# FIRST TIME ADOPTION OF IFRS (IFRS-1)

**Objectives**

To ensure that financial statements and interim financial statements:

- Are transparent and comparable over all periods
- Provide suitable starting point for accounting under IRFS
- Generate at cost less than benefits to users.

**Scope**

This IFRS is applicable to entities which first time adopt IFRS by an explicit and unreserved statement in the FS of confidence with IFRS

Any entity's first financial statements under IFRS will be of the entity: -

a) Presented its most recent financial statements
   - Under national regulations inconsistent with IFRS
   - One is conformity with IFRS except did not contain explicit and un-reserved statements
   - Contained explicit statement of compliance with some but not all IFRS
   - Under national regulations and IFRS only applied where no local regulations exist
   - Under national regulations with reconciliation of amounts to amounts determined under IFRS.

b) IFRS only applied on the internal FS

c) IFRS only on consolidated FS

d) Did not present FS of previous periods

**Definition**

***Date of transition to IFRSs***

The beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statement

***Deemed cost***

An amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortization assumes that the entity had initially recognized the asset or liability at the given date and that its cost was equal to the deemed cost.

***First IFRS financial statements***

The first annual financial statements in which an entity adopts IFRS, by an explicit and un-reserved statement of compliance with IFRS

***First time adopter***

An entity that presents its first IFRS financial statements

***Opening IFRS balance sheet***

An entity's balance sheet at the date of transition to IFRS

***Previous GAAP***

The basis of accounting that a first-time adopter used immediately before adopting IFRS.

***Reporting date***

The end of the latest period covered by financial statements or by an interim financial report

**Recognition and Measurement**

The entity will prepare opening IFRS balance sheet at the date of first time adoption of IFRS.

**Accounting policies**

An entity shall use the same accounting policies in its opening balance sheet and for all the periods presented in its first IFRS statements. Those policies shall comply with the IFRS effective at the reporting date except specified in this IFRS.

Except provided in this IFRS an entity in its opening IFRS balance sheet:-

- **Recognize** all assets and liabilities whose recognition is required by IFRS
  The most important of these are likely to be derivative financial assets and liabilities, and deficits or surpluses under defined benefit plans. These would include not just pension plans but also items such as medical care costs and life insurance. Other recognizable liabilities might be deferred tax balances and certain provisions such as environmental and decommissioning costs.
- **Not recognize** assets/liabilities not permitted by IFRS
  For example, IFRS do not permit the following assets to be recognized: research, start-up and pre-operating costs, staff training, deferred advertising expenditure, and relocation costs.
  Liabilities that are not permitted to be recognized under IFRS are: general or contingency provisions, future restructuring costs and operating losses, and provisions for major overhauls of assets.
- **Reclassify** the assets / liabilities as per the requirement of IFRS
  - Certain intangible assets recognised on a business combination would need to be reclassified as goodwill if their recognition does not meet IAS 38, Intangible Assets criteria. It is also possible that the reverse could occur.
  - Items classified as share capital may need to be reclassified as debt. IAS 32 requires redeemable preference shares to be classified as debt, and compound financial instruments (eg convertible loan notes) may have to be split between debt and equity.
  - IAS 10 does not allow dividends proposed after the balance sheet date to be treated as a liability.
  - The definition of a reportable segment may change - this would cause a reclassification of segment information.
  - Some investments that may not have been consolidated under previous GAAP may meet the definition of a subsidiary under IFRS and have to be consolidated.
- **Apply** all IFRS for measurement of asset/liabilities
  The resultant adjustment of change in measurement basis will be treated as change in accounting policies and will be directly recognized in rationed earnings.
  For example, while IAS 12 does not allow deferred tax assets or liabilities to be discounted to a present value, other jurisdictions do allow discounting.
  The net effect of the above adjustments should be recognized in retained earnings or other appropriate category of equity.

**Exceptions to the IFRS**

These are two categories of exceptions in applying IFRS in opening balance sheet:

a) Exemption from some requirements of IFRS (Optional exemptions)
b) Retrospective applications of some aspects of other IFRS (Mandatory exemptions)

**Exemptions from other IFRS**

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

- Business combinations
- Fair value or revaluations as deemed cost
- Employee benefit
- Commutative transactions difference

**Business Combinations**

Previous business combinations (occurring before the opening balance sheet) do not have to be restated to comply with IFRS. Mergers (pooling of interests) do not have to be re-accounted for as acquisitions, previously written off goodwill does not have to be reinstated, and the fair values of assets and liabilities may be retained. However, an impairment test for any remaining goodwill (after reclassifying any necessary intangibles as goodwill) must be made in the opening balance sheet.

**Fair value or revaluations as deemed cost**

An entity may elect to use the fair value of the above items as the deemed cost under IFRS. Fair values may have been a market-based revaluation or an indexed amount under previous GAAP. IFRS allow the carrying value of the above assets to be based on a cost or revaluation model. This exemption has the effect of allowing a revalued amount to be used under the cost model. One advantage of the cost model is that there is no obligation to keep asset values up-to-date. Thus this exemption means that an entity could use fair value as the deemed cost and not have to revalue each year end.

**Employee benefit**

An entity may choose to recognize all actuarial gains and losses on employee defined benefit plans at the opening balance sheet date. Under IFRS a 'corridor' approach can be used to smooth out fluctuations in the actuarial valuations of defined benefit plans. This exemption has the effect of resetting any corridor to zero.

