

HKFRS 1
Revised ~~May 2006~~[October 2008](#)

Effective for annual periods
beginning on or after 1 January 2004

Hong Kong Financial Reporting Standard 1

First-time Adoption of Hong Kong Financial Reporting Standards

[An entity shall apply amendments resulting from *Improvements to HKFRSs* issued in October 2008 for annual periods beginning on or after 1 July 2009.](#)



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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BASIS FOR CONCLUSIONS**IMPLEMENTATION GUIDANCE**

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

INTRODUCTION

Reason for issuing the HKFRS

- IN1 This HKFRS prescribes the accounting treatment that an entity should apply when it adopts HKFRSs for the first time as the basis for preparing its financial statements and interim financial reports.

Main features of the HKFRS

- IN2 The HKFRS applies when an entity adopts HKFRSs for the first time by an explicit and unreserved statement of compliance with HKFRSs.
- IN3 In general, the HKFRS requires an entity to comply with each HKFRS effective at the reporting date for its first HKFRS financial statements. In particular, the HKFRS requires an entity to do the following in the opening HKFRS balance sheet that it prepares as a starting point for its accounting under HKFRSs:
- (a) recognise all assets and liabilities whose recognition is required by HKFRSs;
 - (b) not recognise items as assets or liabilities if HKFRSs do not permit such recognition;
 - (c) reclassify items that it recognised under previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under HKFRSs; and
 - (d) apply HKFRSs in measuring all recognised assets and liabilities.
- IN4 The HKFRS grants limited exemptions from these requirements in specified areas where the cost of complying with them would be likely to exceed the benefits to users of financial statements. The HKFRS also prohibits retrospective application of HKFRSs in some areas, particularly where retrospective application would require judgements by management about past conditions after the outcome of a particular transaction is already known.
- IN5 The HKFRS requires disclosures that explain how the transition from previous GAAP to HKFRSs affected the entity's reported financial position, financial performance and cash flows.
- IN6 An entity is required to apply the HKFRS if its first HKFRS financial statements are for a period beginning on or after 1 January 2004. Earlier application is encouraged.

Latest version

- IN7 This version is current as at 1 May 2006. It includes amendments* resulting from all new Hong Kong Accounting Standards issued in 2004 and 2005 and the following new Standards and Interpretations and Amendments to Standards issued in 2004 and 2005: HK(IFRIC)-Ints 1 and 4; HKFRS 6; Amendment to HKAS 19 *Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures*; Amendment to HKAS 39 *Financial Instruments: Recognition and Measurement – Transition and Initial Recognition of Financial Assets and Financial Liabilities*; Amendments to HKFRS 1 and HKFRS 6; and HKFRS 7 *Financial Instruments: Disclosures*.

* The consequential amendments set out in the appendices of the relevant Standards and Interpretations will be removed when those Standards and Interpretations are revised.

HONG KONG FINANCIAL REPORTING STANDARD 1

First-time Adoption of Hong Kong Financial Reporting Standards

OBJECTIVE

- 1 The objective of this HKFRS is to ensure that an entity's *first HKFRS financial statements*, and its interim financial reports for part of the period covered by those financial statements, contain high quality information that:
- (a) is transparent for users and comparable over all periods presented;
 - (b) provides a suitable starting point for accounting under *Hong Kong Financial Reporting Standards (HKFRSs)*; and
 - (c) can be generated at a cost that does not exceed the benefits to users.

SCOPE

- 2 An entity shall apply this HKFRS in:
- (a) its first HKFRS financial statements; and
 - (b) each interim financial report, if any, that it presents under ~~SSAP-25~~[HKAS 34](#) *Interim Financial Reporting* for part of the period covered by its first HKFRS financial statements.
- 3 An entity's first HKFRS financial statements are the first annual financial statements in which the entity adopts HKFRSs, by an explicit and unreserved statement in those financial statements of compliance with HKFRSs. Financial statements under HKFRSs are an entity's first HKFRS financial statements if, for example, the entity:
- (a) presented its most recent previous financial statements:
 - (i) under other accounting requirements that are not consistent with HKFRSs in all respects;
 - (ii) in conformity with HKFRSs in all respects, except that the financial statements did not contain an explicit and unreserved statement that they complied with HKFRSs;
 - (iii) containing an explicit statement of compliance with some, but not all, HKFRSs;
 - (iv) under other accounting requirements inconsistent with HKFRSs, using some individual HKFRSs to account for items for which other accounting requirements did not exist; or
 - (v) under other accounting requirements, with a reconciliation of some amounts to the amounts determined under HKFRSs;
 - (b) prepared financial statements under HKFRSs for internal use only, without making them available to the entity's owners or any other external users;
 - (c) prepared a reporting package under HKFRSs for consolidation purposes

without preparing a complete set of financial statements as defined in HKAS 1 *Presentation of Financial Statements*; or

- (d) did not present financial statements for previous periods.
- 4 This HKFRS applies when an entity first adopts HKFRSs. It does not apply when, for example, an entity:
- (a) stops presenting financial statements under other accounting requirements, having previously presented them as well as another set of financial statements that contained an explicit and unreserved statement of compliance with HKFRSs;
 - (b) presented financial statements in the previous year under other accounting requirements and those financial statements contained an explicit and unreserved statement of compliance with HKFRSs; or
 - (c) presented financial statements in the previous year that contained an explicit and unreserved statement of compliance with HKFRSs, even if the auditors qualified their audit report on those financial statements.
- 5 This HKFRS does not apply to changes in accounting policies made by an entity that already applies HKFRSs. Such changes are the subject of:
- (a) requirements on changes in accounting policies in HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; and
 - (b) specific transitional requirements in other HKFRSs.

RECOGNITION AND MEASUREMENT

Opening HKFRS balance sheet

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

Accounting policies

- 7 **An entity shall use the same accounting policies in its opening HKFRS balance sheet and throughout all periods presented in its first HKFRS financial statements. Those accounting policies shall comply with each HKFRS effective at the reporting date for its first HKFRS financial statements, except as specified in paragraphs ~~13-34~~[13-34B, 36A-36C and 37](#).**
- 8 An entity shall not apply different versions of HKFRSs that were effective at earlier dates. An entity may apply a new HKFRS that is not yet mandatory if it permits early application.

Example: Consistent application of latest version of HKFRSs**BACKGROUND**

The reporting date for entity A's first HKFRS financial statements is 31 December 2005. Entity A decides to present comparative information in those financial statements for one year only (see paragraph 36). Therefore, its date of transition to HKFRSs is the beginning of business on 1 January 2004 (or, equivalently, close of business on 31 December 2003). Entity A presented financial statements under its *previous GAAP* annually to 31 December each year up to, and including, 31 December 2004.

APPLICATION OF REQUIREMENTS

Entity A is required to apply the HKFRSs effective for periods ending on 31 December 2005 in:

- (a) preparing its opening HKFRS balance sheet at 1 January 2004; and
- (b) preparing and presenting its balance sheet for 31 December 2005 (including comparative amounts for 2004), income statement, statement of changes in equity and cash flow statement for the year to 31 December 2005 (including comparative amounts for 2004) and disclosures (including comparative information for 2004).
- (c) If a new HKFRS is not yet mandatory but permits early application, entity A is permitted, but not required, to apply that HKFRS in its first HKFRS financial statements.

- 9 The transitional provisions in other HKFRSs apply to changes in accounting policies made by an entity that already uses HKFRSs; they do not apply to a *first-time adopter's* transition to HKFRSs, except as specified in paragraphs 25D, 34A and 34B.
- 10 Except as described in paragraphs ~~13-34~~[13-34B and 36A-36C](#), an entity shall, in its opening HKFRS balance sheet:
- (a) recognise all assets and liabilities whose recognition is required by HKFRSs;
 - (b) not recognise items as assets or liabilities if HKFRSs do not permit such recognition;
 - (c) reclassify items that it recognised under previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under HKFRSs; and
 - (d) apply HKFRSs in measuring all recognised assets and liabilities.
- 11 The accounting policies that an entity uses in its opening HKFRS balance sheet may differ from those that it used for the same date using its previous GAAP. The resulting adjustments arise from events and transactions before the date of transition to HKFRSs. Therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to HKFRSs.

- 12 This HKFRS establishes two categories of exceptions to the principle that an entity's opening HKFRS balance sheet shall comply with each HKFRS:
- (a) paragraphs 13-25G [and 36A-36C](#) grant exemptions from some requirements of other HKFRSs.
 - (b) paragraphs 26-34B prohibit retrospective application of some aspects of other HKFRSs.

Exemptions from other HKFRSs

- 13 An entity may elect to use one or more of the following exemptions:
- (a) business combinations (paragraph 15);
 - (b) *fair value* or revaluation as *deemed cost* (paragraphs 16-19);
 - (c) employee benefits (paragraph [20 20 and 20 A](#));
 - (d) cumulative translation differences (paragraphs 21 and 22);
 - (e) compound financial instruments (paragraph 23);
 - (f) assets and liabilities of subsidiaries, associates and joint ventures (paragraphs 24 and 25);
 - (g) designation of previously recognised financial instruments (paragraph 25A);
 - (h) share-based payment transactions (paragraphs 25B and 25C);
 - (i) insurance contracts (paragraph 25D);
 - (j) decommissioning liabilities included in the cost of property, plant and equipment (paragraph 25E);
 - (k) leases (paragraph 25F); and
 - (l) fair value measurement of financial assets or financial liabilities at initial recognition (paragraph 25G).

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

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

Business combinations

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

Fair value or revaluation as deemed cost

- 16 An entity may elect to measure an item of property, plant and equipment at the date of transition to HKFRSs at its fair value and use that fair value as its deemed cost at that date.
- 17 A first-time adopter may elect to use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to HKFRSs as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:
- (a) fair value; or
 - (b) cost or depreciated cost under HKFRSs, adjusted to reflect, for example, changes in a general or specific price index.
- 18 The elections in paragraphs 16 and 17 are also available for:
- (a) investment property, if an entity elects to use the cost model in ~~SSAP 13~~ [HKAS 40 *Accounting for Investment Properties*](#) ~~Property~~; and
 - (b) intangible assets that meet:
 - (i) the recognition criteria in ~~SSAP 29~~ [HKAS 38 *Intangible Assets*](#) (including reliable measurement of original cost); and
 - (ii) the criteria in ~~SSAP 29~~ [HKAS 38](#) for revaluation (including the existence of an active market).

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

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

Employee benefits

- 20 Under ~~SSAP 34~~ [HKAS 19 *Employee Benefits*](#), an entity may elect to use a 'corridor' approach that leaves some actuarial gains and losses unrecognised. Retrospective application of this approach requires an entity to split the cumulative actuarial gains and losses from the inception of the plan until the date of transition to HKFRSs into a recognised portion and an unrecognised portion. However, a first-time adopter may elect to recognise all cumulative actuarial gains and losses at the date of transition to HKFRSs, even if it uses the corridor approach for later actuarial gains and losses. If a first-time adopter uses this election, it shall apply it to all plans.

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

Cumulative translation differences

- 21 ~~SSAP 11 *Foreign Currency Translation* requires an entity to classify some translation differences as a separate component of equity; and SSAP 32 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* requires an entity, on disposal of a foreign operation, to transfer the cumulative translation difference for that foreign operation (including, if applicable, gains and losses on related hedges) to the~~

~~income statement as part of the gain or loss on disposal.~~ HKAS 21 *The Effects of Changes in Foreign Exchange Rates* requires an entity:

- (a) —to classify some translation differences as a separate component of equity; and
- (b) on disposal of a foreign operation, to transfer the cumulative translation difference for that foreign operation (including, if applicable, gains and losses on related hedges) to the income statement as part of the gain or loss on disposal.

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

- (a) the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to HKFRSs; and
- (b) the gain or loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to HKFRSs and shall include later translation differences.

Compound financial instruments

23 ~~HKAS 32 *Financial Instruments: Disclosure and Presentation*~~¹ requires an entity to split a compound financial instrument at inception into separate liability and equity components. If the liability component is no longer outstanding, retrospective application of ~~HKAS 32~~ involves separating two portions of equity. The first portion is in retained earnings and represents the cumulative interest accreted on the liability component. The other portion represents the original equity component. However, under this HKFRS, a first-time adopter need not separate these two portions if the liability component is no longer outstanding at the date of transition to HKFRSs.

Assets and liabilities of subsidiaries, associates and joint ventures

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

- (a) the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to HKFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary; or
- (b) the carrying amounts required by the rest of this HKFRS, based on the subsidiary's date of transition to HKFRSs. These carrying amounts could differ from those described in (a):
 - (i) when the exemptions in this HKFRS result in measurements that depend on the date of transition to HKFRSs.
 - (ii) when the accounting policies used in the subsidiary's financial

¹ ~~At the time of issue of this HKFRS, a proposed SSAP based on the IASB'S proposed revision to IAS 32 has been issued as an exposure draft. In accordance with paragraph 23 of SSAP 1 *Presentation of Financial Statements*, management should consider the requirements under IAS 32 when accounting for a compound financial instrument. Notwithstanding this, until the proposed SSAP based on IAS 32 becomes effective, paragraph 23 of this HKFRS would apply only to those first-time adopters that elect to adopt IAS 32 in accounting for a compound financial instrument.~~

statements differ from those in the consolidated financial statements. ~~For example, the subsidiary may use the benchmark treatment in SSAP 17 Property, Plant and Equipment, whereas the group may use the allowed alternative treatment.~~ For example, the subsidiary may use as its accounting policy the cost model in HKAS 16 Property, Plant and Equipment, whereas the group may use the revaluation model.

A similar election is available to an associate or joint venture that becomes a first-time adopter later than an entity that has significant influence or joint control over it.

- 25 However, if an entity becomes a first-time adopter later than its subsidiary (or associate or joint venture) the entity shall, in its consolidated financial statements, measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the separate financial statements of the subsidiary (or associate or joint venture), after adjusting for consolidation and equity accounting adjustments and for the effects of the business combination in which the entity acquired the subsidiary. Similarly, if a parent becomes a first-time adopter for its separate financial statements earlier or later than for its consolidated financial statements, it shall measure its assets and liabilities at the same amounts in both financial statements, except for consolidation adjustments.

Designation of previously recognised financial instruments

25A HKAS 39 Financial Instruments: Recognition and Measurement permits a financial asset to be designated on initial recognition as available for sale or a financial instrument (provided it meets certain criteria) to be designated as a financial asset or financial liability at fair value through profit or loss. Despite this requirement exceptions apply in the following circumstances.

- (a) any entity is permitted to make an available-for-sale designation at the date of transition to HKFRSs.
- (b) an entity that presents its first HKFRS financial statements for an annual period beginning on or after 1 September 2006—such an entity is permitted to designate, at the date of transition to HKFRSs, any financial asset or financial liability as at fair value through profit or loss provided the asset or liability meets the criteria in paragraph 9(b)(i), 9(b)(ii) or 11A of HKAS 39 at that date.
- (c) an entity that presents its first HKFRS financial statements for an annual period beginning on or after 1 January 2006 and before 1 September 2006—such an entity is permitted to designate, at the date of transition to HKFRSs, any financial asset or financial liability as at fair value through profit or loss provided the asset or liability meets the criteria in paragraph 9(b)(i), 9(b)(ii) or 11A of HKAS 39 at that date. When the date of transition to HKFRSs is before 1 September 2005, such designations need not be completed until 1 September 2005 and may also include financial assets and financial liabilities recognised between the date of transition to HKFRSs and 1 September 2005.
- (d) an entity that presents its first HKFRS financial statements for an annual period beginning before 1 January 2006 and applies paragraphs 11A, 48A, AG4B-AG4K, AG33A and AG33B and the 2005 amendments in paragraphs 9, 12 and 13 of HKAS 39—such an entity is permitted at the start of its first HKFRS reporting period to designate as at fair value through profit or loss any financial asset or financial liability that qualifies for such designation in accordance with these new and amended paragraphs at that date. When the entity's first HKFRS reporting period begins before 1 September 2005, such designations need not be completed until 1 September 2005 and may also include financial assets and financial liabilities recognised between the

beginning of that period and 1 September 2005. If the entity restates comparative information for HKAS 39 it shall restate that information for the financial assets, financial liabilities, or group of financial assets, financial liabilities or both, designated at the start of its first HKFRS reporting period. Such restatement of comparative information shall be made only if the designated items or groups would have met the criteria for such designation in paragraph 9(b)(i), 9(b)(ii) or 11A of HKAS 39 at the date of transition to HKFRSs or, if acquired after the date of transition to HKFRSs, would have met the criteria in paragraph 9(b)(i), 9(b)(ii) or 11A at the date of initial recognition.

- (e) for an entity that presents its first HKFRS financial statements for an annual period beginning before 1 September 2006—notwithstanding paragraph 91 of HKAS 39, any financial assets and financial liabilities such an entity designated as at fair value through profit or loss in accordance with subparagraph (c) or (d) above that were previously designated as the hedged item in fair value hedge accounting relationships shall be de-designated from those relationships at the same time they are designated as at fair value through profit or loss.

Share-based payment transactions

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

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

Insurance contracts

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

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

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

first-time adopter uses this exemption, it shall:

- (a) measure the liability as at the date of transition to HKFRSs in accordance with HKAS 37;
- (b) to the extent that the liability is within the scope of HK(IFRIC)-Int 1, estimate the amount that would have been included in the cost of the related asset when the liability first arose, by discounting the liability to that date using its best estimate of the historical risk-adjusted discount rate(s) that would have applied for that liability over the intervening period; and
- (c) calculate the accumulated depreciation on that amount, as at the date of transition to HKFRSs, on the basis of the current estimate of the useful life of the asset, using the depreciation policy adopted by the entity under HKFRSs.

Leases

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

Fair value measurement of financial assets or financial liabilities

- 25G Notwithstanding the requirements of paragraphs 7 and 9, an entity may apply the requirements in the last sentence of HKAS 39 paragraph AG76, and paragraph AG76A, in either of the following ways:
- (a) prospectively to transactions entered into after 25 October 2002; or
 - (b) prospectively to transactions entered into after 1 January 2004.

Exceptions to retrospective application of other HKFRSs

- 26 This HKFRS prohibits retrospective application of some aspects of other HKFRSs relating to:
- (a) derecognition of financial assets and financial liabilities (paragraphs [27](#) and [27A](#));
 - (b) hedge accounting (paragraphs 28-30);
 - (c) estimates (paragraphs 31-34);and
 - (d) assets classified as held for sale and discontinued operations ([paragraphs 34A and 34B](#)).

