to provide users with comprehensive information on the transition to IFRS.

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

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

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

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3.2 Reconciliation of total comprehensive income

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

"a reconciliation to its total comprehensive income in accordance with IFRSs for the latest period in the entity's most recent annual financial statements. The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for the same period or, if an entity did not report such a total, profit or loss under previous GAAP."

The concept of total comprehensive income was introduced in the 2007 changes to IAS 1. In the previous version of IAS 1 entities were required to present a reconciliation of profit or loss. IFRS 1 acknowledges that previous GAAP might not include a concept such as total comprehensive income, and therefore allows profit or loss to be used as a starting point. The starting point therefore depends on previous GAAP - profit or loss is used only if a statement corresponding to total comprehensive income was not presented under previous GAAP. The reconciliation is presented for the latest period in the most recent financial statements presented under previous GAAP. Consider the following example:

Example D.3: Reconciliation of total comprehensive income

Same facts as in example D.2 above. Entity C presented its last financial report under previous GAAP as at 31 December 2008. The entity is required to present a reconciliation between total comprehensive income under previous GAAP and IFRS for the period 1 January 2008 to 31 December 2008.

If Entity C presented two years of full comparative information the transition date would be 1 January 2007. The standard does not require a reconciliation for the period ended 31 December 2007. Entities may choose to present an additional reconciliation to provide users with comprehensive information on the transition to IFRS.

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

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3.3 Example of reconciliation

This section presents an example of how a reconciliation may be presented. The first-time adopter presents its first IFRS financial statements for the period ended 31 December 2009. Its date of transition is 1 January 2008.

Reconciliation of equity

		1 January 2008			31 December 2008		
	Note	Previous GAAP CU	Effect of transition to IFRS CU	IFRSs CU	Previous GAAP CU	Effect of transition to IFRS CU	IFRSs CU
Non-current							
Goodwill	1	2,830	(350)	2,480	2,230	250	2,480
Other intangible assets	1, 2	4,230	1,550	5,780	5,330	1,070	6,400
Property, plant and equipment	3	9,000	200	9,200	10,350	280	10,630
Other long-term financial assets	4	630	310	940	630	360	990
Non-current assets		16,690	1,710	18,400	18,540	1,960	20,500
Current							
Inventories		6,000	-	6,000	6,800	-	6,800
Trade and other receivables		7,500	-	7,500	8,100	-	8,100
Cash and cash equivalents		3,010	-	3,010	4,710	-	4,710
Current asset		16,510	-	16,510	19,610	-	19,610
Total assets		33,200	1,710	34,910	38,150	1,960	40,110
Equity							
Share capital		3,000	-	3,000	3,000	-	3,000
Additional paid-in capital		3,050	-	3,050	3,050	-	3,050
Other components of equity	4	990	217	1,207	940	252	1,192
Retained earnings	7	7,760	175	7,935	10,910	474	11,384
Equity attributable to owners of the parent:		14,800	392	15,192	17,900	726	18,626
Total equity		14,800	392	15,192	17,900	726	18,626
Liabilities							
Non-current							
Pension and other employee obligations	5	-	1,000	1,000	-	1,030	1,030
Borrowings		8,000	-	8,000	7,700	-	7,700
Deferred tax liabilities	6	1,900	318	2,218	2,450	204	2,654
Non-current liabilities		9,900	1,318	11,218	10,150	1,234	11,384
Current							
Provisions		1,000	-	1,000	1,300	-	1,300
Trade and other payables		6,000	-	6,000	7,400	-	7,400
Current tax liabilties		1,500	-	1,500	1,400	-	1,400
Current liabilities		8,500	-	8,500	10,100	-	10,100
Total liabilities		18,400	1,318	19,718	20,250	1,234	21,484
Total equity and liabilities		33,200	1,710	34,910	38,150	1,960	40,110

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Reconciliation of total comprehensive income for 2008

	Note	Previous GAAP CU	Effect of transition to IFRS CU	IFRSs CU
Revenue		80,500	-	80,500
Other income		1,000	-	1,000
Costs of material	2	(24,500)	320	(24,180)
Employee benefits expense	5	(44,700)	(30)	(44,730)
Depreciation, amortisation and impairment of non-financial assets	1,2,3	(2,900)	(120)	(3,020)
Other expenses		(2,500)	-	(2,500)
Operating profit		6,900	170	7,070
Finance costs		(2,200)	-	(2,200)
Finance income		400	-	400
Profit before tax		5,100	170	5,270
Tax expense, net	6	(1,950)	129	(1,821)
Profit for the year		3,150	299	3,449
Other comprehensive income for the year				
Items recognised in other comprehensive income under IFRS, net of tax	4	-	(15)	(15)
Total comprehensive income		3,150	284	3,434
Profit for the year attributable to:				
Non-controlling interest		-		-
Owners of the parent		3,150		3,449
		3,150		3,449