**Commutative translation difference**

This exemption allows all translation gains and losses relating to foreign entities to be recognized in retained profits at the opening balance sheet date. Similar to the above, the effect is to reset the translation reserve to zero.

**Retrospective applications of some aspects of other IFRS**

There are three important exceptions to the general restatement and measurement principles set out above.

- De-recognition of financial instruments
- Hedge accounting
- Information to be used in preparing IFRS estimates retrospectively

**De-recognition of financial instruments**

a) A first time adopter is not permitted to de-recognize retrospectively financial assets or financial liabilities that had been recognized under its previous GAAP in a financial year beginning before January 1, 2004, except if the information necessary was obtained at the time of the past transactions. In general, IAS 39 de-recognition requirements should be applied prospectively.

b) However, if an SPE was used to effect the de-recognition of financial instruments and the SPE is controlled at the opening IFRS balance sheet date, the SPE must be consolidated.

**Hedge accounting**

a) The conditions set forth by IAS-39 for hedging relationship that qualifies for hedge accounting are to be applied as of the opening IFRS balance sheet date. The hedge accounting practices, if any, that were used in periods prior to the opening balance sheet may not be retrospectively changed.

b) This is consistent with the transition provisions in IAS-39. However, some adjustments may be needed to take account of the existing hedging relationships under GAAP at the opening balance sheet date.

**Information to be used in preparing IFRS estimates retrospectively**

a) In preparing IFRS estimates retrospectively, the entity must use the inputs and assumptions that had been used to determine previous GAAP estimates in periods before the date of transition to IFRS, provided that those inputs and assumptions are consistent with IFRS.

b) The entity is not permitted to use information that became available only after the previous GAAP estimates were made except to correct an error.

**Disclosures**

IFRS 1 requires disclosures that explain how the transition to IFRS has affected the entity's financial position, performance and cash flows. This is achieved by:

- a reconciliation of equity under previous GAAP to equity under IFRS, both at the date of transition and at the end of the last reported period under previous GAAP. For a 31 December 2005 adopter this would be at 1 January 2004 and 31 December 2004
- a reconciliation of profit from previous GAAP to IFRS for the last reported period under previous GAAP. For the above company this would be for the year to 31 December 2004.

The reconciliations should be supplemented by explanations and disclosure of:

- material adjustments made to the financial statements in adopting IFRS for the first time
- correction of errors discovered in previous GAAP
- the recognition or reversal of any impairment losses in preparing the opening balance sheet
- any specific exemptions it has elected to use under IFRS 1 (eg the use of fair values as deemed cost).

Example 1

**(a)** IFRS 1 'First-time Adoption of International Financial Reporting Standards' was issued in June 2003. Its main objectives are to ensure high quality information that is transparent and comparable over all periods presented and to provide a starting point for subsequent accounting under International Financial Reporting Standards (IFRS) within the framework of a cost benefit exercise.

**Required:**

**(i) Describe the circumstances where the presentation of an entity's financial statements is deemed to be the first-time adoption of IFRSs and explain the main financial reporting implementation issues to beaddressed in the transition to IFRSs.**

**(ii) Describe IFRS 1's accounting requirements where an entity's previous accounting policies for assets and liabilities do not comply with the recognition and measurement requirements of IFRSs.**

**(b)** Transit, a publicly listed holding company, has a reporting date of 31 December each year. Its financial statements include one year's comparatives. Transit currently applies local GAAP accounting rules, but is intending to apply IFRSs for the first time in its financial statements (including comparatives) for the year ending 31 December 2005. Its summarized consolidated balance sheet (under local GAAP) at 1 January 2004 is:

| | Rs. (000) | Rs. (000) |
|---|---|---|
| Property, plant and equipment | | 1,000 |
| Goodwill | | 450 |
| Development costs | | 400 |
| Current assets | | 1,850 |
| Inventory | 150 | |
| Trade receivables | 250 | |
| Bank | 20 | |
| | 420 | |
| Current liabilities | (320) | |
| Net current assets | | 100 |
| | | 1,950 |
| Non-current liabilities | | |
| Restructuring provision | (250) | |
| Deferred tax | (300) | (550) |
| Net assets | | 1,400 |
| Issued share capital | | 500 |
| Retained earnings | | 900 |
| Total equity | | 1,400 |

Additional information:

(i) Transit's depreciation policy for its property, plant and equipment has been based on tax rules set by its government. If depreciation had been based on the most appropriate method under IFRSs, the carrying value of the property, plant and equipment at 1 January 2004 would have been Rs.800,000.

(ii) The development costs originate from an acquired subsidiary of Transit. They do not qualify for recognition under IFRSs. They have a tax base of nil and the deferred tax related to these costs is Rs.100,000.

(iii) The inventory has been valued at prime cost. Under IFRSs it would include an additional Rs.30,000 of overheads.

(iv) The restructuring provision does not qualify for recognition under IFRSs.

(v) Based on IFRSs, the deferred tax provision required at 1 January 2004, including the effects of the development expenditure, is Rs.360,000.

**Required:**

**Prepare a summarized balance sheet for Transit at the date of transition to IFRSs (1 January 2004) applying the requirements of IFRS 1 to the above items.**