Derecognition of financial assets and financial liabilities

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

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

Hedge accounting

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

- (a) measure all derivatives at fair value; and
- (b) eliminate all deferred losses and gains arising on derivatives that were reported under previous GAAP as if they were assets or liabilities.

29 An entity shall not reflect in its opening HKFRS balance sheet a hedging relationship of a type that does not qualify for hedge accounting under ~~HKAS~~ **HKAS 39** (for example, many hedging relationships where the hedging instrument is a cash instrument or written option; where the hedged item is a net position; or where the hedge covers interest risk in a held-to-maturity investment). However, if an entity designated a net position as a hedged item under previous GAAP, it may designate an individual item within that net position as a hedged item under HKFRSs, provided that it does so no later than the date of transition to HKFRSs.

~~30 An entity shall apply the transitional provisions of IAS 39 to all other hedging relationships that existed at the date of transition to HKFRSs. If, before the date of transition to HKFRSs, an entity had designated a transaction as a hedge but the hedge does not meet the conditions for hedge accounting in HKAS 39 the entity shall apply paragraphs 91 and 101 of HKAS 39 to discontinue hedge accounting. Transactions entered into before the date of transition to HKFRSs shall not be retrospectively designated as hedges.~~

Estimates

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

- 32 An entity may receive information after the date of transition to HKFRSs about estimates that it had made under previous GAAP. Under paragraph 31, an entity shall treat the receipt of that information in the same way as non-adjusting events after the balance sheet date under HKAS 10 *Events after the Balance Sheet Date*. For example, assume that an entity's date of transition to HKFRSs is 1 January 2004 and new information on 15 July 2004 requires the revision of an estimate made under previous GAAP at 31 December 2003. The entity shall not reflect that new information in its opening HKFRS balance sheet (unless the estimates need adjustment for any differences in accounting policies or there is objective evidence that the estimates were in error). Instead, the entity shall reflect that new information in its income statement (or, if appropriate, other changes in equity) for the year ended 31 December 2004.
- 33 An entity may need to make estimates under HKFRSs at the date of transition to HKFRSs that were not required at that date under previous GAAP. To achieve consistency with HKAS 10, those estimates under HKFRSs shall reflect conditions that existed at the date of transition to HKFRSs. In particular, estimates at the date of transition to HKFRSs of market prices, interest rates or foreign exchange rates shall reflect market conditions at that date.
- 34 Paragraphs 31-33 apply to the opening HKFRS balance sheet. They also apply to a comparative period presented in an entity's first HKFRS financial statements, in which case the references to the date of transition to HKFRSs are replaced by references to the end of that comparative period.

Assets classified as held for sale and discontinued operations

- 34A HKFRS 5 requires that it shall be applied prospectively to non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and operations that meet the criteria to be classified as discontinued after the effective date of the HKFRS. HKFRS 5 permits an entity to apply the requirements of the HKFRS to all non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and operations that meet the criteria to be classified as discontinued after any date before the effective date of the HKFRS, provided the valuations and other information needed to apply the HKFRS were obtained at the time those criteria were originally met.
- 34B An entity with a date of transition to HKFRSs before 1 January 2005 shall apply the transitional provisions of HKFRS 5. An entity with a date of transition to HKFRSs on or after 1 January 2005 shall apply HKFRS 5 retrospectively.

PRESENTATION AND DISCLOSURE

- 35 Except as described in paragraphs 36A-37, this HKFRS does not provide exemptions from the presentation and disclosure requirements in other HKFRSs.

Comparative information

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

Exemption from the requirement to restate comparative information for HKAS 39 and HKFRS 4

- 36A In its first HKFRS financial statements, an entity that adopts HKFRSs before 1 January 2006 shall present at least one year of comparative information, but this comparative information need not comply with HKAS 32, HKAS 39 or HKFRS 4. An entity that chooses to present comparative information that does not comply with

HKAS 32, HKAS 39 or HKFRS 4 in its first year of transition shall:

- (a) apply the recognition and measurement requirements of its previous GAAP in the comparative information for financial instruments within the scope of HKAS 32 and HKAS 39 and for insurance contracts within the scope of HKFRS 4;
- (b) disclose this fact together with the basis used to prepare this information; and
- (c) disclose the nature of the main adjustments that would make the information comply with HKAS 32, HKAS 39 and HKFRS 4. The entity need not quantify those adjustments. However, the entity shall treat any adjustment between the balance sheet at the comparative period's reporting date (ie the balance sheet that includes comparative information under previous GAAP) and the balance sheet at the start of the first HKFRS reporting period (ie the first period that includes information that complies with HKAS 32, HKAS 39 and HKFRS 4) as arising from a change in accounting policy and give the disclosures required by paragraph 28(a)-(e) and (f)(i) of HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Paragraph 28(f)(i) applies only to amounts presented in the balance sheet at the comparative period's reporting date.

In the case of an entity that chooses to present comparative information that does not comply with HKAS 32, HKAS 39 and HKFRS 4, references to the 'date of transition to HKFRSs' shall mean, in the case of those Standards only, the beginning of the first HKFRS reporting period. Such entities are required to comply with paragraph 15(c) of HKAS 1 to provide additional disclosures when compliance with the specific requirements in HKFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Exemption from the requirement to present comparative information for HKFRS6

- 36B An entity that adopts HKFRSs before 1 January 2006 and chooses to adopt HKFRS 6 *Exploration for and Evaluation of Mineral Resources* before 1 January 2006 need not apply the requirements of HKFRS 6 to comparative information presented in its first HKFRS financial statements.

Exemption from the requirement to provide comparative disclosures for HKFRS 7

- 36C An entity that adopts HKFRSs before 1 January 2006 and chooses to adopt HKFRS 7 *Financial Instruments: Disclosures* in its first HKFRS financial statements need not present the comparative disclosures required by HKFRS 7 in those financial statements.

Non-HKFRS comparative information and historical summaries

- 37 Some entities present historical summaries of selected data for periods before the first period for which they present full comparative information under HKFRSs. This HKFRS does not require such summaries to comply with the recognition and measurement requirements of HKFRSs. Furthermore, some entities present comparative information under previous GAAP as well as the comparative information required by HKAS 1. In any financial statements containing historical summaries or comparative information under previous GAAP, an entity shall:
- (a) label the previous GAAP information prominently as not being prepared under HKFRSs; and

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

Explanation of transition to HKFRSs

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

Reconciliations

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

- (a) reconciliations of its equity reported under previous GAAP to its equity under HKFRSs for both of the following dates:
- (i) the date of transition to HKFRSs; and
 - (ii) the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP;
- (b) a reconciliation of the profit or loss reported under previous GAAP for the latest period in the entity's most recent annual financial statements to its profit or loss under HKFRSs for the same period; and
- (c) if the entity recognised or reversed any impairment losses for the first time in preparing its opening HKFRS balance sheet, the disclosures that ~~SSAP 34~~[HKAS 36](#) *Impairment of Assets* would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition to HKFRSs.

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

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

- 42 ~~SSAP 2 Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies~~ [HKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors](#) does not deal with changes in accounting policies that occur when an entity first adopts HKFRSs. Therefore, ~~SSAP 2~~[HKAS 8](#)'s requirements for disclosures about changes in accounting policies do not apply in an entity's first HKFRS financial statements.

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

Designation of financial assets or financial liabilities

- 43A An entity is permitted to designate a previously recognised financial asset or financial liability as a financial asset or financial liability at fair value through profit or loss or a financial asset as available for sale in accordance with paragraph 25A. The entity shall disclose 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.

Use of fair value as deemed cost

- 44 If an entity uses fair value in its opening HKFRS balance sheet as deemed cost for an item of property, plant and equipment, an investment property or an intangible asset (see paragraphs 16 and 18), the entity's first HKFRS financial statements shall disclose, for each line item in the opening HKFRS balance sheet:
- (a) the aggregate of those fair values; and
 - (b) the aggregate adjustment to the carrying amounts reported under previous GAAP.

Interim financial reports

- 45 To comply with paragraph 38, if an entity presents an interim financial report under ~~SSAP 25~~ [HKAS 34](#) *Interim Financial Reporting* for part of the period covered by its first HKFRS financial statements, the entity shall satisfy the following requirements in addition to the requirements of ~~SSAP 25~~ [HKAS 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 reconciliations of:
 - (i) its equity under previous GAAP at the end of that comparable interim period to its equity under HKFRSs at that date; and
 - (ii) its profit or loss under previous GAAP for that comparable interim period (current and year-to-date) to its profit or loss under HKFRSs for that period.
 - (b) In addition to the reconciliations required by (a), an entity's first interim financial report under ~~SSAP 25~~ [HKAS 34](#) for part of the period covered by its first HKFRS financial statements shall include the reconciliations described in paragraph 39(a) and (b) (supplemented by the details required by paragraphs 40 and 41) or a cross-reference to another published document that includes these reconciliations.
- 46 ~~SSAP 25~~ [HKAS 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, ~~SSAP 25~~ [HKAS 34](#) also requires an entity to disclose 'any events or transactions that are material to an understanding of the current interim period'. Therefore, if a first-time adopter did not, in its most recent annual financial statements under previous GAAP, disclose information material to an understanding of the current interim period, its interim financial report shall disclose that information or include a cross-reference to another published document that includes it.

EFFECTIVE DATE

- 47 An entity shall apply this HKFRS if its first HKFRS financial statements are for a period beginning on or after 1 January 2004. Earlier application is encouraged.
- [47A](#) An entity shall apply the amendments in paragraphs 13(j) and 25E for annual periods beginning on or after 1 September 2004. If an entity applies HK(IFRIC)-Int 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* for an earlier period, these amendments shall be applied for that earlier period.
- [47B](#) An entity shall apply the amendments in paragraphs 13(k) and 25F for annual periods beginning on or after 1 January 2006. If an entity applies HK(IFRIC)-Int 4

Determining whether an Arrangement contains a Lease for an earlier period, these amendments shall be applied for that earlier period.

- 47C An entity shall apply the amendments in paragraph 36B for annual periods beginning on or after 1 January 2006. If an entity applies HKFRS 6 *Exploration for an Evaluation of Mineral Resources* for an earlier period, these amendments shall be applied for that earlier period.
- 47D An entity shall apply the amendments in paragraph 20A for annual periods beginning on or after 1 January 2006. If an entity applies the amendments to HKAS 19 *Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures* for an earlier period, these amendments shall be applied for that earlier period.
- 47E An entity shall apply the amendments in paragraphs 13(l) and 25G for annual periods beginning on or after 1 January 2005. If an entity applies the amendments to HKAS 39 *Financial Instruments: Recognition and Measurement – Transition and Initial Recognition of Financial Liabilities* for an earlier period, these amendments shall be applied for that earlier period.
- 47FEA An entity shall apply paragraphs 23 and 27 to 30 for annual periods beginning on or after 1 January 2005. Earlier application of those paragraphs is encouraged.

Appendix A

Defined terms

This appendix is an integral part of the HKFRS.

date of transition to HKFRSs	The beginning of the earliest period for which an entity presents full comparative information under HKFRSs in its first HKFRS financial statements .
deemed cost	An amount used as a surrogate for cost or depreciated cost at a given date. Subsequent depreciation or amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost.
fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
first HKFRS financial statements	The first annual financial statements in which an entity adopts Hong Kong Financial Reporting Standards (HKFRSs) , by an explicit and unreserved statement of compliance with HKFRSs.
first HKFRS reporting period	The reporting period ending on the reporting date of an entity's first HKFRS financial statements .
first-time adopter	An entity that presents its first HKFRS financial statements .
Hong Kong Financial Reporting Standards (HKFRSs)	Standards and Interpretations issued by the Hong Kong Institute of Certified Public Accountants (HKICPA) (formerly known as Hong Kong Society of Accountants (HKSA)). They comprise: <ul style="list-style-type: none"> (a) Hong Kong Financial Reporting Standards; (b) Hong Kong Accounting Standards (HKASs); and (c) Interpretations.
opening HKFRS balance sheet	An entity's balance sheet (published or unpublished) at the date of transition to HKFRSs .
previous GAAP	The basis of accounting that a first-time adopter used immediately before adopting HKFRSs.
reporting date	The end of the latest period covered by financial statements or by an interim financial report.

Appendix B

Business combinations

This appendix is an integral part of the HKFRS.

- B1 ~~A first-time adopter may elect not to apply SSAP 30 Business Combinations retrospectively to past business combinations (business combinations that occurred before the date of transition to HKFRSs). However, if a first-time adopter restates any business combination to comply with SSAP 30, it shall restate all later business combinations. For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 2002, it shall restate all business combinations that occurred between 30 June 2002 and the date of transition to HKFRSs.~~ A first-time adopter may elect not to apply HKFRS 3 *Business Combinations* retrospectively to past business combinations (business combinations that occurred before the date of transition to HKFRSs). However, if a first-time adopter restates any business combination to comply with HKFRS 3, it shall restate all later business combinations and shall also apply HKAS 36 *Impairment of Assets* and HKAS 38 *Intangible Assets* from that same date. For example, if a first-time adopter elects to restate a business combination that occurred on 30 June 2002, it shall restate all business combinations that occurred between 30 June 2002 and the date of transition to HKFRSs, and it shall also apply HKAS 36 and HKAS 38 from 30 June 2002.
- B1A An entity need not apply HKAS 21 *The Effects of Changes in Foreign Exchange Rates* retrospectively to fair value adjustments and goodwill arising in business combinations that occurred before the date of transition to HKFRSs. If the entity does not apply HKAS 21 retrospectively to those fair value adjustments and goodwill, it shall treat them as assets and liabilities of the entity rather than as assets and liabilities of the acquiree. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate applied under previous GAAP.
- B1B An entity may apply HKAS 21 retrospectively to fair value adjustments and goodwill arising in either:
- (a) all business combinations that occurred before the date of transition to HKFRSs; or
 - (b) all business combinations that the entity elects to restate to comply with HKFRS 3, as permitted by paragraph B1 above.
- B2 If a first-time adopter does not apply ~~SSAP 30~~ HKFRS 3 retrospectively to a past business combination, this has the following consequences for that business combination:
- (a) The first-time adopter shall keep the same classification (as an acquisition by the legal acquirer, a reverse acquisition by the legal acquiree, or a uniting of interests) as in its previous GAAP financial statements.
 - (b) The first-time adopter shall recognise all its assets and liabilities at the date of transition to HKFRSs that were acquired or assumed in a past business combination, other than:
 - (i) some financial assets and financial liabilities derecognised under previous GAAP (see paragraph 27); and
 - (ii) assets, including goodwill, and liabilities that were not recognised in the acquirer's consolidated balance sheet under previous GAAP and

also would not qualify for recognition under HKFRSs in the separate balance sheet of the acquiree (see paragraph B2(f)-B2(i)).

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

- (c) The first-time adopter shall exclude from its opening HKFRS balance sheet any item recognised under previous GAAP that does not qualify for recognition as an asset or liability under HKFRSs. The first-time adopter shall account for the resulting change as follows:
- (i) the first-time adopter may have classified a past business combination as an acquisition and recognised as an intangible asset an item that does not qualify for recognition as an asset under ~~SSAP 29~~ [HKAS 38](#) *Intangible Assets*. It shall reclassify that item (and, if any, the related deferred tax and minority interests) as part of goodwill (unless it deducted goodwill directly from equity under previous GAAP, see paragraph B2(g)(i) and B2(i)).
 - (ii) the first-time adopter shall recognise all other resulting changes in retained earnings.*
- (d) HKFRSs require subsequent measurement of some assets and liabilities on a basis that is not based on original cost, such as fair value. The first-time adopter shall measure these assets and liabilities on that basis in its opening HKFRS balance sheet, even if they were acquired or assumed in a past business combination. It shall recognise any resulting change in the carrying amount by adjusting retained earnings (or, if appropriate, another category of equity), rather than goodwill.
- (e) Immediately after the business combination, the carrying amount under previous GAAP of assets acquired and liabilities assumed in that business combination shall be their deemed cost under HKFRSs at that date. If HKFRSs require a cost-based measurement of those assets and liabilities at a later date, that deemed cost shall be the basis for cost-based depreciation or amortisation from the date of the business combination.
- (f) If an asset acquired, or liability assumed, in a past business combination was not recognised under previous GAAP, it does not have a deemed cost of zero in the opening HKFRS balance sheet. Instead, the acquirer shall recognise and measure it in its consolidated balance sheet on the basis that HKFRSs would require in the separate balance sheet of the acquiree. To illustrate: if the acquirer had not, under its previous GAAP, capitalised finance leases acquired in a past business combination, it shall capitalise those leases in its consolidated financial statements, as ~~SSAP 14~~ [HKAS 17](#) *Leases* would require the acquiree to do in its separate HKFRS balance sheet. Conversely, if an asset or liability was subsumed in goodwill under previous GAAP but would have been recognised separately under ~~SSAP 30~~ [HKFRS 3](#), that asset or liability remains in goodwill unless HKFRSs would require its recognition in the separate financial statements of the acquiree.
- (g) The carrying amount of goodwill in the opening HKFRS balance sheet shall be its carrying amount under previous GAAP at the date of transition to HKFRSs, after the following three adjustments:

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

- (i) If required by paragraph B2(c)(i) above, the first-time adopter shall increase the carrying amount of goodwill when it reclassifies an item that it recognised as an intangible asset under previous GAAP. Similarly, if paragraph B2(f) requires the first-time adopter to recognise an intangible asset that was subsumed in recognised goodwill under previous GAAP, the first-time adopter shall decrease the carrying amount of goodwill accordingly (and, if applicable, adjust deferred tax and minority interests).
 - (ii) A contingency affecting the amount of the purchase consideration for a past business combination may have been resolved before the date of transition to HKFRSs. If a reliable estimate of the contingent adjustment can be made and its payment is probable, the first-time adopter shall adjust the goodwill by that amount. Similarly, the first-time adopter shall adjust the carrying amount of goodwill if a previously recognised contingent adjustment can no longer be measured reliably or its payment is no longer probable.
 - (iii) Regardless of whether there is any indication that the goodwill may be impaired, the first-time adopter shall apply ~~SSAP 31~~ HKAS 36 *Impairment of Assets* in testing the goodwill for impairment at the date of transition to HKFRSs and in recognising any resulting impairment loss in retained earnings (or, if so required by ~~SSAP 34~~ HKAS 36, in revaluation surplus). The impairment test shall be based on conditions at the date of transition to HKFRSs.
- (h) No other adjustments shall be made to the carrying amount of goodwill at the date of transition to HKFRSs. For example, the first-time adopter shall not restate the carrying amount of goodwill:
- (i) to exclude in-process research and development acquired in that business combination (unless the related intangible asset would qualify for recognition under ~~SSAP 29~~ HKA 38 in the separate balance sheet of the acquiree);
 - (ii) to adjust previous amortisation of goodwill;
 - (iii) to reverse adjustments to goodwill that ~~SSAP 30~~ HKFRS 3 would not permit, but were made under previous GAAP because of adjustments to assets and liabilities between the date of the business combination and the date of transition to HKFRSs.
- (i) If the first-time adopter recognised goodwill under previous GAAP as a deduction from equity:
- (i) it shall not recognise that goodwill in its opening HKFRS balance sheet. Furthermore, it shall not transfer that goodwill to the income statement if it disposes of the subsidiary or if the investment in the subsidiary becomes impaired.
 - (ii) adjustments resulting from the subsequent resolution of a contingency affecting the purchase consideration shall be recognised in retained earnings.
- (j) Under its previous GAAP, the first-time adopter may not have consolidated a subsidiary acquired in a past business combination (for example, because the parent did not regard it as a subsidiary under previous GAAP or did not prepare consolidated financial statements). The first-time adopter shall adjust the carrying amounts of the subsidiary's assets and liabilities to the amounts that HKFRSs would require in the subsidiary's separate balance sheet. The

deemed cost of goodwill equals the difference at the date of transition to HKFRSs between:

- (i) the parent's interest in those adjusted carrying amounts; and
 - (ii) the cost in the parent's separate financial statements of its investment in the subsidiary.
- (k) The measurement of minority interests and deferred tax follows from the measurement of other assets and liabilities. Therefore, the above adjustments to cognised assets and liabilities affect minority interests and deferred tax.
- B3 The exemption for past business combinations also applies to past acquisitions of investments in associates and of interests in joint ventures. Furthermore, the date selected for paragraph B1 applies equally for all such acquisitions.