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

Total basic earnings per share in 2008 under previous GAAP amount to CU X.XX (under IFRS: CU X.XX), while total diluted earnings per share in 2008 under previous GAAP amount to CU X.XX (under IFRS: CU X.XX).

Notes to the reconciliations

1. The Group has elected not to restate past business combinations that occurred before the date of transition. Under previous GAAP, the Group did not recognise intangible assets acquired in the acquisition of Shopmore Ltd in 2006. Under IFRS an indefinite useful life intangible asset of CU 350 qualified for recognition in the financial statements of the subsidiary. Accordingly, this amount has been recognised at the date of transition. A corresponding decrease has been recorded in goodwill as the intangible asset was subsumed within goodwill under previous GAAP. As required by IFRS 1, goodwill recognised under previous GAAP has been tested for impairment at the date of transition to IFRS. No impairment was identified. For the year ended 31 December 2008, goodwill is not amortised under IFRS. As a result, the amortisation of goodwill as required under previous GAAP (CU 600) was reversed resulting in an increase in goodwill and corresponding reduction in the amortisation expense. The total effect of the adjustments to goodwill at 31 December 2008 is CU 250.

2. The increase in other intangible assets as at 1 January 2008 and 31 December 2008 is a result of the recognition of internally developed software used in production or administration. Under previous GAAP, development costs had been expensed as incurred. The effect upon transition is to increase other intangible assets by CU 1,200. In the year ended 31 December 2008, a further capitalisation of CU 320 was recognised reducing 'cost of material' by that amount. Increased amortisation for the year ended 31 December 2008 amount to CU 800. The total effect on the income statement for the year ended 31 December 2008 is CU 480, comprising increased amortisation expense (CU 800) and a decrease in 'cost of material' by CU 320.

3. Depreciation of property, plant and equipment was influenced by tax requirements under previous GAAP but under IFRSs reflects the useful life of the assets and their residual value. The cumulative

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adjustment at the date of transition increased the carrying amount of property, plant and equipment by CU 200 thereby increasing retained earnings. At 31 December 2008 the effect is a further increase of the asset by CU 80 reducing depreciation expense for the year by that amount.

4. The Group has elected to designate certain equity instruments as available-for-sale under IFRS, which under previous GAAP were measured at cost less impairment charge. Accordingly, these securities have been measured at fair value at the date of transition. The effect is to increase other long-term financial assets by CU 310 (31 December 2008: CU 360). The available-for-sale reserve within equity was increased by CU 217 net of tax (31 December 2008: CU 252).

5. Under previous GAAP a cash basis was used to account for defined benefit plans. A pension liability of CU 1,000 has been recorded under IFRS. A further increase of CU 30 in this liability was recorded in the year ended 31 December 2008. The effect on profit or loss for the year ended 31 December 2008 is to increase 'employee benefits expense' by CU 30.

6. The above changes affected the deferred tax liability as follows.

	1 January 2008	31 December 2008
Deferred tax liability:	**CU**	**CU**
Other intangible assets	465	321
Property, plant and equipment	60	84
Defined benefit plans	(300)	(309)
Other long-term financial assets	93	108
Increase in deferred tax liability	318	204

Movement in deferred tax recognised in profit or loss for 2008 is CU 129. Movement in deferred tax recognised in other comprehensive income is CU 15.

7. The above changes affected retained earnings as follows:

	1 January 2008	31 December 2008
Retained earnings:	**CU**	**CU**
Recognition of internally developed intangible assets	1,200	720
Change in depreciation of PPE	200	280
Recognition of pension liability	(1,000)	(1,030)
Deferred tax liability, recognised in retained earnings	(225)	(96)
Depreciation of goodwill	-	600
Increase in retained earnings	175	474

3.4 Presentation differences

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

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3.5 Statement of cash flows

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

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

Other examples

In our view, reconciliation differences in the statement of cash flows will often arise as a result of the broader concept of 'cash and cash equivalents' in IFRS compared to local GAAP in some jurisdictions (IAS 7.7). Short-term, highly liquid financial assets that are readily convertible to known amounts of cash and are subject to only insignificant risk of value changes are 'cash equivalents' under IFRS. This will require changes to the cash flow statements on transition to IFRS in some cases.