APPENDIX C

Comparison with International Financial Reporting Standards

This comparison appendix, which was prepared as at May 2006 and deals only with significant differences in the standards extant, is produced for information only and does not form part of the standards in HKFRS 1.

The International Financial Reporting Standard comparable with HKFRS 1 is IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

The following sets out the major textual differences between HKFRS 1 and IFRS 1 and the reasons for such differences.

Differences	Reasons for the differences
<p>1. <u>IFRS 1 Paras 3(a) and 4</u> <u>HKFRS 1 Paras 3(a) and 4</u></p> <p>IFRS 1 contains references to "national" requirements whereas HKFRS 1 uses references to "other accounting" requirements.</p>	<p>IFRS 1 is an international statement whereas HKFRS 1 is a national statement.</p>

Appendix D

Amendments to HKFRS 1 and HKAS 27 *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* (issued in October 2008) - effective for annual periods beginning on or after 1 January 2009

The following sets out amendments required for this Standard resulting from amendments to HKFRS 1 and HKAS 27 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted.

The rubric is amended (new text is underlined and deleted text is struck through). After paragraph 13(e), paragraph 13(ea) is added. After paragraph 23, a heading and paragraphs 23A and 23B are added. Paragraphs 25A and 34C are amended (deleted text is struck through). After paragraph 44, a heading and paragraph 44A are added. After paragraph 47J, paragraph 47K is added.

In the rubric the first sentence is amended as follows:

Hong Kong Financial Reporting Standard 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (HKFRS 1) is set out in paragraphs 1–47J 47K ...

Recognition and measurement

Exemptions from other HKFRSs

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

(a) ...

(ea) investments in subsidiaries, jointly controlled entities and associates (paragraphs 23A and 23B);

(f) ...

Investments in subsidiaries, jointly controlled entities and associates

23A When an entity prepares separate financial statements, HKAS 27 *Consolidated and Separate Financial Statements* requires it to account for its investments in subsidiaries, jointly controlled entities and associates either:

(a) at cost or

(b) in accordance with HKAS 39 *Financial Instruments: Recognition and Measurement*.

23B If a first-time adopter measures such an investment at cost in accordance with paragraph 23A(a), it shall measure that investment at one of the following amounts in its separate opening HKFRS statement of financial position:

(a) cost determined in accordance with HKAS 27 or

- (b) deemed cost. The deemed cost of such an investment shall be its:
- (i) fair value (determined in accordance with HKAS 39) at the entity's date of transition to HKFRSs in its separate financial statements or
 - (ii) previous GAAP carrying amount at that date.

A first-time adopter may choose either (i) or (ii) above to measure its investment in each subsidiary, jointly controlled entity or associate that it elects to measure using a deemed cost.

Designation of previously recognised financial instruments

25A HKAS 39 *Financial Instruments: Recognition and Measurement* permits...

Exceptions to retrospective application of other HKFRSs

Non-controlling interests

34C A first-time adopter shall apply the following requirements of HKAS 27 *Consolidated and Separate Financial Statements* (as amended in 2008)...

Presentation and disclosure

Use of deemed cost for investments in subsidiaries, jointly controlled entities and associates

- 44A Similarly, if an entity uses a deemed cost in its opening HKFRS statement of financial position for an investment in a subsidiary, jointly controlled entity or associate in its separate financial statements (see paragraph 23B), the entity's first HKFRS separate financial statements shall disclose:
- (a) the aggregate deemed cost of those investments for which deemed cost is their previous GAAP carrying amount;
 - (b) the aggregate deemed cost of those investments for which deemed cost is fair value; and
 - (c) the aggregate adjustment to the carrying amounts reported under previous GAAP.

Effective date

47K *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* (Amendments to HKFRS 1 and HKAS 27), issued in October 2008, added paragraphs 13(ea), 23A, 23B and 44A. An entity shall apply those paragraphs for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the paragraphs for an earlier period, it shall disclose that fact.

Appendix **DE**

Amendments resulting from other HKFRSs

The following sets out amendments required for this Standard resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Standard and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HK(IFRIC)- Int 12 *Service Concession Arrangements* (issued in March 2007) - effective for annual periods beginning on or after 1 January 2008

Paragraph 9 is amended as follows:

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

In paragraph 12(a), the reference to paragraphs 13-25G is changed to 13-25H.

In paragraph 13, subparagraphs (k) and (l) are amended, and subparagraph (m) is inserted, as follows:

- (k) leases (paragraph 25F); ~~and~~
- (l) fair value measurement of financial assets or financial liabilities at initial recognition (paragraph 25G); ~~and~~
- (m) a financial asset or an intangible asset accounted for in accordance with HK(IFRIC)-Int 12 *Service Concession Arrangements* (paragraph 25H).

After paragraph 25G, a new heading and paragraph 25H are inserted as follows:

Service concession arrangements

- 25H A first-time adopter may apply the transitional provisions in HK(IFRIC)-Int 12 *Service Concession Arrangements*.

After paragraph 47E, a new paragraph 47F is inserted as follows:

- 47F An entity shall apply the amendments in paragraphs 9, 12(a), 13(m) and 25H for annual periods beginning on or after 1 January 2008. If an entity applies HK(IFRIC)-Int 12 for an earlier period, these amendments shall be applied for that earlier period.

HKAS 23 *Borrowing Costs* (issued in June 2007) - effective for annual periods beginning on or after 1 January 2009

In the rubric, the first sentence is amended as follows:

Hong Kong Financial Reporting Standard 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (HKFRS 1) is set out in paragraphs ~~1-47E-1-47G~~...

Paragraphs 9, 12 and 13 are amended, after paragraph 25H a heading and paragraph 25I are inserted, and paragraph 47G is added as follows:

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

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

- (a) paragraphs 13-25H and 36A-36C grant exemptions from some requirements of other HKFRSs.
- (b) paragraphs 26-34B prohibit retrospective application of some aspects of other HKFRSs.

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

- (a) ...
- (l) fair value measurement of financial assets or financial liabilities at initial recognition (paragraph 25G); and
- (m) a financial asset or an intangible asset accounted for in accordance with HK(IFRIC)-Int 12 *Service Concession Arrangements* (paragraph 25H); and
- (n) borrowing costs (paragraph 25I).

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

Borrowing costs

25I A first-time adopter may apply the transitional provisions set out in paragraphs 27 and 28 of HKAS 23 *Borrowing Costs*, as revised in 2007. In those paragraphs references to the effective date shall be interpreted as 1 January 2009 or the date of transition to HKFRSs, whichever is later.

47G An entity shall apply the amendments in paragraphs 13(n) and 25I for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 23 for an earlier period, these amendments shall be applied for that earlier period.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) - effective for annual periods beginning on or after 1 January 2009

In the rubric, the first sentence is amended as follows:

Hong Kong Financial Reporting Standard 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (HKFRS 1) is set out in paragraphs 4-47G 1-47H and Appendices A-C. All the paragraphs ...

In paragraph IN3, 'at the reporting date for its first HKFRS financial statements' is amended to 'at the end of its first HKFRS reporting period'.

Paragraphs 6 and 7 are amended as follows:

6 An entity shall prepare and present an opening HKFRS balance sheet statement of financial position at the date of transition to HKFRSs. This is the starting point for its accounting under HKFRSs. ~~An entity need not present its opening HKFRS balance sheet in its first HKFRS financial statements.~~

7 An entity ... **Those accounting policies shall comply with each HKFRS effective at the reporting date for end of its first HKFRS financial statements reporting period, except as specified in paragraphs 13-34B, 36A-36C and 37.**

The Example after paragraph 8 is amended as described below.

References to the years '2003' to '2005' are amended to '20X3' to '20X5' respectively.

The paragraphs **Background** and **Application of requirements** are amended as follows:

Background

The ~~reporting date for end of~~ entity A's first HKFRS financial statements ~~reporting period~~ is 31 December 20X5 ~~2005~~. Entity A decides to present comparative information in those financial statements for one year only (see paragraph 36) ...

Application of requirements

Entity A ... in:

- (a) ~~preparing and presenting its opening HKFRS balance sheet statement of financial position at 1 January 20X4~~ 2004; and ...

Paragraphs 10, 12(a) and 21 are amended as follows:

- 10 ~~Except as described in paragraphs 13–34B and 36A–36C, an entity shall, in its opening HKFRS balance sheet statement of financial position: ...~~

- 12 This HKFRS establishes two categories of exceptions to the principle that an entity's opening HKFRS ~~balance sheet statement of financial position~~ shall comply with each HKFRS:

- (a) ~~paragraphs 13–25I and 36A–36C~~ grant exemptions from some requirements of other HKFRSs.

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

- (a) ~~to classify~~ recognise some translation differences ~~in other comprehensive income and accumulate these as in~~ a separate component of equity; and
- (b) on disposal of a foreign operation, to ~~transfer~~ reclassify the cumulative translation difference for that foreign operation (including, if applicable, gains and losses on related hedges) ~~from equity to the income statement~~ profit or loss as part of the gain or loss on disposal.

In paragraph 32, references to the years '2003' and '2004' are amended to '20X4' and '20X5' respectively.

Paragraphs 32, 35 and 36 are amended as follows:

- 32 An entity ... Instead, the entity shall reflect that new information in ~~its income statement~~ profit or loss (or, if appropriate, other comprehensive income ~~other changes in equity~~) for the year ended 31 December 20X4 ~~2004~~.

- 35 Except as described in paragraphs ~~36A–37~~, this HKFRS does not provide exemptions from the presentation and disclosure requirements in other HKFRSs.

- 36 To comply with HKAS 1, an entity's first HKFRS financial statements shall include at least ~~one year of comparative information under HKFRSs. 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.~~

Paragraphs 36A–36C and the headings above them are deleted.

Paragraphs 39 and 45(a) are amended as follows:

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

- (a) (ii) the end ... under previous GAAP;
- (b) a reconciliation to its total comprehensive income under HKFRSs of ~~the profit or loss reported under previous GAAP~~ for the latest period in the entity's most recent annual financial statements to its profit or loss under HKFRSs for the same period; ~~The starting point for that reconciliation shall be total comprehensive income under previous GAAP for the same period or, if an entity did not report such a total, profit or loss under previous GAAP. and~~
- (c) ...

- 45 To comply with ...

- (a) Each such interim financial report shall, if the entity presented an interim financial report for the comparable interim period of the immediately preceding financial year, include ~~reconciliations of:~~
- (i) a reconciliation of its equity under previous GAAP at the end of that comparable interim period to its equity under HKFRSs at that date; and
- (ii) a reconciliation to its profit or loss total comprehensive income under HKFRSs ~~previous GAAP~~ for that comparable interim period (current and year-to-date). ~~The starting point for that reconciliation shall be total comprehensive income under previous GAAP for that period or, if an entity did not report such a total, profit or loss under previous GAAP. to its profit or loss under HKFRSs for that period.~~

Paragraph 47C is deleted.

Paragraph 47H is added as follows:

- 47H HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 6, 7, 8 (Example), 10, 12(a), 21, 32, 35, 36, 39(b) and 45(a), Appendix A and paragraph B2(i) in Appendix B, and deleted paragraphs 36A–36C and 47C. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

In Appendix A, the defined terms are amended as follows:

first HKFRS reporting period	The <u>latest</u> reporting period ending on the reporting date of covered by an entity's first HKFRS financial statements .
opening HKFRS balance sheet statement of financial position	An entity's balance sheet statement of financial position (published or unpublished) at the date of transition to HKFRSs .
reporting date	The end of the latest period covered by financial statements or by an interim financial report.

In Appendix B, paragraph B2(i) is amended as follows:

B2 If a first-time adopter ...

- (i) If the first-time adopter recognised goodwill under previous GAAP as a deduction from equity:
 - (i) it shall not recognise that goodwill in its opening HKFRS ~~balance sheet~~ statement of financial position. Furthermore, it shall not ~~transfer~~ reclassify that goodwill to ~~the income statement~~ profit or loss if it disposes of the subsidiary or if the investment in the subsidiary becomes impaired.

HKFRS 3 *Business Combinations* (issued in March 2008) - effective for annual periods beginning on or after 1 July 2009

In the rubric, the first sentence is amended as follows:

Hong Kong Financial Reporting Standard 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (HKFRS 1) is set out in paragraphs 1–47H 1 – 47I and Appendices A – C. All the paragraphs ...

Paragraph 14 is amended as follows:

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

Paragraph 47I is added as follows:

47I HKFRS 3 (as revised in 2008) amended paragraphs 14, B1, B2(f) and B2(g). An entity shall apply those amendments for annual periods beginning on or after 1 July 2009. If an entity applies HKFRS 3 (revised 2008) for an earlier period, the amendments shall also be applied for that earlier period.

In Appendix B, paragraphs B1, B2(f) and B2(g) are amended as follows:

B1 A first-time adopter may elect not to apply HKFRS 3 *Business Combinations* retrospectively to past business combinations (business combinations that occurred before the date of transition to HKFRSs). However, if a first-time adopter restates any business combination to comply with HKFRS 3, it shall restate all later business combinations and shall also apply HKAS 27 (as amended in 2008) ~~HKAS 36 *Impairment of Assets* (as revised in 2004) and HKAS 38 *Intangible Assets* (as revised in 2004)~~ from that same date. For example, if a first-time adopter elects to restate a business combination that occurred on 30 June ~~20X6 2002~~, it shall restate all business combinations that occurred between 30 June ~~20X6 2002~~ and the date of transition to HKFRSs, and it shall also apply HKAS 27 (amended 2008) ~~HKAS 36 (as revised in 2004) and HKAS 38 (as revised in 2004)~~ from 30 June ~~20X6 2002~~.

B2(f) If an asset acquired, or liability assumed, in a past business combination was not recognised under previous GAAP, it does not have a deemed cost of zero in the opening HKFRS statement of financial position. Instead, the acquirer shall recognise and measure it in its consolidated statement of financial position on the basis that HKFRSs would require in the statement of financial position of the acquiree. To illustrate: if the acquirer had not, under its previous GAAP, capitalised finance leases acquired in a past business combination, it shall capitalise those leases in its consolidated financial statements, as HKAS 17 *Leases* would require the acquiree to do in its HKFRS statement of financial position. Similarly, if the acquirer had not, under its previous GAAP, recognised a contingent liability that still exists at the date of transition to HKFRSs, the acquirer shall recognise that contingent liability at that date unless HKAS 37 would prohibit its recognition in the financial statements of the acquiree. Conversely, ...

B2(g) The carrying amount of goodwill in the opening HKFRS statement of financial position shall be its carrying amount under previous GAAP at the date of transition to HKFRSs, after the following ~~three~~ two adjustments:

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

HKAS 27 Consolidated and Separate Financial Statements (issued in March 2008) - effective for annual periods beginning on or after 1 July 2009

References to '[a] minority interest' or 'minority interests' are amended to 'non-controlling interests' in paragraphs B2(c)(i), B2(g)(i) and B2(k).

In the rubric, the first sentence is amended as follows:

Hong Kong Financial Reporting Standard 1 *First-time Adoption of Hong Kong Financial Reporting Standards* (HKFRS 1) is set out in paragraphs ~~4–47I~~ 1 – 47J and Appendices A – C. All the paragraphs...

Paragraph 26 is amended as follows:

- 26 This HKFRS prohibits the retrospective application of some aspects of other HKFRSs relating to:
- ...
 - (c) estimates (paragraphs 31 – 34); ~~and~~
 - (d) assets classified as held for sale and discontinued operations (paragraphs 34A and 34B); ~~and~~
 - (e) some aspects of accounting for non-controlling interests (paragraph 34C).

After paragraph 34B a new heading and paragraph 34C are added as follows:

Non-controlling interests

34C A first-time adopter shall apply the following requirements of HKAS 27 *Consolidated and Separate Financial Statements* (as amended in 2008) prospectively from the date of transition to HKFRSs:

- (a) the requirement in paragraph 28 that total comprehensive income is attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance;
- (b) the requirements in paragraphs 30 and 31 for accounting for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and
- (c) the requirements in paragraphs 34 - 37 for accounting for a loss of control over a subsidiary.

However, if a first-time adopter elects to apply HKFRS 3 (as revised in 2008) retrospectively to past business combinations, it also shall apply HKAS 27 (as amended in 2008) in accordance with paragraph B1 of this HKFRS.

Paragraph 47J is added as follows:

- 47J HKAS 27 (as amended in 2008) amended paragraphs 26 and 34C. An entity shall apply those amendments for annual periods beginning on or after 1 July 2009. If an entity applies HKAS 27 (amended 2008) for an earlier period, the amendments shall be applied for that earlier period.

Basis for Conclusions

HKFRS 1 First-time Adoption of Hong Kong Financial Reporting Standards

HKFRS 1 is based on IFRS 1 *First-time Adoption of International Financial Reporting Standards*. In approving HKFRS 1, the Council of the Hong Kong ~~Society of Accountants~~ [Institute of Certified Public Accountants](#) considered and agreed with the IASB's basis for conclusions on IFRS 1. Accordingly, there are no significant differences between HKFRS 1 and IFRS 1. The IASB's basis for conclusions is reproduced below for reference. The paragraph numbers of IFRS 1 referred to below generally correspond with those in HKFRS 1.

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Basis for Conclusions on

IFRS 1 First-time Adoption of International Financial Reporting Standards

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

INTRODUCTION

- BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching the conclusions in IFRS 1 *First-time Adoption of International Financial Reporting Standards*. Individual Board members gave greater weight to some factors than to others.
- BC2 SIC-8 *First-time Application of IASs as the Primary Basis of Accounting*, issued in 1998, dealt with matters that arose when an entity first adopted IASs. In 2001, the Board began a project to review SIC-8. In July 2002, the Board published ED 1 *First-time Application of International Financial Reporting Standards*, with a comment deadline of 31 October 2002. The Board received 83 comment letters on ED 1.
- BC3 This project took on added significance because of the requirement that listed European Union companies should adopt International Financial Reporting Standards (IFRSs) in their consolidated financial statements from 2005. Several other countries have announced that they will permit or require entities to adopt IFRSs in the next few years. Nevertheless, the Board's aim in developing the IFRS was to find solutions that will be appropriate for any entity, in any part of the world, regardless of whether adoption occurs in 2005 or at a different time.

SCOPE

- BC4 The IFRS applies to an entity that presents its first IFRS financial statements (a first-time adopter). Some suggested that an entity should not be regarded as a first-time adopter if its previous financial statements contained an explicit statement of compliance with IFRSs, except for specified (and explicit) departures. They argued that an explicit statement of compliance establishes that an entity regards IFRSs as its basis of accounting, even if the entity does not comply with every requirement of every IFRS. Some regarded this argument as especially strong if an entity previously complied with all recognition and measurement requirements of IFRSs, but did not give some required disclosures—for example, segmental disclosures that IAS 14 *Segment Reporting* requires or the explicit statement of compliance with IFRSs that IAS 1 *Presentation of Financial Statements* requires.
- BC5 To implement that approach, it would be necessary to establish how many departures are needed—and how serious they must be—before an entity would conclude that it has not adopted IFRSs. In the Board's view, this would lead to complexity and uncertainty. Also, an entity should not be regarded as having adopted IFRSs if it does not give all disclosures required by IFRSs, because that approach would diminish the importance of disclosures and undermine efforts to promote full compliance with IFRSs. Therefore, the IFRS contains a simple test that gives an unambiguous answer: an entity has adopted IFRSs if, and only if, its financial statements contain an explicit and unreserved statement of compliance with IFRSs (paragraph 3 of the IFRS).

- BC6 If an entity's financial statements in previous years contained that statement, any material disclosed or undisclosed departures from IFRSs are errors. The entity applies IAS 8 ~~Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies~~ Accounting Policies, Changes in Accounting Estimates and Errors in correcting them.

BASIC CONCEPTS

Useful information for users

- BC7 In developing recognition and measurement requirements for an entity's opening IFRS balance sheet, the Board referred to the objective of financial statements, as set out in the *Framework for the Preparation and Presentation of Financial Statements*. The Framework states that the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.
- BC8 The *Framework* identifies four qualitative characteristics that make information in financial statements useful to users. In summary, the information should be:
- (a) readily understandable by users.
 - (b) relevant to the decision-making needs of users.
 - (c) reliable, in other words financial statements should:
 - (i) represent faithfully the transactions and other events they either purport to represent or could reasonably be expected to represent;
 - (ii) represent transactions and other events in accordance with their substance and economic reality and not merely their legal form;
 - (iii) be neutral, that is to say, free from bias;
 - (iv) contend with the uncertainties that inevitably surround many events and circumstances by the exercise of prudence; and
 - (v) be complete within the bounds of materiality and cost.
 - (d) comparable with information provided by the entity in its financial statements through time and with information provided in the financial statements of other entities.

Comparability

- BC9 The previous paragraph notes the need for comparability. Ideally, a regime for first-time adoption of IFRSs would achieve comparability:
- (a) within an entity over time;
 - (b) between different first-time adopters; and
 - (c) between first-time adopters and entities that already apply IFRSs.
- BC10 SIC-8 gave priority to ensuring comparability between a first-time adopter and entities that already applied IASs. It was based on the principle that a first-time adopter should comply with the same Standards as an entity that already applied IASs. However, the

Board decided that it is more important to achieve comparability over time within a first-time adopter's first IFRS financial statements and between different entities adopting IFRSs for the first time at a given date; achieving comparability between first-time adopters and entities that already apply IFRSs is a secondary objective.

Current version of IFRSs

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

- (a) enhances comparability, because the information in a first-time adopter's first IFRS financial statements is prepared on a consistent basis over time;
- (b) gives users comparative information prepared using later versions of IFRSs that the Board regards as superior to superseded versions; and
- (c) avoids unnecessary costs.

BC12 The transitional provisions in other IFRSs do not apply to a first-time adopter (paragraph 9 of the IFRS), except for derecognition and hedge accounting (paragraphs 27-30 of the IFRS). Some of these transitional provisions require or permit an entity already reporting under IFRSs to apply a new requirement prospectively. These provisions generally reflect a conclusion that one or both of the following factors are present in a particular case:

- (a) Retrospective application may be difficult or involve costs exceeding the likely benefits. The IFRS permits prospective application in specific cases where this could occur (paragraphs BC30-BC73).
- (b) There is a danger of abuse if retrospective application would require judgements by management about past conditions after the outcome of a particular transaction is already known. The IFRS prohibits retrospective application in some areas where this could occur (paragraphs BC74-BC84).

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

- (a) to alleviate unforeseen consequences of a new IFRS if another party uses financial statements to monitor compliance with a contract or agreement. However, in the Board's view, it is up to the parties to an agreement to determine whether to insulate the agreement from the effects of a future IFRS and, if not, how they might renegotiate it so that it reflects changes in the underlying financial condition rather than changes in reporting (paragraph 21 of the *Preface to International Financial Reporting Standards*).
- (b) to give a first-time adopter the same accounting options as an entity that already applies IFRSs. However, permitting prospective application by a first-time adopter would conflict with the Board's primary objective of comparability within an entity's first IFRS financial statements (paragraph BC10). Therefore, the Board did not adopt a general policy of giving first-time adopters the same accounting options of prospective application that existing IFRSs give to entities that already apply IFRSs. Paragraphs BC20-BC23 discuss one specific case, namely derecognition of financial assets and financial liabilities.
- (c) to avoid difficult distinctions between changes in estimates and changes in the basis for making estimates. However, a first-time adopter need not make this distinction in preparing its opening IFRS balance sheet, so the IFRS does not include exemptions on these grounds. If an entity becomes aware of errors

made under previous GAAP, the IFRS requires it to disclose the correction of the errors (paragraph 41 of the IFRS).

- BC14 The Board will consider case by case when it issues a new IFRS whether a first-time adopter should apply that IFRS retrospectively or prospectively. The Board expects that retrospective application will be appropriate in most cases, given its primary objective of comparability over time within a first-time adopter's first IFRS financial statements. However, if the Board concludes in a particular case that prospective application by a first-time adopter is justified, it will amend the IFRS on first-time adoption of IFRSs. As a result, IFRS 1 will contain all material on first-time adoption of IFRSs and other IFRSs will not refer to first-time adopters (except, when needed, in the Basis for Conclusions and consequential amendments).
- BC15 Under the proposals in ED 1, a first-time adopter could have elected to apply IFRSs as if it had always applied IFRSs. This alternative approach was intended mainly to help an entity that did not wish to use any of the exemptions proposed in ED 1 because it had already been accumulating information under IFRSs without presenting IFRS financial statements. To enable an entity using this approach to use the information it had already accumulated, ED 1 would have required it to consider superseded versions of IFRSs if more recent versions required prospective application. However, as explained in paragraphs BC28 and BC29, the Board abandoned ED 1's all-or-nothing approach to exemptions. Because this eliminated the reason for the alternative approach, the Board deleted it in finalising the IFRS.

OPENING IFRS BALANCE SHEET

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

Recognition

- BC17 The Board considered a suggestion that the IFRS should not require a first-time adopter to investigate transactions that occurred before the beginning of a 'look back' period of, say, three to five years before the date of transition to IFRSs. Some argued that this would be a practical way for a first-time adopter to give a high level of transparency and comparability, without incurring the cost of investigating very old transactions. They noted two particular precedents for transitional provisions that have permitted an entity to omit some assets and liabilities from its balance sheet:
- (a) ~~IAS 39 Financial Instruments: Recognition and Measurement prohibits restatement of securitisation, transfer or other derecognition transactions entered into before the beginning of the financial year in which IAS 39 is initially applied. A previous version of IAS 39 Financial Instruments: Recognition and Measurement prohibited restatement of securitisation, transfer or other derecognition transactions entered into before the beginning of the financial year in which it was initially applied.~~
 - (b) Some national accounting standards and IAS 17 *Accounting for Leases* (superseded in 1997 by IAS 17 *Leases*) permitted prospective application of a requirement for lessees to capitalise finance leases. Under this approach, a lessee would not be required to recognise finance lease obligations and the related leased assets for leases that began before a specified date.
- BC18 However, limiting the look back period could lead to the omission of material assets or liabilities from an entity's opening IFRS balance sheet. Material omissions would undermine the understandability, relevance, reliability and comparability of an entity's first IFRS financial statements. Therefore, the Board concluded that an entity's

opening IFRS balance sheet should:

- (a) include all assets and liabilities whose recognition is required by IFRSs, except:
 - (i) some financial assets or financial liabilities derecognised under previous GAAP before the date of transition to IFRSs (paragraphs BC20-BC23); and
 - (ii) goodwill and other assets acquired, and liabilities assumed, in a past business combination that were not recognised in the acquirer's consolidated balance sheet under previous GAAP and also would not qualify for recognition under IFRSs in the separate balance sheet of the acquiree (paragraphs BC31-BC40).
- (b) not report items as assets or liabilities if they do not qualify for recognition under IFRSs.

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

Derecognition under previous GAAP

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

- (a) Restating past derecognition transactions would be costly, especially if restatement involves determining the fair value of retained servicing assets and liabilities and other components retained in a complex securitisation. Furthermore, it may be difficult to obtain information on financial assets held by transferees that are not under the transferor's control.
- (b) Restatement undermines the legal certainty expected by parties who entered into transactions on the basis of the accounting rules in effect at the time.
- (c) IAS 39 does not, before the improvements proposed in June 2002, require (or even permit) entities to restate past derecognition transactions. Without a similar exemption, first-time adopters would be unfairly disadvantaged.
- (d) ~~In publishing the June 2002 Exposure Draft of proposed improvements to IAS 39, the Board acknowledged that the existing derecognition requirements require improvement. Retrospective application of these imperfect requirements may involve costs that exceed the benefits to users. Retrospective application would not result in consistent measurement, as entities would need to recreate information about past transactions with the benefit of hindsight.~~

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

- (a) The omission of material assets or liabilities would undermine the understandability, relevance, reliability and comparability of an entity's financial statements. Many of the transactions under discussion are large and will have effects for many years.
- (b) Such an exemption would be inconsistent with the June 2002 Exposure Draft of improvements to IAS 39.
- (c) The Board's primary objective is to achieve comparability over time within an entity's first IFRS financial statements. Prospective application by a first-time adopter would conflict with that primary objective, even if prospective application were available to entities already applying IFRSs.
- (d) Although a new IFRS may have unforeseen consequences if another party uses financial statements to monitor compliance with a contract or agreement, that possibility does not justify prospective application (paragraph BC13(a)).

BC22 ~~Nevertheless, in finalising the IFRS, the Board concluded that it would be premature to require a treatment different from the current version of IAS 39 before completing the proposed improvements to IAS 39. Accordingly, the IFRS requires the same treatment as the current version of IAS 39 for derecognition transactions before the effective date of the current version of IAS 39 (paragraph 27 of the IFRS). When it completes the improvements to IAS 39, the Board may amend or delete this exemption.~~ Nevertheless, in finalising the IFRS, the Board concluded that it would be premature to require a treatment different from the current version of IAS 39 before completing the proposed improvements to IAS 39. Accordingly, the IFRS originally required the same treatment as the then current version of IAS 39 for derecognition transactions before the effective date of the then current version of IAS 39, namely that any financial assets or financial liabilities derecognised under previous GAAP before financial years beginning on 1 January 2001 remain derecognised. The Board agreed that when it completed the improvements to IAS 39, it might amend or delete this exemption.

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

BC22B The Board also noted that financial statements that include financial assets and financial liabilities that would otherwise be omitted under the provisions of the IFRS would be more complete and therefore more useful to users of financial statements. The Board therefore decided to permit retrospective application of the derecognition requirements. It also decided that retrospective application should be limited to cases when the information needed to apply the IFRS to past transactions was obtained at the time of initially accounting for those transactions. This limitation prevents the unacceptable use of hindsight.

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

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

- (b) ~~to confirm that there are no exemptions for special purpose entities (SPEs) that existed before the date of transition to IFRSs. ED 1 did not propose any exemptions for SPEs and SIC-12 Consolidation-Special Purpose Entities contains no exemption for pre-existing SPEs. The Board added a project on consolidation and SPEs to its active agenda in June 2002. [the confirmation that there are no exemptions for special purpose entities that existed before the date of transition to IFRSs.](#)~~

Measurement

- BC24 The Board considered whether it should require a first-time adopter to measure all assets and liabilities at fair value in the opening IFRS balance sheet. Some argued that this would result in more relevant information than an aggregation of costs incurred at different dates, or of costs and fair values. However, the Board concluded that a requirement to measure all assets and liabilities at fair value at the date of transition to IFRSs would be unreasonable, given that an entity may use an IFRS-compliant cost-based measurement before and after that date for some items.
- BC25 The Board decided as a general principle that a first-time adopter should measure all assets and liabilities recognised in its opening IFRS balance sheet on the basis required by the relevant IFRSs. This is needed for an entity's first IFRS financial statements to present understandable, relevant, reliable and comparable information.

Benefits and costs

- BC26 The *Framework* acknowledges that the need for a balance between the benefits of information and the cost of providing it may constrain the provision of relevant and reliable information. The Board considered these cost-benefit constraints and developed targeted exemptions from the general principle described in paragraph BC25. SIC-8 did not include specific exemptions of this kind, although it provided general exemptions from:
- (a) retrospective adjustments to the opening balance of retained earnings 'when the amount of the adjustment relating to prior periods cannot be reasonably determined'.
- (b) provision of comparative information when it is 'impracticable' to provide such information.
- BC27 The Board expects that most first-time adopters will begin planning on a timely basis for the transition to IFRSs. Accordingly, in balancing benefits and costs, the Board took as its benchmark an entity that plans the transition well in advance and can collect most information needed for its opening IFRS balance sheet at, or very soon after, the date of transition to IFRSs.
- BC28 ED 1 proposed that a first-time adopter should use either all the exemptions in ED 1 or none. However, some respondents disagreed with this all-or-nothing approach for the following reasons:
- (a) Many of the exemptions are not interdependent, so there is no conceptual reason to condition use of one exemption on use of other exemptions.
- (b) Although it is necessary to permit some exemptions on pragmatic grounds, entities should be encouraged to use as few exemptions as possible.
- (c) Some of the exemptions proposed in ED 1 were implicit options because they relied on the entity's own judgement of undue cost or effort and some others were explicit options. Only a few exemptions were really mandatory.

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

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

- (a) Some exceptions consist of optional exemptions (paragraphs BC30-BC63).
- (b) The other exceptions prohibit full retrospective application of IFRSs to some aspects of derecognition (paragraphs BC20-BC23), hedge accounting (paragraphs BC75-BC80), and estimates (paragraph BC84).

Exemptions from other IFRSs

BC30 ~~Under the IFRS, a first-time adopter may elect to use exemptions in one or more of the following areas:~~ An entity may elect to use one or more of the following exemptions:

- (a) business combinations (paragraphs BC31-BC40);
- (b) fair value or revaluations as deemed cost (paragraphs BC41-BC47);
- (c) employee benefits (paragraphs BC48-BC52);
- (d) cumulative translation differences (paragraphs BC53-BC55);
- (e) compound financial instruments (paragraphs BC56-BC58); and
- (f) assets and liabilities of subsidiaries, associates and joint ventures (paragraphs BC59-BC63);
- (g) designation of previously recognised financial instruments (paragraph BC63A); and
- (h) share-based payment transactions (paragraph 63B).

Business combinations

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

- (a) whether retrospective restatement of past business combinations should be prohibited, permitted or required (paragraphs BC32- BC34).
- (b) whether an entity should recognise assets acquired and liabilities assumed in a past business combination if it did not recognise them under previous GAAP (paragraph BC35).
- (c) whether an entity should restate amounts assigned to the assets and liabilities of the combining entities if previous GAAP brought forward unchanged their pre-combination carrying amounts (paragraph BC36).
- (d) whether an entity should restate goodwill for adjustments made in its opening IFRS balance sheet to the carrying amounts of assets acquired and liabilities assumed in past business combinations (paragraphs BC37-BC40).