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

3.6 Impairments

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

4 Previous GAAP errors

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

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

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5 Other disclosures

In accordance with IAS 8, an ongoing IFRS entity is required to provide disclosures concerning changes in accounting policies. IFRS 1 states that the disclosures required by IAS 8 for changes in accounting policies do not apply to a first-time adopter (IFRS 1.27). For later periods the same entity is of course required to provide the IAS 8 disclosures.

In accordance with IAS 19.120A(p) an entity is required to disclose the present value of the defined benefit obligation, the fair value of plan assets, the surplus or deficit in the plan and experience adjustments. This information is required for a five year-period. IFRS 1.D11 states that a first-time adopter may disclose this information prospectively from the date of transition to IFRS. In effect, this means that a first-time adopter is not required to measure its defined benefit plans in accordance with IAS 19 before the date of transition (assuming also that it elects to recognise all cumulative actuarial gains and losses at the date of transition - see Section C2.4).

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

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

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

The remeasurement also appears in the reconciliation to previous GAAP, however, the note disclosure is required to highlight the use of fair value. It does not apply if event-driven fair value measurement or previous GAAP revaluation is used (IFRS 1.D6 and D8).

6 IFRS 1 exemptions applied

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

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

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

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7 Interim financial reports

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

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

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

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

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

(ii) a reconciliation to its total comprehensive income in accordance with IFRSs for that comparable interim period (current and year to date). The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for that period or, if an entity did not report such a total, profit or loss in accordance with previous GAAP.

(b) In addition to the reconciliations required by (a), an entity's first interim financial report in accordance with IAS 34 for part of the period covered by its first IFRS financial statements shall include the reconciliations described in paragraph 24(a) and (b) (supplemented by the details required by paragraphs 25 and 26) or a cross-reference to another published document that includes these reconciliations."

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

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

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

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Example D.4: Interim financial reporting

Entity A's first IFRS financial statements are for the year ending 31 December 2009. Its first interim financial report under IAS 34 is for the quarter ended 31 March 2009. It is required by a stock exchange to provide interim reports each quarter. Entity A prepared previous GAAP annual financial statements for the year ended 31 December 2008 and prepared quarterly reports in 2008 under previous GAAP. The date of transition is 1 January 2008.

Which interim reports include reconciliations?
Paragraph 32(a):
In each quarterly interim financial report for 2009, Entity A includes reconciliations of:
(a) equity under previous GAAP at the end of the comparable quarter of 2008 to its equity under IFRS at that date; and
(b) total comprehensive income (or, if it did not report such a total, profit or loss) under previous GAAP for the comparable quarter of 2008 (current and year-to-date) to its total comprehensive income under IFRS (current and year-to-date). For the quarter ended 31 March 2009 the current period amounts and year-to-date totals are the same. For the period ended 30 June 2009 two reconciliations are required (current and year-to-date).

Paragraph 32(b):
In addition to the reconciliations required above and the disclosures required by IAS 34, Entity A's interim financial report for the first quarter of 2009 includes reconciliations (or alternatively a cross-reference to another published document that includes these reconciliations) of:
(a) its equity under previous GAAP at 1 January 2008 (the date of transition) and 31 December 2008 (the end of the latest period presented under previous GAAP) to its equity under IFRS at those dates; and
(b) its total comprehensive income (or, if it did not report such a total, profit or loss) for the year ended 31 December 2008 under previous GAAP to its total comprehensive income for 2008 under IFRS (a reconciliation of the last year presented under previous GAAP)

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

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

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

IAS 34 requires minimum disclosures, which are based on the assumption that users of the interim financial report also have access to the most recent annual financial statements. However, IAS 34 also requires an entity to disclose 'any events or transactions that are material to an understanding of the current interim period'. Therefore, if a first-time adopter did not, in its most recent annual financial statements under previous GAAP, disclose information material to an understanding of the current interim period, its interim financial report must disclose that information or include a cross-reference to another published document that includes it (IFRS 1.33). In practice, disclosures will vary substantially between entities, and judgement is required to establish whether additional disclosures are required in other areas.