- BC32 Retrospective application of ~~IAS 22~~ [IFRS 3](#) *Business Combinations* could require an entity to recreate data that it did not capture at the date of a past business combination and make subjective estimates about conditions that existed at that date. These factors could reduce the relevance and reliability of the entity's first IFRS financial statements. Therefore, ED 1 would have prohibited restatement of past business combinations (unless an entity used the proposed alternative approach, discussed in paragraph BC15, of applying IFRSs as if it had always applied IFRSs). Some respondents agreed, arguing that restatement of past business combinations would involve subjective, and potentially selective, use of hindsight that would diminish the relevance and reliability of financial statements.
- BC33 Other respondents disagreed. They argued that:
- (a) effects of business combination accounting can last for many years. Previous GAAP may differ significantly from IFRSs, and in some countries there are no accounting requirements at all for business combinations. Previous GAAP balances might not result in decision-useful information in these countries.
 - (b) restatement is preferable and may not involve as much cost or effort for more recent business combinations.
- BC34 In the light of these comments, the Board concluded that restatement of past business combinations is conceptually preferable, although for cost-benefit reasons this should be permitted but not required. The Board decided to place some limits on this election and noted that information is more likely to be available for more recent business combinations. Therefore, if a first-time adopter restates any business combination, the IFRS requires it to restate all later business combinations (paragraph B1 of Appendix B of the IFRS).
- BC35 If an entity did not recognise a particular asset or liability under previous GAAP at the date of the business combination, ED 1 proposed that its deemed cost under IFRSs would be zero. As a result, the entity's opening IFRS balance sheet would not have included that asset or liability if IFRSs permit or require a cost-based measurement. Some respondents to ED 1 argued that this would be an unjustifiable departure from the principle that the opening IFRS balance sheet should include all assets and liabilities. The Board agreed with that conclusion. Therefore, paragraph B2(f) of Appendix B of the IFRS requires that the acquirer should recognise those assets and liabilities and measure them on the basis that IFRSs would require in the separate balance sheet of the acquiree.
- BC36 Under previous GAAP, an entity might have brought forward unchanged the pre-combination carrying amounts of the combining entities' assets and liabilities. Some argued that it would be inconsistent to use these carrying amounts as deemed cost under IFRSs, given that the IFRS does not permit the use of similar carrying amounts as deemed cost for assets and liabilities that were not acquired in a business combination. However, the Board identified no specific form of past business combination, and no specific form of accounting for past business combinations, for which it would not be acceptable to bring forward cost-based measurements made under previous GAAP.
- BC37 Although the IFRS treats amounts assigned under previous GAAP to goodwill and other assets acquired and liabilities assumed in a past business combination as their deemed cost under IFRSs at the date of the business combination, an entity needs to adjust their carrying amounts in its opening IFRS balance sheet, as follows.
- (a) Assets and liabilities measured under IFRSs at fair value or other forms of current value: remeasure to fair value or that other current value.
 - (b) Assets (other than goodwill) and liabilities for which IFRSs apply a cost-based measurement: adjust the accumulated depreciation or amortisation since the

date of the business combination if it does not comply with IFRSs. Depreciation is based on deemed cost, which is the carrying amount under previous GAAP immediately following the business combination.

- (c) Assets (other than goodwill) and liabilities not recognised under previous GAAP: measure on the basis that IFRSs would require in the separate balance sheet of the acquiree.
- (d) Items that do not qualify for recognition as assets and liabilities under IFRSs: eliminate from the opening IFRS balance sheet.

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

- (a) eliminates an item that was recognised under previous GAAP as an intangible asset but does not qualify for separate recognition under IFRSs; or
- (b) recognises an intangible asset that was subsumed within goodwill under previous GAAP.

However, to avoid costs that would exceed the likely benefits to users, the IFRS prohibits restatement of goodwill for most other adjustments reflected in the opening IFRS balance sheet, unless a first-time adopter elects to apply IAS 22 retrospectively (paragraph B2(g) of the IFRS).

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

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

Fair value or revaluation as deemed cost

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

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

- BC43 Some expressed concerns that the use of fair value would lead to lack of comparability. However, cost is generally equivalent to fair value at the date of acquisition. Therefore, the use of fair value as the deemed cost of an asset means that an entity will report the same cost data as if it had acquired an asset with the same remaining service potential at the date of transition to IFRSs. If there is any lack of comparability, it arises from the aggregation of costs incurred at different dates, rather than from the targeted use of fair value as deemed cost for some assets. The Board regarded this approach as justified to solve the unique problem of introducing IFRSs in a cost-effective way without damaging transparency.
- BC44 The IFRS restricts the use of fair value as deemed cost to those assets for which reconstructing costs is likely to be of limited benefit to users and particularly onerous: property, plant and equipment, investment property (if an entity elects to use the cost method in IAS 40 *Investment Property*) and intangible assets that meet restrictive criteria (paragraphs 16 and 18 of the IFRS).
- BC45 ~~Under the allowed alternative treatment in IAS 16 Property, Plant and Equipment, if an entity revalues an asset, it must revalue all assets in that class. This restriction prevents selective revaluation of only those assets whose revaluation would lead to a particular result. Some suggested a similar restriction on the use of fair value as deemed cost. However, IAS 36 Impairment of Assets requires an impairment test if there is any indication that an asset is impaired. Thus, if an entity uses fair value as deemed cost for assets whose fair value is above cost, it cannot ignore indications that the recoverable amount of other assets may have fallen below their carrying amount. Therefore, the IFRS does not restrict the use of fair value as deemed cost to entire classes of asset.~~ Under the revaluation model in IAS 16 Property, Plant and Equipment, if an entity revalues an asset, it must revalue all assets in that class. This restriction prevents selective revaluation of only those assets whose revaluation would lead to a particular result. Some suggested a similar restriction on the use of fair value as deemed cost. However, IAS 36 Impairment of Assets requires an impairment test if there is any indication that an asset is impaired. Thus, if an entity uses fair value as deemed cost for assets whose fair value is above cost, it cannot ignore indications that the recoverable amount of other assets may have fallen below their carrying amount. Therefore, the IFRS does not restrict the use of fair value as deemed cost to entire classes of asset.
- BC46 Some revaluations under previous GAAP might be more relevant to users than original cost. If so, it would not be reasonable to require time-consuming and expensive reconstruction of a cost that complies with IFRSs. In consequence, the IFRS permits an entity to use amounts determined using previous GAAP as deemed cost for IFRSs in the following cases:
- (a) if an entity revalued one of the assets described in paragraph BC44 using its previous GAAP and the revaluation met specified criteria (paragraphs 17 and 18 of the IFRS).
 - (b) if an entity established a deemed cost under previous GAAP for some or all assets and liabilities by measuring them at their fair value at one particular date because of an event such as a privatisation or initial public offering (paragraph 19 of the IFRS).
- BC47 Paragraph 17 of the IFRS refers to revaluations that are broadly comparable to fair value or reflect an index applied to a cost that is broadly comparable to cost determined under IFRSs. It may not always be clear whether a previous revaluation was intended as a measure of fair value or differs materially from fair value. The flexibility in this area permits a cost-effective solution for the unique problem of transition to IFRSs. It allows a first-time adopter to establish a deemed cost using a measurement that is already available and is a reasonable starting point for a cost-based measurement.

Employee benefits

- BC48 If an entity elects to use the 'corridor' approach in IAS 19 *Employee Benefits*, full retrospective application of IAS 19 would require the entity to determine actuarial gains or losses for each year since the inception of the plan in order to determine the net cumulative unrecognised gains or losses at the date of transition to IFRSs. The Board concluded that this would not benefit users and would be costly. Therefore, the IFRS permits a first-time adopter to recognise all actuarial gains or losses up to the date of transition to IFRSs, even if its accounting policy under IAS 19 involves leaving some later actuarial gains and losses unrecognised (paragraph 20 of the IFRS).
- BC49 The revision of IAS 19 in 1998 increased the reported employee benefit liabilities of some entities. IAS 19 permitted entities to amortise that increase over up to five years. Some suggested a similar transitional treatment for first-time adopters. However, the Board has no general policy of exempting transactions occurring before a specific date from the requirements of new IFRSs (paragraph 21 of the *Preface to International Financial Reporting Standards*). Therefore, the Board did not include a similar transitional provision for first-time adopters.
- BC50 An entity's first IFRS financial statements may reflect measurements of pension liabilities at three dates: the reporting date, the end of the comparative year and the date of transition to IFRSs. Some suggested that obtaining three separate actuarial valuations for a single set of financial statements would be costly. Therefore, they proposed that the Board should permit an entity to use a single actuarial valuation, based, for example, on assumptions valid at the reporting date, with service costs and interest costs based on those assumptions for each of the periods presented.
- BC51 However, the Board concluded that a general exemption from the principle of measurement at each date would conflict with the objective of providing understandable, relevant, reliable and comparable information for users. If an entity obtains a full actuarial valuation at one or two of these dates and rolls that (those) valuation(s) forward or back to the other date(s), any such roll forward or roll back needs to reflect material transactions and other material events (including changes in market prices and interest rates) between those dates (IAS 19, paragraph 57).
- BC52 Some suggested that the Board should exempt a first-time adopter from the requirement to identify and amortise the unvested portion of past service cost at the date of transition to IFRSs. However, this requirement is less onerous than the retrospective application of the corridor for actuarial gains and losses because it does not require the recreation of data since the inception of the plan. The Board concluded that no exemption was justified for past service cost.

Cumulative translation differences

- BC53 IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires an entity to classify some cumulative translation differences (CTDs) relating to a net investment in a foreign operation as a separate component of equity. The entity transfers the CTDs to the income statement on subsequent disposal of the foreign operation. The proposals in ED 1 would have permitted a first-time adopter to use the CTDs under previous GAAP as the deemed CTDs under IFRSs if reconstructing CTDs would have involved undue cost or effort.
- BC54 Some respondents to ED 1 argued that it would be more transparent and comparable to exempt an entity from the requirement to identify CTDs at the date of transition to IFRSs, for the following reasons:
- (a) An entity might know the aggregate CTDs, but might not know the amount for each subsidiary. If so, it could not transfer that amount to the income statement on disposal of that subsidiary. This would defeat the objective of identifying CTDs as a separate component of equity.

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

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

Compound financial instruments

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

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

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

Assets and liabilities of subsidiaries, associates and joint ventures

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

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

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

- (a) The exemption would not eliminate all differences between the group reporting package and the subsidiary's own financial statements. The reporting package does not constitute a full set of financial statements, the parent may have made adjustments to the reported numbers (for example, if pension cost adjustments were made centrally), and the group materiality threshold may be higher than for the subsidiary.
- (b) The Board's objective of comparability between different entities adopting IFRSs for the first time at the same date (paragraph BC10) should apply

equally to any entity, including subsidiaries, particularly if the subsidiary's debt or equity securities are publicly traded.

- BC62 However, the Board retained the exemption because it will ease some practical problems. Although the exemption does not eliminate all differences between the subsidiary's separate financial statements and a group reporting package, it does reduce them. Furthermore, the exemption does not diminish the relevance and reliability of the subsidiary's separate financial statements because it permits a measurement that is already acceptable under IFRSs in the consolidated financial statements of the parent. Therefore, the Board also eliminated the proposal in ED 1 that the exemption should be conditional on the consent of minorities.
- BC63 In finalising the IFRS, the Board simplified the description of the exemption for a subsidiary that adopts IFRSs after its parent. Under the IFRS, the subsidiary may measure its assets and liabilities at the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary. Alternatively, it may elect to measure them at the carrying amounts required by the rest of the IFRS, based on the subsidiary's date of transition to IFRSs. The Board also extended the exemption to an associate or joint venture that becomes a first-time adopter later than an entity that has significant influence or joint control over it (paragraph 24 of the IFRS). However, if a parent adopts IFRSs later than a subsidiary, the parent cannot, in its consolidated financial statements, elect to change IFRS measurements that the subsidiary has already used in its separate financial statements, except to adjust for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary (paragraph 25 of the IFRS).

Designation of previously recognised financial instruments

BC63A IAS 39 permits an entity to designate, on initial recognition only, a financial instrument as (a) available for sale (for a financial asset) or (b) a financial asset or financial liability at fair value through profit or loss (provided the asset or liability qualifies for such designation in accordance with paragraph 9(b)(i), 9(b)(ii) or 11A of IAS 39). Despite this requirement, an entity that had already applied IFRSs before the effective date of IAS 39 (as revised in March 2004) may (a) designate a previously recognised financial asset as available for sale on initial application of IAS 39 (as revised in March 2004), or (b) designate a previously recognised financial instrument as at fair value through profit or loss in the circumstances specified in paragraph 105B of IAS 39. The Board decided that the same considerations apply to first-time adopters as to entities that already apply IFRSs. Accordingly, a first-time adopter of IFRSs may similarly designate a previously recognised financial instrument in accordance with paragraph 25A. Such an entity shall disclose the fair value of the 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.

Share-based payment transactions

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

be required to apply IFRS 2 to equity instruments that were granted after 7 November 2002 if those equity instruments vested before 1 January 2005. In addition, the Board decided that a first-time adopter should not be required to apply IFRS 2 to equity instruments that were granted after 7 November 2002 if those equity instruments vested before the date of transition to IFRSs. Similarly, the Board decided that a first-time adopter should not be required to apply IFRS 2 to liabilities arising from cash-settled share-based payment transactions if those liabilities were settled before 1 January 2005, or before the date of transition to IFRSs.

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

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

Leases

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

Other possible exemptions rejected

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

Embedded derivatives

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

BC66 The Board noted that US GAAP provides an option in this area. Under the transitional provisions of SFAS 133 *Accounting for Derivative Instruments and Hedging Activities*, an entity need not account separately for some pre-existing embedded derivatives. Nevertheless, the Board concluded that the failure to measure embedded derivatives at fair value would diminish the relevance and reliability of an entity's first IFRS

financial statements. The Board also observed that IAS 39 addresses an inability to measure an embedded derivative and the host contract separately. In such cases, IAS 39 requires an entity to measure the entire combined contract at fair value.

Hyperinflation

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

Intangible assets

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

- (a) Using hindsight to assess retrospectively when the recognition criteria for intangible assets were met could be subjective, open up possibilities for manipulation and involve costs that might exceed the benefits to users.
- (b) The benefits expected from intangible assets are often not related directly to the costs incurred. Therefore, capitalising the costs incurred is of limited benefit to users, particularly if the costs were incurred in the distant past.
- (c) Such an exclusion would be consistent with the transitional provisions in IAS 38 *Intangible Assets*. These encourage (but do not require) the recognition of intangible assets acquired in a previous business combination that was an acquisition and prohibit the recognition of all other previously unrecognised intangible assets.

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

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

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

- (a) the recognition criteria in IAS 38 (including reliable measurement of original cost); and
- (b) the criteria in IAS 38 for revaluation (including the existence of an active market) (paragraph 18 of the IFRS).

Transaction costs: financial instruments

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

- (a) to use the fair value of the financial asset or financial liability at the date of transition to IFRSs as its deemed cost at that date; or
- (b) to determine amortised cost without considering transaction costs.

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

Retrospective designation

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

- (a) hedge accounting (paragraphs BC75-BC80); ~~and~~
- (b) the treatment of cumulative fair value changes on available-for-sale financial assets at the date of transition to IFRSs (paragraphs BC81- BC83); ~~and~~
- (c) 'day 1' gain or loss recognition (paragraph BC83A).

Hedge accounting

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

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

BC77 ~~ED 1 included a redrafted version of the transitional provisions in IAS 39 and related Questions and Answers (Q&A) developed by the IAS 39 Implementation Guidance Committee. The Board confirmed in the Basis for Conclusions published with ED 1 that it did not intend the redrafting to create substantive changes. However, in the light of responses to ED 1, the Board decided that the redrafting would not make it easier for first-time adopters and others to understand and apply the transitional provisions and Q&A. Therefore, paragraphs 28-30 of the IFRS refer readers to the transitional provisions in IAS 39.~~ ED 1 included a redrafted version of the transitional provisions in IAS 39 and related Questions and Answers (Q&As) developed by the IAS 39 Implementation Guidance Committee. The Board confirmed in the Basis for Conclusions published with ED 1 that it did not intend the redrafting to create

substantive changes. However, in the light of responses to ED 1, the Board decided in finalising IFRS 1 that the redrafting would not make it easier for first-time adopters and others to understand and apply the transition provisions and Q&As. However, the project to improve IAS 32 and IAS 39 resulted in certain amendments to the transition requirements. In addition, this project incorporated selected other Q&As (i.e. not on transition) into IAS 39. The Board therefore took this opportunity to consolidate all the guidance for first-time adopters in one place, by incorporating the Q&As on transition into IFRS 1.

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

- (a) recognising deferred debits and credits that are not assets and liabilities (for a fair value hedge); or
- (b) deferring gains or losses in equity when there is, at best, a weak link to an underlying item that defines when they should be transferred to the income statement (for a cash flow hedge).

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

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

- (a) The Board's primary objective is comparability within a first-time adopter's first IFRS financial statements and between different first-time adopters switching to IFRSs at the same time (paragraph BC10).
- (b) The continuation of previous GAAP hedge accounting practices could permit the non-recognition of derivatives or the recognition of deferred debits and credits that are not assets and liabilities.
- (c) The Board's benchmark for cost-benefit assessments was an entity that has planned the transition to IFRSs and is able to collect the necessary information at, or very soon after, the date of transition to IFRSs (paragraph BC27). Entities should not be 'rewarded' by concessions if they failed to plan for transition, nor should that failure be allowed to undermine the integrity of their opening IFRS balance sheet. Entities switching to IFRSs in 2005 need to have their hedge accounting systems in place by the beginning of 2004. In the Board's view, that is a challenging but achievable timetable. Entities preparing to switch to IFRSs in 2004 should have been aware of the implications of IAS 39 already and the Exposure Draft of improvements to IAS 39, published in June 2002, proposed very few changes in this area, so delayed transition is

^{*} In IAS 39, as revised in 2003, paragraph 133 has replaced by paragraphs 84 and AG101.

not justified for these entities either.

Available-for-sale financial assets

- BC81 Retrospective application of IAS 39 to available-for-sale financial assets requires a first-time adopter to recognise the cumulative fair value changes in a separate component of equity in the opening IFRS balance sheet, and transfer those fair value changes to the income statement on subsequent disposal or impairment of the asset. This could allow, for example, selective classification of assets with cumulative gains as available-for-sale (with subsequent transfers to the income statement on disposal) and assets with cumulative losses as held for trading (with no transfers on disposal).
- BC82 ~~The Exposure Draft of June 2002 proposed an option for an entity that already applies IFRSs to designate any financial asset as held for trading when it first applies the proposed improvements. This proposal could, if implemented, increase the risk of selective classification by first-time adopters of the kind discussed in the previous paragraph. However, an entity could achieve a similar result by selective disposal of some assets before the date of transition to IFRSs. Therefore, the Board concluded that it should treat first-time adopters in the same way as entities that already apply IFRSs by requiring retrospective application.~~ IAS 39 confirmed the proposal in the Exposure Draft of June 2002 to give an entity that already applies IFRSs an option to designate any financial asset as at fair value through profit or loss when it first applies the proposed improvements. Although this requirement could increase the risk of selective classification by first-time adopters of the kind discussed in the previous paragraph, the Board noted that an entity could achieve a similar result by selective disposal of some assets before the date of transition to IFRSs. Therefore, the Board concluded that it should treat first-time adopters in the same way as entities that already apply IFRSs by requiring retrospective application.
- BC83 Some respondents to ED 1 commented that the cost of determining the amount to be included in a separate component of equity would exceed the benefits. However, the Board noted that these costs would be minimal if a first-time adopter carried the available-for-sale financial assets under previous GAAP at cost or the lower of cost and market value. These costs might be more significant if it carried them at fair value, but in that case it might well classify the assets as held for trading. Therefore, the Board made no changes to ED 1's proposal that a first-time adopter should apply IAS 39 retrospectively to available-for-sale financial assets.

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

- (a) _____ retrospectively;
- (b) _____ prospectively to transactions entered into after 25 October 2002; or
- (c) _____ prospectively to transactions entered into after 1 January 2004.

Estimates

- BC84 An entity will have made estimates under previous GAAP at the date of transition to IFRSs. Events between that date and the reporting date for the entity's first IFRS financial statements might suggest a need to change those estimates. Some of those events might qualify as adjusting events under IAS 10 *Events after the Balance Sheet*

Date. However, if the entity made those estimates on a basis consistent with IFRSs, the Board concluded that it would be more helpful to users-and more consistent with IAS 8 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*-to recognise the revision of those estimates as income or expense in the period when the entity made the revision, rather than in preparing the opening IFRS balance sheet (paragraphs 31-34 of the IFRS).

PRESENTATION AND DISCLOSURE

Comparative information

- BC85 IAS 1 *Presentation of Financial Statements* requires an entity to disclose comparative information (under IFRSs) for the previous period. Some suggested that a first-time adopter should disclose comparative information for more than one previous period. For entities that already apply IFRSs, users normally have access to financial statements prepared on a comparable basis for several years. However, this is not the case for a first-time adopter.
- BC86 Nevertheless, the Board did not require a first-time adopter to present more comparative information than IAS 1 requires, because such a requirement would impose costs out of proportion to the benefits to users, and increase the risk that preparers might need to make arbitrary assumptions in applying hindsight.
- BC87 ED 1 proposed that if the first IFRS financial statements include more than one year of comparative information, the additional comparative information should comply with IFRSs. Some respondents to ED 1 noted that some regulators require entities to prepare more than two years of comparatives. They argued the following:
- (a) A requirement to restate two years of comparatives would impose excessive costs and lead to arbitrary restatements that might be biased by hindsight.
 - (b) Consider an entity adopting IFRSs in 2005 and required by its regulator to give two years of comparatives. Its date of transition to IFRSs would be 1 January 2003-several months before the publication of the IFRS and of the standards resulting from the Improvements project. This could contradict the Board's assertion in paragraph BC27 above that most preparers could gather most information they need for their opening IFRS balance sheet at, or soon after, the date of transition to IFRSs.
- BC88 In response to these comments, the Board deleted this proposal. Instead, if a first-time adopter elects to give more than one year of comparative information, the additional comparative information need not comply with IFRSs, but the IFRS requires the entity:
- (a) to label previous GAAP information prominently as not being prepared under IFRSs.
 - (b) to disclose the nature of the main adjustments that would make it comply with IFRSs (paragraph 37 of the IFRS).
- BC89 Some respondents to ED 1 suggested that it would be onerous to prepare comparative disclosures under IAS 32 and IAS 39 about financial instruments. They suggested that an entity should be able to apply IAS 39 prospectively from the beginning of the year of its first IFRS financial statements (eg 1 January 2005 for many first-time adopters). They noted that US companies were not required to restate comparatives on the introduction of SFAS 133 *Accounting for Derivative Instruments and Hedging Activities*. However, given the Board's emphasis on comparability within the first IFRS financial statements (paragraph BC10) and the assumption of timely planning (paragraph BC27), the Board introduced no exemption in this area.

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

Historical summaries

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

Explanation of transition to IFRSs

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

- (a) the most recent information published under previous GAAP, so that users have the most up-to-date information; and
- (b) the date of transition to IFRSs. This is an important focus of attention for users, preparers and auditors because the opening IFRS balance sheet is the starting point for accounting under IFRSs.

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

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

- (a) information about changes in accounting policies helps explain the transition to IFRSs.
- (b) information about errors helps users assess the reliability of financial information. Furthermore, a failure to disclose the effect of material errors would obscure the 'results of the stewardship of management, or the accountability of management for the resources entrusted to it' (Framework,

paragraph 14).

- BC94 For impairment losses (and reversals) recognised in preparing the opening IFRS balance sheet, paragraph 39(c) of the IFRS requires the disclosures that IAS 36 *Impairment of Assets* would require if those impairment losses (and reversals) were recognised during the period beginning with the date of transition to IFRSs. The rationale for this requirement is that there is inevitably subjectivity about impairment losses. This disclosure provides transparency about impairment losses recognised on transition to IFRSs. These losses might otherwise receive less attention than impairment losses recognised in earlier or later periods.
- BC95 Paragraph 44 of the IFRS requires disclosures about the use of fair value as deemed cost. Although the adjustment arising from the use of this exemption appears in the reconciliations discussed above, this more specific disclosure highlights it. Furthermore, this exemption differs from the other exemptions that might apply for property, plant and equipment (previous GAAP revaluation or event-driven fair value measurement). The latter two exemptions do not lead to a restatement on transition to IFRSs because they apply only if the measurement was already used in previous GAAP financial statements.

Interim financial reports

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

- BC97 [Deleted]

Appendix A

Amendments to Basis for Conclusions on HKFRS 1 and HKAS 27 *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* (issued in October 2008) – effective for annual periods beginning on or after 1 January 2009

The following sets out amendments required for this Basis for Conclusions resulting from amendments to HKFRS 1 and HKAS 27 that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

In the Basis for Conclusions, after paragraph BC58, a heading and paragraphs BC58A–BC58M are added.

Investments in subsidiaries, jointly controlled entities and associates

BC58A IAS 27 *Consolidated and Separate Financial Statements* requires an entity, in its separate financial statements, to account for investments in subsidiaries, jointly controlled entities and associates either at cost or in accordance with IAS 39. For those investments that are measured at cost, the previous version of IAS 27 (before *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* was issued in May 2008) required an entity to recognise income from the investment only to the extent the entity received distributions from post-acquisition retained earnings (the ‘cost method’). Distributions received in excess of such profits were regarded as a recovery of investment and were recognised as a reduction in the cost of the investment.

BC58B For some jurisdictions, these aspects of IAS 27 led to practical difficulties on transition to IFRSs. In order to apply IAS 27 retrospectively, it would be necessary:

- (a) to measure the fair value of the consideration given at the date of acquisition; and
- (b) to determine whether any dividends received from a subsidiary after its acquisition were paid out of pre-acquisition retained earnings, which would reduce the carrying amount of the investment in the subsidiary in the parent’s separate financial statements.

BC58C If a parent held an investment in a subsidiary for many years, such an exercise might be difficult, or even impossible, and perhaps costly. For example, in some jurisdictions, entities accounted for some previous acquisitions that were share-for-share exchanges using so-called ‘merger relief’ or ‘group reconstruction relief’. In this situation, the carrying amount of the investment in the parent’s separate financial statements was based on the nominal value of the shares given rather than the value of the purchase consideration. This might make it difficult or impossible to measure the fair value of the shares given.

BC58D The Board published *Cost of an Investment in a Subsidiary*, an exposure draft of proposed amendments to IFRS 1, in January 2007. In response to the issues outlined in paragraphs BC58A–BC58C, the Board proposed two exemptions from applying the requirements of IAS 27 retrospectively upon first-time adoption of IFRSs:

- (a) an alternative approach for determining the cost of an investment in a subsidiary in the separate financial statements of a parent; and
- (b) a simplification of the process for determining the pre-acquisition retained earnings of that subsidiary.

BC58E In developing that exposure draft, the Board considered three ways of determining a deemed cost of an investment in a subsidiary at the parent's date of transition to IFRSs in its separate financial statements. These were:

- (a) the previous GAAP cost of the investment (previous GAAP deemed cost).
- (b) the parent's interest in the subsidiary's assets less liabilities, using the carrying amounts that IFRSs would require in the subsidiary's statement of financial position (net asset deemed cost).
- (c) the fair value of the investment (fair value deemed cost).

BC58F The Board decided that the net asset deemed cost option would provide relevant information to users about the subsidiary's financial position at the date of transition to IFRSs and would be relatively easy to determine. The fair value deemed cost option would provide relevant information at the date of transition to IFRSs, but might be more costly and difficult to determine.

BC58G In some situations, the cost of an investment in a subsidiary determined using the previous GAAP carrying amount might bear little resemblance to cost determined in accordance with IAS 27. Therefore, the Board rejected the use of a deemed cost based on the previous GAAP carrying amount. The Board proposed to allow entities a choice between the net asset deemed cost and the fair value deemed cost.

BC58H Respondents to the exposure draft stated that the previous GAAP carrying amount is a more appropriate deemed cost. They argued that:

- (a) A net asset deemed cost would not include goodwill or other intangible assets that might be present in a carrying amount determined under previous GAAP. When this is the case, the net asset deemed cost option would understate the assets of the entities for which it is used. The resulting reduction in the carrying amount of the investment could reduce the distributable profits of the parent.
- (b) It was difficult to see why, in the light of the exemption in IFRS 1 from applying IFRS 3 retrospectively, the Board did not propose to permit the cost of the investment in a subsidiary under previous GAAP to be used as a deemed cost. When an entity had chosen not to apply IFRS 3 retrospectively to a past business combination, it would be logical not to require it to restate the cost of the related investment in the separate financial statements of the parent.

BC58I In the light of respondents' comments, the Board observed that, in many instances, neither the previous GAAP carrying amount nor the net asset deemed cost represents 'cost'—both numbers could be viewed as being equally arbitrary.

BC58J In order to reduce the cost of adopting IFRSs in the parent entity's separate financial statements without significantly reducing the benefits of those statements, the Board decided to allow entities a choice between the previous GAAP carrying amount and the fair value as deemed cost.

BC58K The Board also agreed with respondents that similar issues arise for investments in associates and jointly controlled entities. As a result, paragraph 23B of the IFRS applies to such investments.

BC58L The Board published its revised proposals in *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*, an exposure draft of proposed amendments to IFRS 1 and IAS 27, in December 2007. Respondents generally supported the proposed amendments to IFRS 1. The Board included the amendments in *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* issued in May 2008.

BC58M In developing the December 2007 exposure draft, the Board decided to address the simplification of the process for determining the pre-acquisition retained earnings of a subsidiary more generally through an amendment to IAS 27. See paragraph 38A of IAS 27 and paragraphs BC66D–BC66J of the Basis for Conclusions on IAS 27.

Appendix B

Amendments resulting from other Basis for Conclusions

The following sets out amendments required for this Basis for Conclusions resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Basis for Conclusions and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKFRS 8 *Operating Segments* (issued in March 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraph BC4 is footnoted as follows:

In 2006 IAS 14 was replaced by IFRS 8 *Operating Segments* (as revised in 2007).

HKAS 23 *Borrowing Costs* (issued in June 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraph BC63D a heading and paragraph BC63E are added as follows:

Borrowing costs

BC63E IAS 23 *Borrowing Costs* (as revised in 2007) contains transitional provisions because the Board acknowledged that if an entity has been following the accounting policy of immediately recognising borrowing costs as an expense and has not previously gathered the necessary information for capitalisation of borrowing costs, getting the information retrospectively may be costly. First-time adopters of IFRSs face problems similar to those facing entities that already apply IFRSs. Moreover, although first-time adopters have the option of using fair value as the deemed cost of an asset at the date of transition to IFRSs, this option is not applicable to all qualifying assets, such as inventories. Furthermore, the Board concluded that the existence of the deemed cost option is not sufficient to justify a more stringent requirement for the application of IAS 23 for first-time adopters than for entities that already apply IFRSs. A more stringent requirement for the adoption of the capitalisation treatment could be justified when IFRS 1 was originally issued because capitalisation was then an option. The requirements for the application of mandatory capitalisation, on the other hand, should be the same for entities that already apply IFRSs and for first-time adopters. Therefore, the Board decided to amend IFRS 1, allowing first-time adopters transitional provisions equivalent to those available to entities that already apply IFRSs in paragraphs 27 and 28 of IAS 23, as revised in 2007.

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

The rubric preceding the Basis for Conclusions is amended as follows:

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

*In this Basis for Conclusions the terminology has not been amended to reflect the changes made by IAS 1 *Presentation of Financial Statements* (as revised in 2007).*

Paragraphs BC84 and BC89A are footnoted as follows:

BC84 An entity ... Some of those events might qualify as adjusting events under IAS 10 *Events after the Balance Sheet Date*.^{*} However, if the entity made those estimates on a basis consistent with IFRSs

...

* In September 2007 the IASB amended the title of IAS 10 from *Events after the Balance Sheet Date* to *Events after the Reporting Period* as a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007.

BC89A Nevertheless The disclosures in paragraph 36A^{*} inform users of the lack of comparability.

* As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007, paragraph 36A has been deleted.

Paragraph BC92 is amended and paragraphs BC92A–BC92C are added as follows:

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

BC92A The Board decided to require a first-time adopter to include in its first IFRS financial statements a reconciliation of total comprehensive income (or, if an entity did not report such a total, profit or loss) in accordance with previous GAAP to total comprehensive income in accordance with IFRSs for the latest period reported in accordance with previous GAAP.

BC92B The Board observed that the amendments to IAS 1 in 2007 regarding the presentation of income and expense might result in users having to change their analytical models to include both income and expense that are recognised in profit or loss and those recognised outside profit or loss. Accordingly, the Board concluded that it would be helpful to those users to provide information on the effect and implication of the transition to IFRSs on all items of income and expense, not only those recognised in profit or loss.

BC92C The Board acknowledged that GAAP in other jurisdictions might not have a notion of total comprehensive income. Accordingly, it decided that an entity should reconcile to total comprehensive income in accordance with IFRSs from the previous GAAP equivalent of total comprehensive income. The previous GAAP equivalent might be profit or loss.

HKAS 27 *Consolidated and Separate Financial Statements* (issued in March 2008) – effective for annual periods beginning on or after 1 July 2009

Paragraph BC60 is footnoted as follows:

In January 2008 the IASB issued an amended IAS 27 *Consolidated and Separate Financial Statements*, which amended 'minority interests' to 'non-controlling interests'.

Guidance on Implementing

HKFRS 1 First-time Adoption of Hong Kong Financial Reporting Standards

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Guidance on implementing HKFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*

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

INTRODUCTION

IG1 This implementation guidance:

- (a) explains how the requirements of the HKFRS interact with the requirements of some other HKFRSs (paragraphs IG2-IG62). This explanation addresses those HKFRSs that are most likely to involve questions that are specific to first-time adopters.
- (b) includes an illustrative example to show how a first-time adopter might disclose how the transition to HKFRSs affected its reported financial position, financial performance and cash flows, as required by paragraphs 39(a) and (b), 40 and 41 of the HKFRS (paragraph IG63).

~~SSAP~~ HKAS 910 *Events after the Balance Sheet Date*

IG2 Except as described in paragraph IG3, an entity applies ~~SSAP 9~~ HKAS 10 in determining whether:

- (a) its opening HKFRS balance sheet reflects an event that occurred after the date of transition to HKFRSs; and
- (b) comparative balance sheet amounts in its first HKFRS financial statements reflect an event that occurred after the end of that comparative period.

IG3 Paragraphs 31-34 of the HKFRS require some modifications to the principles in ~~SSAP~~ HKAS 910 when a first-time adopter determines whether changes in estimates are adjusting or non-adjusting events at the date of transition to HKFRSs (or, when applicable, the end of the comparative period). Cases 1 and 2 below illustrate those modifications. In case 3 below, paragraphs 31-34 of the HKFRS do not require modifications to the principles in ~~SSAP~~ HKAS 910.

- (a) Case 1. Previous GAAP required estimates of similar items for the date of transition to HKFRSs, using an accounting policy that is consistent with HKFRSs. In this case, the estimates under HKFRSs need to be consistent with estimates made for that date under previous GAAP, unless there is objective evidence that those estimates were in error (see ~~SSAP 2 Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies~~ HKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors). The entity reports later revisions to those estimates as events of the period in which it makes the revisions, rather than as adjusting events resulting from the receipt of further evidence about conditions that existed at the date of transition to HKFRSs.
- (b) Case 2. Previous GAAP required estimates of similar items for the date of transition to HKFRSs, but the entity made those estimates using accounting policies that are not consistent with its accounting policies under HKFRSs. In this case, the estimates under HKFRSs need to be consistent with the estimates required under previous GAAP for that date (unless there is objective evidence that those estimates were in error), after adjusting for the

difference in accounting policies. The opening HKFRS balance sheet reflects those adjustments for the difference in accounting policies. As in case 1, the entity reports later revisions to those estimates as events of the period in which it makes the revisions. For example, previous GAAP may have required an entity to recognise and measure provisions on a basis consistent with ~~SSAP 28~~[HKAS 37](#) *Provisions, Contingent Liabilities and Contingent Assets*, except that the previous GAAP measurement was on an undiscounted basis. In this example, the entity uses the estimates under previous GAAP as inputs in making the discounted measurement required by ~~SSAP 28~~[HKAS 37](#).

- (c) Case 3. Previous GAAP did not require estimates of similar items for the date of transition to HKFRSs. Estimates under HKFRSs for that date reflect conditions existing at that date. In particular, estimates of market prices, interest rates or foreign exchange rates at the date of transition to HKFRSs reflect market conditions at that date. This is consistent with the distinction in ~~SSAP 28~~[HKAS 10](#) between adjusting events after the balance sheet date and non-adjusting events after the balance sheet date.