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

When publishing interim financial reports, a first-time adopter may not be able to identify all the IFRSs that will be mandatorily effective at the end of the reporting period (the IASB has in recent months made a small number of 'fast-track' changes). Moreover, new IFRSs, IFRICs and

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amendments might be published before the end of the first annual period that are not mandatory but are available for early adoption. We therefore consider that a first-time adopter should base its accounting policies on IFRS in effect at the date of authorisation of those interim financial reports (see section B2.3). If the accounting policies are changed between the interim financial report and the annual financial statements (either because of mandatory revisions to IFRS or voluntary early adoption of newer pronouncements), we consider that the reconciliations of equity, total comprehensive income and cash flows will need to be updated to reflect the accounting policies in effect at the reporting date. An explanation of the change will be required.

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Appendix I. Current effective exemptions

This Appendix provides an overview of current IFRS 1 exemptions.

The tables set out (for an entity whose financial year ends on 31 December) the exemptions in effect for annual periods ending on 31 December 2008, 31 December 2009 and 31 December 2010. Where an exemption is not effective, early application may be permitted. First-time adopters whose reporting date is not 31 December should look to the specific dates in IFRS 1.

Future amendments to IFRS 1

Readers should note that the tables below reflect IFRS requirements at the date of release of this guide (1 May 2009). Many important amendments to IFRS 1 and other IFRSs are expected in the next few months and years, and will need to be considered by first-time adopters.

1 Mandatory exemptions

Mandatory exemptions from full retrospective application				
	Effective date / early application permitted	***Effective at the end of the reporting period:***		
		31 Dec 2008	**31 Dec 2009**	**31 Dec 2010**
Derecognition of financial assets and financial liabilities	n/a	Yes	Yes	Yes
Hedge accounting	n/a	Yes	Yes	Yes
Estimates	n/a	Yes	Yes	Yes
Assets classified as held for sale and discontinued operations	Deleted in 2008 edition of IFRS 1.	N/A - see section C3.4		
Some aspects of accounting for non-controlling interests	Reporting periods beginning on or after 1 July 2009 / Yes, but apply transitional provisions.	No	No	Yes

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

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

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2 Optional exemptions

Optional exemptions from full retrospective application

	Effective date / early application permitted	***Effective at the end of the reporting period:***		
		31 Dec 2008	**31 Dec 2009**	**31 Dec 2010**
Business combinations (see note 1)	n/a	Yes	Yes	Yes
Fair value or revaluation as deemed cost	n/a	Yes	Yes	Yes
Employee benefits	n/a	Yes	Yes	Yes
Assets and liabilities of subsidiaries, associates and joint ventures	n/a	Yes	Yes	Yes
Designation of previously recognised financial instruments	n/a	Yes	Yes	Yes
Cumulative translation differences	n/a	Yes	Yes	Yes
Compound financial instruments	n/a	Yes	Yes	Yes
Share-based payment transactions	n/a	Yes	Yes	Yes
Insurance contracts	n/a	Yes	Yes	Yes
Decommissioning liabilities included in the cost of property, plant and equipment	n/a	Yes	Yes	Yes
Leases	n/a	Yes	Yes	Yes
Fair value measurement of financial assets or financial liabilities at initial recognition	n/a	Yes	Yes	Yes
Financial assets or intangible assets accounted for in accordance with IFRIC 12 *Service Concession Arrangements*	n/a	Yes	Yes	Yes
Borrowing costs (see note 2)	Reporting periods beginning on or after 1 January 2009 / Yes	No	Yes	Yes
Investments in subsidiaries, jointly controlled entities and associates (see note 2)	Reporting periods beginning on or after 1 January 2009 / Yes	No	Yes	Yes
		Yes: The exemption is effective at the end of the reporting period and can be applied (optional).		
		No: The exemption is not effective, but may be available for early application		

Note 1: *Users should determine whether the revised version of IFRS 3 is applicable. IFRS 3(Revised) becomes mandatory for annual periods beginning on or after 1 July 2009 with early adoption permitted.*

Note 2: *Based on the 2008 version of IFRS 1 the effective date is 1 July 2009.*

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Appendix II. Selected application issues

1 Introduction

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

Guidance is included on the following issues:

- Can an entity apply IFRS 1 more than once?
- Intangible assets - capitalisation of development costs
- Financial instruments -recognition and measurement
- Presentation of financial instruments as liabilities or equity
- Embedded derivatives
- Hedge accounting
- Leases
- Income taxes
- Business combinations
- Venture capital organisations and investments in associates
- Pre-transition share-based payments

2 Can an entity apply IFRS 1 more than once?

An entity applies IFRS 1 when it adopts IFRS for the first time. It therefore applies IFRS 1 in its transition to IFRS and cannot generally apply that standard again.