IG Example 1: Estimates

BACKGROUND

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

- (a) made estimates of accrued expenses and provisions at those dates;
- (b) accounted on a cash basis for a defined benefit pension plan; and
- (c) did not recognise a provision for a court case arising from events that occurred in September 2004. When the court case was concluded on 30 June 2005, entity A was required to pay 1,000 and paid this on 10 July 2005.

In preparing its first HKFRS financial statements, entity A concludes that its estimates under previous GAAP of accrued expenses and provisions at 31 December 2003 and 2004 were made on a basis consistent with its accounting policies under HKFRSs. Although some of the accruals and provisions turned out to be overestimates and others to be underestimates, entity A concludes that its estimates were reasonable and that, therefore, no error had occurred. As a result, accounting for those over- and underestimates involves the routine adjustment of estimates under ~~SSAP 2~~[HKAS 8](#).

APPLICATION OF REQUIREMENTS

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

- (a) does not adjust the previous estimates for accrued expenses and provisions; and
- (b) makes estimates (in the form of actuarial assumptions) necessary to account for the pension plan under ~~SSAP 34~~[HKAS 19](#) *Employee Benefits*. Entity A's actuarial assumptions at 1 January 2004 and 31 December 2004 do not reflect conditions that arose after those dates. For example, entity A's:
 - (i) discount rates at 1 January 2004 and 31 December 2004 for the pension plan and for provisions reflect market conditions at those dates; and

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

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

ASSUMPTION 1 - Previous GAAP was consistent with ~~SSAP 28~~ [HKAS 37](#) *Provisions, Contingent Liabilities and Contingent Assets*. Entity A concluded that the recognition criteria were not met. In this case, entity A's assumptions under HKFRSs are consistent with its assumptions under previous GAAP. Therefore, entity A does not recognise a provision at 31 December 2004.

ASSUMPTION 2 - Previous GAAP was not consistent with ~~SSAP 28~~ [HKAS 37](#). Therefore, entity A develops estimates under ~~SSAP 28~~ [HKAS 37](#). Under ~~SSAP 28~~ [HKAS 37](#), an entity determines whether an obligation exists at the balance sheet date by taking account of all available evidence, including any additional evidence provided by events after the balance sheet date. Similarly, under ~~SSAP 9~~ [HKAS 10](#) *Events after the Balance Sheet Date*, the resolution of a court case after the balance sheet date is an adjusting event after the balance sheet date if it confirms that the entity had a present obligation at that date. In this instance, the resolution of the court case confirms that entity A had a liability in September 2004 (when the events occurred that gave rise to the court case). Therefore, entity A recognises a provision at 31 December 2004. Entity A measures that provision by discounting the 1,000 paid on 10 July 2005 to its present value, using a discount rate that complies with ~~SSAP 28~~ [HKAS 37](#) and reflects market conditions at 31 December 2004.

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

- (a) the distinction between finance leases and operating leases (see ~~SSAP~~ [HKAS 17](#) *Leases*);
- (b) the restrictions in ~~SSAP 29~~ [HKAS 38](#) *Intangible Assets* that prohibit capitalisation of expenditure on an internally generated intangible asset if the asset did not qualify for recognition when the expenditure was incurred; and
- (c) the distinction between financial liabilities and equity instruments (see ~~HKAS 32~~ *Financial Instruments: Disclosure and Presentation*⁴).

~~SSAP~~ [HKAS 12](#) *Income Taxes*

IG5 An entity applies ~~SSAP~~ [HKAS 12](#) to temporary differences between the carrying amount of the assets and liabilities in its opening HKFRS balance sheet and their tax bases.

IG6 Under ~~SSAP~~ [HKAS 12](#), the measurement of current and deferred tax reflects tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date. An entity accounts for the effect of changes in tax rates and tax laws when those changes are enacted or substantively enacted.

⁴ ~~At the time of issue of this HKFRS, a proposed SSAP based on the IASB's proposed revision to IAS 32 has been issued as an exposure draft. In accordance with paragraph 23 of SSAP 1, management should consider IAS 32 when accounting for a financial liability or an equity instrument. Notwithstanding this, until the proposed SSAP based on IAS 32 becomes effective, IG4 is only relevant to those first-time adopters that elect to adopt the treatment under IAS 32.~~

SSAP ~~HKAS 1716~~ Property, Plant and Equipment

- IG7 If an entity's depreciation methods and rates under previous GAAP are acceptable under HKFRSs, it accounts for any change in estimated useful life or depreciation pattern prospectively from when it makes that change in estimate (paragraphs 31 and 32 of the HKFRS and paragraph ~~5461~~ of ~~SSAP~~HKAS 1716). However, in some cases, an entity's depreciation methods and rates under previous GAAP may differ from those that would be acceptable under HKFRSs (for example, if they were adopted solely for tax purposes and do not reflect a reasonable estimate of the asset's useful life). If those differences have a material effect on the financial statements, the entity adjusts accumulated depreciation in its opening HKFRS balance sheet retrospectively so that it complies with HKFRSs.
- IG8 An entity may elect to use one of the following amounts as the deemed cost of an item of property, plant and equipment:
- (a) fair value at the date of transition to HKFRSs (paragraph 16 of the HKFRS), in which case the entity gives the disclosures required by paragraph 44 of the HKFRS;
 - (b) a revaluation under previous GAAP that meets the criteria in paragraph 17 of the HKFRS; or
 - (c) fair value at the date of an event such as a privatisation or initial public offering (paragraph 19 of the HKFRS).
- IG9 Subsequent depreciation is based on that deemed cost and starts from the date for which the entity established the fair value measurement or revaluation.
- IG10 ~~If an entity adopts the allowed alternative treatment in SSAP 17 for some or all classes of property, plant and equipment, it presents the cumulative revaluation surplus as a separate component of equity. The revaluation surplus at the date of transition to HKFRSs is based on a comparison of the carrying amount of the asset at that date with its cost or deemed cost. If the deemed cost is the fair value at the date of transition to HKFRSs, the entity gives the disclosures required by paragraph 44 of the HKFRS. If an entity chooses as its accounting policy the revaluation model in HKAS 16 for some or all classes of property, plant and equipment, it presents the cumulative revaluation surplus as a separate component of equity. The revaluation surplus at the date of transition to HKFRSs is based on a comparison of the carrying amount of the asset at that date with its cost or deemed cost. If the deemed cost is the fair value at the date of transition to HKFRSs, the entity gives the disclosures required by paragraph 44 of the HKFRS.~~
- IG11 If revaluations under previous GAAP did not satisfy the criteria in paragraph 17 or 19 of the HKFRS, an entity measures the revalued assets in its opening balance sheet on one of the following bases:
- (a) cost (or deemed cost) less any accumulated depreciation and any accumulated impairment losses under the cost model in HKAS 16 ~~SSAP 17 benchmark treatment~~;
 - ~~(b) deemed cost, being the fair value at the date of transition to HKFRSs (paragraph 16 of the HKFRS); or deemed cost, being the fair value at the date of transition to HKFRSs (paragraph 16 of the HKFRS); or~~
 - ~~(c) revalued amount, if the entity adopts the SSAP 17 allowed alternative treatment as its accounting policy under HKFRSs for all assets in the same class. revalued amount, if the entity adopts the revaluation model in HKAS 16 as its accounting policy under HKFRSs for all items of property, plant and equipment in the same class.~~

- IG12 ~~Some assets are made up of components that have different useful lives or provide benefits to the entity in different patterns. Under SSAP 17, the entity accounts for these components as separate assets (see SSAP 17, paragraphs 13 and 27 to 29). HKAS 16 requires each part of an item of property, plant equipment with a cost that is significant in relation to the cost of the item to be depreciated separately. However, HKAS 16 does not prescribe the unit of measure for recognition of an asset, ie what constitutes an item of property, plant and equipment. Thus, judgement is required in applying recognition criteria to an entity's specific circumstances (see HKAS 16, paragraphs 9 and 43).~~
- IG13 In some cases, the construction or commissioning of an asset results in an obligation for an entity to dismantle or remove the asset and restore the site on which the asset stands. An entity applies ~~SSAP 28~~ HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* in recognising and measuring any resulting provision. The entity applies ~~SSAP 17~~ HKAS 16 in determining the resulting amount included in the cost of the asset, before depreciation and impairment losses. Items such as depreciation and, when applicable, impairment losses cause differences between the carrying amount of the provision and the amount included in the carrying amount of the asset. An entity accounts for changes in such liabilities in accordance with HK(IFRIC)-Int 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*. However, paragraph 25E of HKFRS 1 provides an exemption for changes that occurred before the date of transition to HKFRSs, and prescribes an alternative treatment where the exemption is used. An example of the first-time adoption of HK(IFRIC)-Int 1, which illustrates the use of this exemption, is given at paragraphs IG201-IG203.

~~SSAP 14~~ HKAS 17 *Leases*

- IG14 At the date of transition to HKFRSs, a lessee or lessor classifies leases as operating leases or finance leases on the basis of circumstances existing at the inception of the lease (~~SSAP 14~~ HKAS 17, paragraph ~~40~~13). In some cases, the lessee and the lessor may agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification under ~~SSAP 14~~ HKAS 17 had the changed terms been in effect at the inception of the lease. If so, the revised agreement is considered as a new agreement over its term. However, changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased property) or changes in circumstances (for example, default by the lessee) do not give rise to a new classification of a lease.
- IG15 When ~~SSAP 14~~ HKAS 17 was ~~revised~~ issued in ~~2000~~2004, the net cash investment method for recognising finance income of lessors was eliminated. ~~SSAP 14~~ HKAS 17 permits finance lessors to eliminate this method prospectively. However, the transitional provisions in ~~SSAP 14~~ HKAS 17 do not apply to an entity's opening HKFRS balance sheet (paragraph 9 of the HKFRS). Therefore, a finance lessor measures finance lease receivables in its opening HKFRS balance sheet as if the net cash investment method had never been permitted.
- IG16 ~~SSAP 14 paragraphs 27, 28, 48 and 49~~ HK(SIC)-Int 15 *Operating Leases - Incentives*, dealing with the accounting of an incentive arising from an operating lease, apply to lease terms beginning on or after 1 ~~July 2000~~ January 2005. However, a first-time adopter applies those paragraphs to all leases, whether they started before or after that date.

~~SSAP~~ HKAS 18 *Revenue*

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

HKAS 19 *Employee Benefits*

- IG18 At the date of transition to HKFRSs, an entity applies HKAS 19 in measuring net employee benefit assets or liabilities under defined benefit plans, but it may elect to recognise all cumulative actuarial gains or losses from the inception of the plan until the date of transition to HKFRSs even if its accounting policy under HKAS 19 will involve leaving some later actuarial gains and losses unrecognised (paragraph 20 of the HKFRS). The transitional provisions in HKAS 19 do not apply to an entity's opening HKFRS balance sheet (paragraph 9 of the HKFRS).
- IG19 An entity's actuarial assumptions at the date of transition to HKFRSs are consistent with actuarial assumptions made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 31 of the HKFRS). The impact of any later revisions to those assumptions is an actuarial gain or loss of the period in which the entity makes the revisions.
- IG20 An entity may need to make actuarial assumptions at the date of transition to HKFRSs that were not necessary under its previous GAAP. Such actuarial assumptions do not reflect conditions that arose after the date of transition to HKFRSs. In particular, discount rates and the fair value of plan assets at the date of transition to HKFRSs reflect market conditions at that date. Similarly, the entity's actuarial assumptions at the date of transition to HKFRSs about future employee turnover rates do not reflect a significant increase in estimated employee turnover rates as a result of a curtailment of the pension plan that occurred after the date of transition to HKFRSs (paragraph [3233](#) of the HKFRS).
- IG21 In many cases, an entity's first HKFRS financial statements will reflect measurements of employee benefit obligations at three dates: the reporting date, the date of the comparative balance sheet and the date of transition to HKFRSs. HKAS 19 encourages an entity to involve a qualified actuary in the measurement of all material post-employment benefit obligations. To minimise costs, an entity may request a qualified actuary to carry out a detailed actuarial valuation at one or two of these dates and roll the valuation(s) forward or back to the other date(s). Any such roll forward or roll back reflects any material transactions and other material events (including changes in market prices and interest rates) between those dates (HKAS 19, paragraph 57).

HKAS 21 *The Effects of Changes in Foreign Exchange Rates*

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

HKFRS 3 *Business Combinations*

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

IG Example 2: Business combination**BACKGROUND**

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

- (a) classified the business combination as an acquisition by entity B.
- (b) measured the assets acquired and liabilities assumed at the following amounts under previous GAAP at 31 December 2003 (date of transition to HKFRSs):
 - (i) identifiable assets less liabilities for which HKFRSs require cost-based measurement at a date after the business combination: 200 (with a tax base of 150 and an applicable tax rate of 30 per cent).
 - (ii) pension liability (for which the present value of the defined benefit obligation measured under ~~SSAP 34~~ [HKAS 19](#) *Employee Benefits* is 130 and the fair value of plan assets is 100): nil (because entity B used a pay-as-you-go cash method of accounting for pensions under its previous GAAP). The tax base of the pension liability is also nil.
 - (iii) goodwill: 180.
- (c) did not, at the date of acquisition, recognise deferred tax arising from temporary differences associated with the identifiable assets acquired and liabilities assumed.

APPLICATION OF REQUIREMENTS

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

- (a) classifies the business combination as an acquisition by entity B even if the business combination would have qualified under ~~SSAP 30~~ [HKFRS 3](#) as a reverse acquisition by subsidiary C (paragraph B2(a) of the HKFRS).
- (b) does not adjust the accumulated amortisation of goodwill. Entity B tests the goodwill for impairment under ~~SSAP 34~~ [HKAS 36](#) *Impairment of Assets* and recognises any resulting impairment loss, based on conditions that existed at the date of transition to HKFRSs. If no impairment exists, the carrying amount of the goodwill remains at 180 (paragraph B2(g)).
- (c) for those net identifiable assets acquired for which HKFRSs require cost-based measurement at a date after the business combination, treats their carrying amount under previous GAAP immediately after the business combination as their deemed cost at that date (paragraph B2(e)).
- (d) does not restate the accumulated depreciation and amortisation of the net identifiable assets in (c), unless the depreciation methods and rates under previous GAAP result in amounts that differ materially from those required under HKFRSs (for example, if they were adopted solely for tax purposes and do not reflect a reasonable estimate of the asset's useful life under HKFRSs). If no such restatement is made, the carrying amount of those assets in the opening HKFRS balance sheet equals their carrying amount under previous GAAP at the date of transition to HKFRSs (200) (paragraph IG7).
- (e) if there is any indication that identifiable assets are impaired, tests those assets for impairment, based on conditions that existed at the date of transition to HKFRSs (see ~~SSAP 34~~ [HKAS 36](#) *Impairment of Assets*).

- (f) recognises the pension liability, and measures it, at the present value of the defined benefit obligation (130) less the fair value of the plan assets (100), giving a carrying amount of 30, with a corresponding debit of 30 to retained earnings (paragraph B2(d)). However, if subsidiary C had already adopted HKFRSs in an earlier period, entity B would measure the pension liability at the same amount as in subsidiary C's separate financial statements (paragraph 25 of the HKFRS and IG Example 9).
- (g) recognises a net deferred tax liability of 6 (20 at 30 per cent) arising from:
- (i) the taxable temporary difference of 50 (200 less 150) associated with the identifiable assets acquired and non-pension liabilities assumed, less
 - (ii) the deductible temporary difference of 30 (30 less nil) associated with the pension liability.

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

IG Example 3: Business combination – restructuring provision

BACKGROUND

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

- (a) had paid restructuring costs of 60; and
- (b) estimated that it would pay further costs of 40 in 2004, and that the effect of discounting were immaterial. At 31 December 2003, those further costs did not qualify for recognition as a provision under HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

APPLICATION OF REQUIREMENTS

In its opening HKFRS balance sheet, entity D:

- (a) does not recognise a restructuring provision (paragraph B2(c) of the HKFRS).
- (b) does not adjust the amount assigned to goodwill. However, entity D tests the goodwill for impairment under HKAS 36 *Impairment of Assets*, and recognises any resulting impairment loss (paragraph B2(g)).
- (c) as a result of (a) and (b), reports retained earnings in its opening HKFRS balance sheet that are higher by 40 (before income taxes, and before recognising any impairment loss) that in the balance sheet at the same date under previous GAAP.

IG Example 4: Business combination – intangible assets**BACKGROUND**

Entity F's first HKFRS financial statements have a reporting date of 31 December 2005 and include comparative information for 2004 only. On 1 July 2001, entity F acquired 75 per cent of subsidiary G. Under its previous GAAP, entity F assigned an initial carrying amount of 200 to intangible assets that would not have qualified for recognition under ~~SSAP 29~~ [HKAS 38](#) *Intangible Assets*. The tax base of the intangible assets was nil, giving rise to a deferred tax liability (at 30 per cent) of 60. ~~Under SSAP 30 Business Combinations, entity F measured minority interests at the minority's share of the fair value of the identifiable net assets acquired.~~

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

APPLICATION OF REQUIREMENTS

Because the intangible assets do not qualify for recognition as separate assets under ~~SSAP 29~~ [HKAS 38](#), entity F transfers them to goodwill, together with the related deferred tax liability (48) and minority interests (paragraph B2(g)(i) of the HKFRS). The related minority interests amount to 28 (25 per cent of [160 - 48 = 112]). Thus, the increase in goodwill is 84 – intangible assets (160) less deferred tax liability (48) less minority interests (28).

Entity F tests the goodwill for impairment under ~~SSAP 31~~ [HKAS 36](#) *Impairment of Assets* and recognises any resulting impairment loss, based on conditions that existed at the date of transition to HKFRSs (paragraph B2(g)(iii) of the HKFRS).

IG Example 5: Business combination – goodwill deducted from equity and treatment of related intangible assets**BACKGROUND**

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

- (a) recognised goodwill as an immediate deduction from equity;
- (b) recognised an intangible asset of the subsidiary that does not qualify for recognition as an asset under ~~SSAP 29~~ [HKAS 38](#); and
- (c) did not recognise an intangible asset of the subsidiary that would qualify under ~~SSAP 29~~ [HKAS 38](#) *Intangible Assets* for recognition as an asset in the financial statements of the subsidiary. The subsidiary held the asset at the date of its acquisition by entity H.