However, in relatively rare cases an entity might have adopted IFRS (or IAS, if adoption took place prior to the change in terminology) but later switched to another financial reporting framework (eg local generally accepted accounting practice or GAAP). If the entity subsequently re-adopts IFRS in a future period, we consider that the re-adoption is within the scope of IFRS 1. It is therefore possible that IFRS 1 can be applied more than once.

It is **not** appropriate to apply IFRS 1 when (for example) an entity, having applied IFRS in the past:

- changes the description of its accounting framework, but the change is not substantive and subsequently reverts to referring to IFRS as its basis of preparation, or
- retains IFRS as its basis of preparation but fails to comply fully with IFRS in one or more periods, and then reverts back to full compliance.

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3 Intangible assets - capitalisation of development costs

This discussion is in the context of internally developed intangible assets rather than items acquired in a business combination (see paragraph 8.2 of this appendix) or through separate acquisition.

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

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

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

4 Financial instruments

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

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

4.1 Recognition

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

- derecognition of some financial assets and liabilities under previous GAAP (IFRS 1.B2 and B3). In accordance with this exemption the entity does not recognise non-derivative financial assets or liabilities derecognised under previous GAAP before 1 January 2004, to which the first-time adopter chooses not to apply IFRS 1.B3, unless they qualify for recognition as a result of a later event (See discussion in section C3.1),
- the hedge accounting requirements on first-time adoption of IFRS (IFRS 1.B4-B6) (IFRS 1.IG52).

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

4.2 Measurement

4.2.1 Categories

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

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

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

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

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

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

For non-derivative financial assets and non-derivative financial liabilities that are not held for trading, IAS 39 includes what is commonly referred to as a **'fair value option'**. The fair value option allows entities to designate, at initial recognition, financial assets and liabilities in the fair value through profit or loss category. A first-time adopter is permitted to designate a non-derivative

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financial asset or liability at fair value through profit or loss at the date of transition if the criteria in IAS 39 are met at the date of transition to IFRS (IFRS 1.D19). In other words, the first-time adopter is not required to have made this designation on initial recognition if that date was prior to the transition date. This exemption from normal IFRS rules is available only for an entity that presents its first IFRS financial statements for an annual period beginning on or after 1 January 2006 (IFRS 1.IG56(d)(iii)).[16]

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

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

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

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

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

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

4.2.3 Estimates of impairment at the date of transition

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

[16] Further requirements are stated in IFRS 1.IG.56(d)(iv) for entities that present their first IFRS financial statements for an annual period beginning before 1 January 2006. These are, however, not presented here as they are expected to be less relevant for current first-time adopters.

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4.2.4 Transition adjustments

A first-time adopter treats an adjustment to the carrying amount of a financial asset or financial liability as a transition adjustment to be recognised in the opening balance of retained earnings (or another appropriate part of equity) at the date of transition to IFRS only to the extent that it results from adopting IAS 39 (IFRS 1.IG58A and IG59). IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (IAS 8) applies to adjustments resulting from changes in estimates. If an entity is unable to determine whether a particular portion of an adjustment is a transition adjustment or a change in estimate, it treats that portion as a change in accounting estimate under IAS 8, with appropriate disclosures in accordance with IAS 8.32–40 (IFRS 1.IG58B).

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

4.3 Presentation of financial instruments as liabilities or equity

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

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

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

4.4 Embedded derivatives

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

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

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

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

5 Hedge accounting

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

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

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

5.1 Reflecting hedges in the opening statement of financial position

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

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

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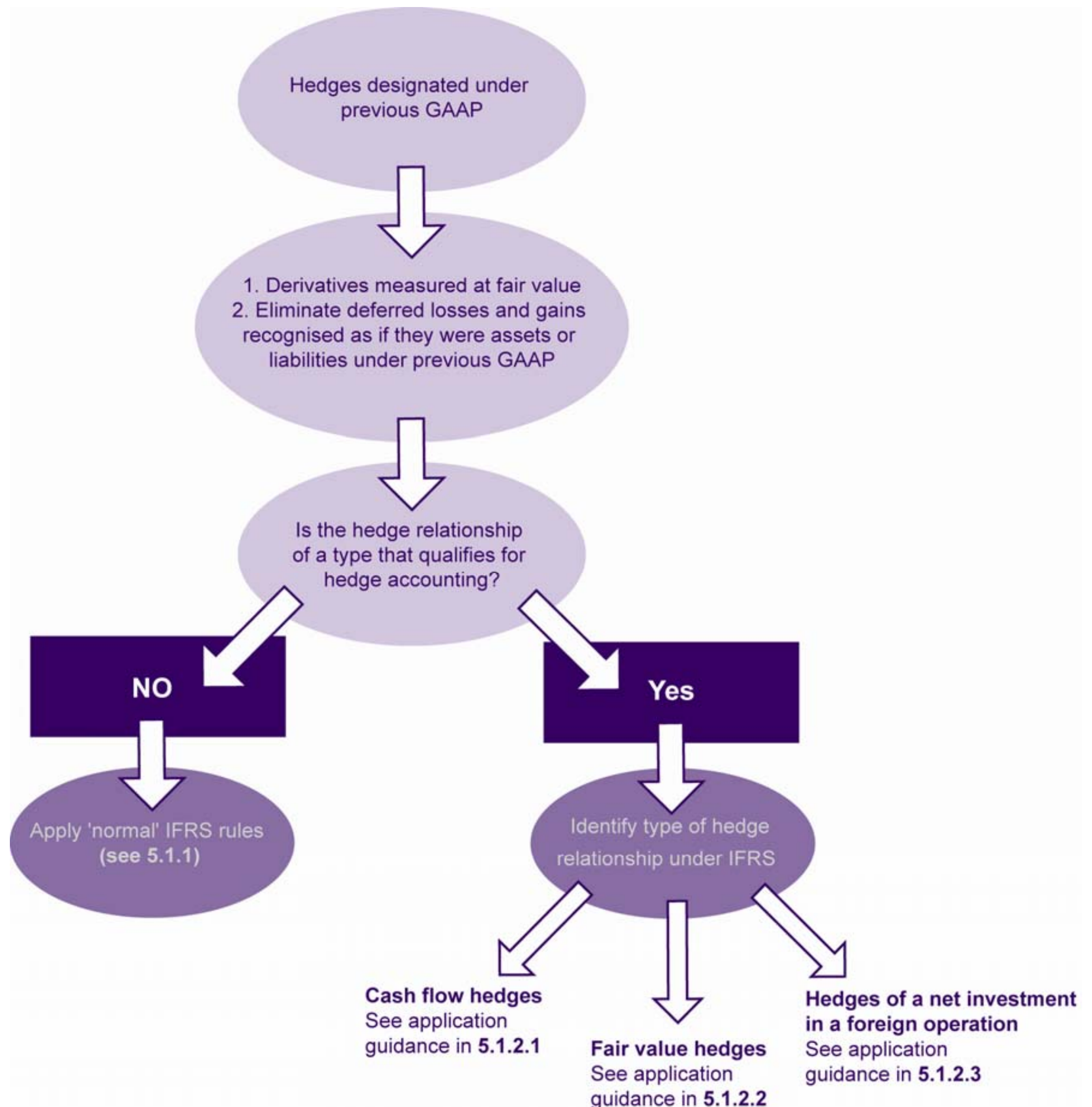
In its opening statement of financial position, the first-time adopter does reflect hedging relationships that were designated as such under previous GAAP and which are of a type that qualify for hedge accounting under IAS 39. The treatment in the opening statement of financial position is summarised in the following flowchart, and is described in turn below.



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

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

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

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

IFRS 1.B5 provides one exemption to this rule. If an entity designated a net position as a hedged item under previous GAAP, it **may** designate an individual item within that net position as a hedged item under IFRSs provided that it does so no later than the date of transition to IFRS.

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

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

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

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

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

Under IAS 39.88(c) a forecast transaction that is subject to a hedge must be highly probable when the hedge is designated. If, at the date of transition to IFRS, the hedged forecast transaction is not highly probable but is still expected to occur, the deferred gain or loss is recognised in equity as a cash-flow hedging reserve. The amount recognised in the cash-flow hedging reserve is not reduced by any ineffectiveness up to the date of transition. This cumulative gain or loss remains in equity until (a) the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, (b) the forecast transaction affects profit or loss or (c) subsequently

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circumstances change and the forecast transaction is no longer expected to occur, in which case any related net cumulative gain or loss is reclassified from equity to profit or loss (IFRS 1.IG60B).

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

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

A first-time adopter (F) prepares its first IFRS financial statements at 31 December 2009. Its transition date is 1 January 2008. In 2007 Entity F designated a cash flow hedging relationship under previous GAAP over currency risk in a highly probable sale of goods for foreign currency (FC) 100. The hedging relationship qualifies as a cash flow hedge of a highly probable forecast transaction under IAS 39. The first-time adopter entered into a forward contract to sell FC 100 and buy local currency (LC) at a forward rate of 0.9 LC/1 FC. Under its previous GAAP, the entity was not required to recognise the forward contract. The forecast transaction remains highly probable at the date of transition to IFRS (1 January 2008).

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

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

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

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

IFRS 1 requires the hedged item to be adjusted in a manner that is similar (but not quite identical) to the entries that would have been made had the entity always applied IAS 39's fair value hedge accounting rules. The adjustment to the hedged item is the lower of:

- that portion of the cumulative change in the fair value of the hedged item that reflects the designated hedged risk and was not recognised under previous GAAP, and
- that portion of the cumulative change in the fair value of the hedging instrument that reflects the designated hedged risk and, under previous GAAP, was either (i) not recognised or (ii) deferred in the statement of financial position as an asset or liability (IFRS 1.IG60A).

To illustrate, consider the following example:

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

A first-time adopter (F) prepares its first IFRS financial statements at 31 December 2009. Its date of transition is 1 January 2008. In 2006 Entity F took out a loan of CU 100 from a bank. The loan is repayable in 2012 and has a fixed interest rate payable every 4 months. Subsequently the first-time adopter decided to alter its interest payments on the loan by agreeing a pay floating-receive fixed interest rate swap with maturity in 2012 (same date as loan).

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

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

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

5.1.2.3 Net investment hedges

There is no guidance in IFRS on the treatment of net investment hedges on the date of transition. IAS 39.102 states that net investment hedges are treated similarly to cash flow hedges. Therefore, we believe that the accounting in an entity's first IFRS financial statements should reflect the guidance for cash flow hedges by analogy.

Often, entities choose the exemption to reset cumulative translation differences on foreign operations to zero at the date of transition (IFRS 1.D13). In our view, if a net investment hedge was entered into before the date of transition, the accounting treatment will depend on whether the first-time adopter chooses the exemption for cumulative translation differences.

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

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Where a first-time adopter does **not** use the exemption to reset cumulative translation differences at the date of transition, the net investment hedge should be reflected in the opening statement of financial position in a similar manner to that described above for cash flow hedges.

5.2 Subsequent accounting after the date of transition

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

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

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

5.2.1 Cash flow hedges

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

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

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

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

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

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

Subsequent measurement:
Scenario 1: The forecast transaction is still highly probable and all other IAS 39 requirements are met from the date of transition. From the date of transition the portion of gain or loss on the forward contract that is determined to be an effective hedge is then recognised in the cash flow hedging reserve. The cumulative gains or losses included in the cash flow hedging reserve remain until the forecast transaction affects profit or loss or results in the recognition of a non-financial asset or liability.

Scenario 2: The forecast transaction is no longer highly probable but still expected to occur. The cumulative gains or losses up to the date that the forecast transaction ceases to be highly probable are recognised in the cash flow hedging reserve until the forecast transaction affects profit or loss or subsequently results in the recognition of a non-financial asset or liability. Later gains and losses on the forward contract are recognised in profit or loss.

Scenario 3: The forecast transaction is no longer expected to occur. The cumulative gain or loss recognised in the cash flow hedging reserve up to that date is reclassified from equity to profit or loss. Subsequent gains and losses on the forward contract are also recognised in profit or loss.

5.2.2 Fair value hedges

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

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

Example 4: Fair value hedge - subsequent measurement

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

Hedge accounting requirements are not met at the date of transition
The first-time adopter discontinues hedge accounting prospectively from the date of transition in accordance with IAS 39.91.

Hedge accounting requirements are met at the date of transition and thereafter
The first-time adopter applies fair value hedge accounting prospectively from the date of transition in accordance with IAS 39.

Hedge accounting requirements met after the date of transition
The documentation was prepared after the date of transition, for example on 1 August 2008. As a result, hedge accounting can be applied prospectively with effect from 1 August 2008. For the period 1 January 2008 (date of transition) to 31 July 2008, hedge accounting cannot be applied. Consequently, at the date of transition to IFRS, the first-time adopter discontinues hedge accounting prospectively in accordance with IAS 39.91.

5.2.2.1 Net investment hedges

The principle for cash flow hedges applies equally to net investment hedges. The designation and documentation of a hedging relationship must be completed on or before the date of transition to

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IFRS if the hedging relationship is to qualify for hedge accounting from that date (IFRS 1.IG60). Hedge accounting can be applied prospectively only from the date that the hedging relationship is fully designated and documented. Therefore, if the net investment hedge does not qualify for hedge accounting at the date of transition it is discontinued prospectively. If the net investment hedge qualifies for hedge accounting, the first-time adopter accounts for the hedge in accordance with the requirements in IAS 39.102.

6 Leases

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

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

7 Income taxes

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

In the opening statement of financial position deferred tax shall be recognised on temporary differences between the carrying amount of assets and liabilities and their tax bases (IFRS 1.IG5). Under IAS 12, an entity is required to use the tax rates and laws that have been enacted or substantially enacted at the end of the reporting period. IFRS 1 notes that an entity shall account for the effects of changes in tax laws and tax rates when those changes are enacted or substantially enacted (IFRS 1.IG6). This is consistent with the IFRS 1 requirements for estimates, ie estimates shall be consistent with those under previous GAAP, unless there is objective evidence that those estimates were in error. For example, a first-time adopter with a reporting date of 31 December 2009 would not recognise a change in tax rates occurring in September 2009 in its opening statement of financial position (1 January 2008). The change in tax rates will be reflected in the year ended 31 December 2009.

7.1 IAS 12 initial recognition exemption

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

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

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

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

Deferred tax and business combinations

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

7.2 Deferred tax on share options granted before 7 November 2002

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

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

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

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

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

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

If the entity decides not to apply IFRS 3 retrospectively, it applies the requirements in Appendix C of IFRS 1 in accounting for the combination. Where this results in separate recognition in the

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opening IFRS statement of financial position of intangible assets acquired in the business combination, a deferred tax provision will be required on the full taxable temporary difference. If those assets were also recognised separately under previous GAAP, any consequent adjustment to deferred tax balances will lead to an adjustment to retained earnings. By contrast, if the assets were previously subsumed within recognized goodwill, adjustments to deferred tax will lead to adjustments to goodwill and (if applicable) non-controlling interests (IFRS 1.C4(g)).

8 Business combinations

8.1 Double-counting of fair value adjustments within goodwill

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

Example 5: Double-counting of fair value adjustments

A first-time adopter will apply IFRS for the first time for the annual period ending on 31 December 2009. It has opted not to apply IFRS 3 to past business combinations. It holds various investment properties and has opted to measure them using the IAS 40 fair value model.

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

Requirements

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

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

Application of the requirements

The first-time adopter performs an impairment test of goodwill (based on the cash-generating units). This reveals that no impairment of goodwill has to be recognized.

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

The first-time adopter recognises a fair value adjustment to the investment properties at the date of transition, which includes the amount included in goodwill. Accordingly, the difference between fair value and the carrying amount at the date of acquisition is double-counted in the opening statement of financial position as it is included within both investment properties and goodwill.

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

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

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8.2 Intangible assets acquired in a past business combination

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

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

Example 6: Intangible asset was recognised under previous GAAP

Background
Entity A's first IFRS financial statements are for the year ended 31 December 2009 and its date of transition is 1 January 2008. It has acquired a subsidiary in a past business combination that occurred before the date of transition. Entity A does not restate past business combinations, ie it applies the exemption in IFRS 1 Appendix C.

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

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

Application of the requirements
Management determines that the internally generated trademarks qualify for recognition under IAS 38 (paragraphs 33 and 34). Therefore, the intangible asset shall be recognised in the opening statement of financial position (IFRS 1.C4(c)).

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

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

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The requirements are illustrated in the following example:

Example 7: Intangible asset was not recognised under previous GAAP

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

Internally generated trademarks are still held by the subsidiary at the date of transition. At the date of transition Entity A determines that the intangible asset does not qualify for recognition under IAS 38 in the statement of financial position of the acquiree (subsidiary). This is because it is internally generated (IAS 38.63).

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

9 Venture capital organisations and investments in associates

Investments or interests in associates or joint ventures held by a venture capital organisation or a mutual fund, unit trust or similar organisation, including investment-linked insurance funds are excluded from the scope of IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures* (IAS 28.1 and IAS 31.1) when they are measured at fair value in accordance with IAS 39.

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

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

10 Pre-transition share-based payments costs

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

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

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