APPLICATION OF REQUIREMENTS

In its opening HKFRS balance sheet, entity H:

- (a) does not recognise the goodwill, as it did not recognise the goodwill as an asset under previous GAAP (paragraph B2(g)-B2(i)).
- (b) does not recognise the intangible asset that does not qualify for recognition as an asset under ~~SSAP 29~~ [HKAS 38](#). Because entity H deducted goodwill from equity under its previous GAAP, the elimination of this intangible asset reduces retained earnings (paragraph B2(c)(ii)).

- (c) recognises the intangible asset that qualifies under ~~SSAP 29~~ [HKAS 38](#) for recognition as an asset in the separate financial statements of the subsidiary, even though the amount assigned to it under previous GAAP in entity H's consolidated financial statements was nil (paragraph B2(f)). The recognition criteria in ~~SSAP 29~~ [HKAS 38](#) include the availability of a reliable measurement of cost (paragraphs IG45-IG48) and entity H measures the asset at cost less accumulated depreciation and less any impairment losses identified under ~~SSAP 31~~ [HKAS 36](#). Because entity H deducted goodwill from equity under its previous GAAP, the recognition of this intangible asset increases retained earnings (paragraph B2(c)(ii)). However, if this intangible asset had been subsumed in goodwill recognised as an asset under previous GAAP, entity H would have decreased the carrying amount of that goodwill accordingly (and, if applicable, adjusted deferred tax and minority interests) (paragraph B2(g)(i)).

IG Example 6: Business combination – subsidiary not consolidated under previous GAAP

BACKGROUND

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

- (a) the cost of parent J's investment in subsidiary K is 180.
- (b) under HKFRSs, subsidiary K would measure its assets at 500 and its liabilities (including deferred tax under ~~SSAP 12~~ [HKAS 12](#)) at 300. On this basis, subsidiary K's net assets are 200 under HKFRSs.

APPLICATION OF REQUIREMENTS

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

- (a) subsidiary K's assets at 500 and liabilities at 300;
- (b) minority interests of 50 (25 per cent of [500-300]); and
- (c) goodwill of 30 (cost of 180 less 75 per cent of [500-300]) (paragraph B2(j)). Parent J tests the goodwill for impairment under ~~SSAP 31~~ [HKAS 36](#) *Impairment of Assets* and recognises any resulting impairment loss, based on conditions that existed at the date of transition to HKFRSs (paragraph B2(g)(iii)).

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

BACKGROUND

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

APPLICATION OF REQUIREMENTS

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

~~SSAP 19~~ HKAS 23 *Borrowing Costs*

- IG23 On first adopting HKFRSs, an entity adopts a policy of capitalising borrowing costs (HKAS 23 allowed alternative treatment) or not capitalising them (HKAS 23 benchmark treatment). The entity applies that policy consistently in its opening HKFRS balance sheet and in all periods presented in its first HKFRS financial statements. However, if the entity established a deemed cost for an asset, the entity does not capitalise borrowing costs incurred before the date of the measurement that established the deemed cost.
- IG24 Under the allowed alternative treatment, ~~SSAP 19~~ HKAS 23 requires disclosure of interest capitalised during the period. Neither ~~SSAP 19~~ HKAS 23 nor the HKFRS requires disclosure of the cumulative amount capitalised.
- IG25 ~~SSAP 19~~ HKAS 23 contains transitional provisions that encourage retrospective application, but permit an entity that adopts the allowed alternative treatment to capitalise (prospectively) only those borrowing costs incurred after the effective date of ~~SSAP 19~~ HKAS 23 that meet the criteria for capitalisation. However, if a first time adopter adopts the HKAS 23 allowed alternative treatment, the HKFRS requires retrospective application even for periods before the effective date of ~~SSAP 19~~ HKAS 23 (paragraph 9 of the HKFRS).

~~SSAP 32~~ HKAS 27 *Consolidated and Separate Financial Statements and Accounting for Investments in Subsidiaries*

- IG26 A first-time adopter consolidates all subsidiaries that it controls, unless ~~SSAP 32~~ HKAS 27 requires otherwise.
- IG27 If a first-time adopter did not consolidate a subsidiary under previous GAAP, then:
- (a) in its consolidated financial statements, the first-time adopter measures the subsidiary's assets and liabilities at the same carrying amounts as in the separate HKFRS financial statements of the subsidiary, after adjusting for consolidation procedures and for the effects of the business combination in which it acquired the subsidiary (paragraph 25 of the HKFRS). If the subsidiary has not adopted HKFRSs in its separate financial statements, the carrying amounts described in the previous sentence are those that HKFRSs would require in those separate financial statements (paragraph B2(j) of the HKFRS).
 - (b) if the parent acquired the subsidiary in a business combination before the date of transition to HKFRS, the parent recognises goodwill, as explained in IG Example 6.
 - (c) if the parent did not acquire the subsidiary in a business combination because it created the subsidiary, the parent does not recognise goodwill.
- IG28 When a first-time adopter adjusts the carrying amounts of assets and liabilities of its subsidiaries in preparing its opening HKFRS balance sheet, this may affect minority interests and deferred tax.
- IG29 IG Examples 8 and 9 illustrate paragraphs 24 and 25 of the HKFRS, which address cases where a parent and its subsidiary become first-time adopters at different dates.

IG Example 8: Parent adopts HKFRSs before subsidiary**BACKGROUND**

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

APPLICATION OF REQUIREMENTS

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

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

IG Example 9: Subsidiary adopts HKFRSs before parent**BACKGROUND**

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

APPLICATION OF REQUIREMENTS

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

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

- (a) to apply Appendix B of the HKFRS to assets acquired, and liabilities assumed, in a business combination that occurred before the acquirer's date of transition to HKFRSs. However, the acquirer applies paragraph 25 to new assets acquired, and liabilities assumed, by the acquiree after that business combination and still held at the acquirer's date of transition to HKFRSs.
- (b) to apply the rest of the HKFRS in measuring all assets and liabilities for which paragraphs 24 and 25 are not relevant.
- (c) to give all disclosures required by the HKFRS as of the first-time adopter's own date of transition to HKFRSs.

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

HKAS 29 *Financial Reporting in Hyperinflationary Economies*²

- IG32 ~~An entity complies with IAS 21 The Effects of Changes in Foreign Exchange Rates in determining its measurement currency and presentation currency (see SIC-19 Reporting Currency—Measurement and Presentation of Financial Statements under IAS 21 and IAS 29). When the entity prepares its opening HKFRS balance sheet, it applies IAS 292 to any periods during which the economy of the measurement currency or presentation currency was hyperinflationary. An entity complies with HKAS 21 The Effects of Changes in Foreign Exchange Rates in determining its functional currency and presentation currency. When the entity prepares its opening HKFRS balance sheet, it applies HKAS 29 to any periods during which the economy of the functional currency or presentation currency was hyperinflationary.~~
- IG33 An entity may elect to use the fair value of an item of property, plant and equipment at the date of transition to HKFRSs as its deemed cost at that date (paragraph 16 of the HKFRS), in which case it gives the disclosures required by paragraph 44 of the HKFRS.
- IG34 If an entity elects to use the exemptions in paragraphs 16-19 of the HKFRS, it applies HKAS 29 to periods after the date for which the revalued amount or fair value was determined.

HKAS 32 *Financial Instruments: Disclosure and Presentation*³

- IG35 In its opening HKFRS balance sheet, an entity applies the criteria in HKAS 32 to classify financial instruments issued (or components of compound instruments issued) as either financial liabilities or equity instruments in accordance with the substance of the contractual arrangement when the instrument first satisfied the recognition criteria in HKAS 32 (paragraphs ~~48~~15 and ~~26~~30), without considering events after that date (other than changes to the terms of the instruments).
- IG36 ~~For compound instruments outstanding at the date of transition to HKFRSs, an entity determines the initial carrying amounts of the components on the basis of circumstances existing when the instrument was issued (IAS 32, paragraph 26). An entity determines those carrying amounts using the version of IAS 32 effective at the reporting date for its first HKFRS financial statements. If the liability component is no~~

² ~~At the time of issue of this HKFRS, proposed SSAPs based on IAS 29 and the IASB's proposed revised IAS 21 (included in the IASB's Exposure Draft "Improvements to International Accounting Standards") have been issued as exposure drafts. In accordance with paragraph 23 of SSAP 1, management should consider IAS 21 and IAS 29. Notwithstanding this, until the proposed SSAPs based on IAS 21 and IAS 29 become effective, IG32-IG34 are only relevant to those first-time adopters that elect to follow IAS 21 and IAS 29.~~

³ ~~At the time of issue of this HKFRS, a proposed SSAP based on the IASB's proposed revision to IAS 32 has been issued as an exposure draft. In accordance with paragraph 23 of SSAP 1, management should consider IAS 32 when accounting for a financial instrument. Notwithstanding this, until the proposed SSAP based on IAS 32 becomes effective, IG 35 and IG 36 are only relevant to those first-time adopters that elect to follow IAS 32.~~

~~longer outstanding at the date of transition to HKFRSs, a first-time adopter need not separate the initial equity component of the instrument from the cumulative interest accreted on the liability component (paragraph 23 of the HKFRS). For compound instruments outstanding at the date of transition to HKFRSs, an entity determines the initial carrying amounts of the components on the basis of circumstances existing when the instrument was issued (HKAS 32, paragraph 30). An entity determines those carrying amounts using the version of HKAS 32 effective at the reporting date for its first HKFRS financial statements. If the liability component is no longer outstanding at the date of transition to HKFRSs, a first-time adopter need not separate the initial equity component of the instrument from the cumulative interest accreted on the liability component (paragraph 28 of the HKFRS).~~

~~SSAP 25~~ **HKAS 34** *Interim Financial Reporting*

IG37 ~~SSAP 25~~ **HKAS 34** applies if an entity is required, or elects, to present an interim financial report in accordance with HKFRSs. Accordingly, neither ~~SSAP 25~~ **HKAS 34** nor the HKFRS requires an entity:

- (a) to present interim financial reports that comply with ~~SSAP 25~~ **HKAS 34**; or
- (b) to prepare new versions of interim financial reports presented under previous GAAP. However, if an entity does prepare an interim financial report under ~~SSAP 25~~ **HKAS 34** for part of the period covered by its first HKFRS financial statements, the entity restates the comparative information presented in that report so that it complies with HKFRSs.

IG38 An entity applies the HKFRS in each interim financial report that it presents under ~~SSAP 25~~ **HKAS 34** for part of the period covered by its first HKFRS financial statements. In particular, paragraph 45 of the HKFRS requires an entity to disclose various reconciliations (see IG Example 10).

IG Example 10: Interim financial reporting

BACKGROUND

Entity R's first HKFRS financial statements have a reporting date of 31 December 2005, and its first interim financial report under ~~SSAP 25~~ **HKAS 34** is for the quarter ended 31 March 2005. Entity R prepared previous GAAP annual financial statements for the year ended 31 December 2004, and prepared quarterly reports throughout 2004.

APPLICATION OF REQUIREMENTS

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

- (a) its equity under previous GAAP at the end of the comparable quarter of 2004 to its equity under HKFRSs at that date; and
- (b) its profit or loss under previous GAAP for the comparable quarter of 2004 (current and year-to-date) to its profit or loss under HKFRSs.

In addition to the reconciliations required by (a) and (b) and the disclosures required by ~~SSAP 25~~ **HKAS 34**, entity R's interim financial report for the first quarter of 2005 includes reconciliations of (or a cross-reference to another published document that includes these reconciliations):

- (a) its equity under previous GAAP at 1 January 2004 and 31 December 2004 to its equity under HKFRSs at those dates; and
- (b) its profit or loss for 2004 under previous GAAP to its profit or loss for 2004 under HKFRSs.

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

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

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

~~SSAP 31~~ HKAS 36 *Impairment of Assets* and ~~SSAP 28~~ HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

- IG39 An entity applies ~~SSAP 31~~ HKAS 36 in:
- (a) determining whether any impairment loss exists at the date of transition to HKFRSs; and
 - (b) measuring any impairment loss that exists at that date, and reversing any impairment loss that no longer exists at that date. An entity's first HKFRS financial statements include the disclosures that ~~SSAP 31~~ HKAS 36 would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition to HKFRSs (paragraph 39(c) of the HKFRS).
- IG40 The estimates used to determine whether an entity recognises an impairment loss or provision (and to measure any such impairment loss or provision) at the date of transition to HKFRSs are consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error (paragraphs 31 and 32 of the HKFRS). The entity reports the impact of any later revisions to those estimates as an event of the period in which it makes the revisions.
- IG41 In assessing whether it needs to recognise an impairment loss or provision (and in measuring any such impairment loss or provision) at the date of transition to HKFRSs, an entity may need to make estimates for that date that were not necessary under its previous GAAP. Such estimates and assumptions do not reflect conditions that arose after the date of transition to HKFRSs (paragraph 33 of the HKFRS).
- IG42 The transitional provisions in ~~SSAP 31~~ HKAS 36 and ~~SSAP 28~~ HKAS 37 do not apply to an entity's opening HKFRS balance sheet (paragraph 9 of the HKFRS).
- IG43 ~~SSAP 31~~ HKAS 36 requires the reversal of impairment losses in some cases. If an entity's opening HKFRS balance sheet reflects impairment losses, the entity recognises any later reversal of those impairment losses in the income statement (except when ~~SSAP 31~~ HKAS 36 requires the entity to treat that reversal as a

revaluation). This applies to both impairment losses recognised under previous GAAP and additional impairment losses recognised on transition to HKFRSs.

~~SSAP 29~~ HKAS 38 *Intangible Assets*

- IG44 An entity's opening HKFRS balance sheet:
- (a) excludes all intangible assets and other intangible items that do not meet the criteria for recognition under ~~SSAP 29~~ HKAS 38 at the date of transition to HKFRSs; and
 - (b) includes all intangible assets that meet the recognition criteria in ~~SSAP 29~~ HKAS 38 at that date, except for intangible assets acquired in a business combination that were not recognised in the acquirer's consolidated balance sheet under previous GAAP and also would not qualify for recognition under ~~SSAP 29~~ HKAS 38 in the separate balance sheet of the acquiree (see paragraph B2(f) of Appendix B of the HKFRS).
- IG45 The criteria in ~~SSAP 29~~ HKAS 38 require an entity to recognise an intangible asset if, and only if:
- (a) it is probable that the future economic benefits that are attributable to the asset will flow to the entity; and
 - (b) the cost of the asset can be measured reliably.
- ~~SSAP 29~~ HKAS 38 supplements these two criteria with further, more specific, criteria for internally generated intangible assets.
- IG46 Under paragraphs ~~5365~~ and ~~5971~~ of ~~SSAP 29~~ HKAS 38, an entity capitalises the costs of creating internally generated intangible assets prospectively from the date when the recognition criteria are met. ~~SSAP 29~~ HKAS 38 does not permit an entity to use hindsight to conclude retrospectively that these recognition criteria are met. Therefore, even if an entity concludes retrospectively that a future inflow of economic benefits from an internally generated intangible asset is probable and the entity is able to reconstruct the costs reliably, ~~SSAP 29~~ HKAS 38 prohibits it from capitalising the costs incurred before the date when the entity both:
- (a) concludes, based on an assessment made and documented at the date of that conclusion, that it is probable that future economic benefits from the asset will flow to the entity; and
 - (b) has a reliable system for accumulating the costs of internally generated intangible assets when, or shortly after, they are incurred.
- IG47 If an internally generated intangible asset qualifies for recognition at the date of transition to HKFRSs, an entity recognises the asset in its opening HKFRS balance sheet even if it had recognised the related expenditure as an expense under previous GAAP. If the asset does not qualify for recognition under ~~SSAP 29~~ HKAS 38 until a later date, its cost is the sum of the expenditure incurred from that later date.
- IG48 The criteria discussed in paragraph IG45 also apply to an intangible asset acquired separately. In many cases, contemporaneous documentation prepared to support the decision to acquire the asset will contain an assessment of the future economic benefits. Furthermore, as explained in paragraph ~~2326~~ of ~~SSAP 29~~ HKAS 38, the cost of a separately acquired intangible asset can usually be measured reliably.

- IG49 For an intangible asset acquired in a business combination before the date of transition to HKFRSs, its carrying amount under previous GAAP immediately after the business combination is its deemed cost under HKFRSs at that date (paragraph B2(e) of the HKFRS). If that carrying amount was zero, the acquirer does not recognise the intangible asset in its consolidated opening HKFRS balance sheet, unless it would qualify under ~~SSAP 29~~ HKAS 38, applying the criteria discussed in paragraphs IG45-IG48, for recognition at the date of transition to HKFRSs in the separate balance sheet of the acquiree (paragraph B2(f) of the HKFRS). If those recognition criteria are met, the acquirer measures the asset on the basis that ~~SSAP 29~~ HKAS 38 would require in the separate balance sheet of the acquiree. The resulting adjustment affects goodwill (paragraph B2(g)(i) of the HKFRS).
- IG50 A first-time adopter may elect to use the fair value of an intangible asset at the date of an event such as a privatisation or initial public offering as its deemed cost at the date of that event (paragraph 19 of the HKFRS), provided that the intangible asset qualifies for recognition under ~~SSAP 29~~ HKAS 38 (paragraph 10 of the HKFRS). In addition, if, and only if, an intangible asset meets both the recognition criteria in ~~SSAP 29~~ HKAS 38 (including reliable measurement of original cost) and the criteria in ~~SSAP 29~~ HKAS 38 for revaluation (including the existence of an active market), a first-time adopter may elect to use one of the following amounts as its deemed cost (paragraph 18 of the HKFRS):
- (a) fair value at the date of transition to HKFRSs (paragraph 16 of the HKFRS), in which case the entity gives the disclosures required by paragraph 44 of the HKFRS; or
 - (b) a revaluation under previous GAAP that meets the criteria in paragraph 17 of the HKFRS.
- IG51 If an entity's amortisation methods and rates under previous GAAP would be acceptable under HKFRSs, the entity does not restate the accumulated amortisation in its opening HKFRS balance sheet. Instead, the entity accounts for any change in estimated useful life or amortisation pattern prospectively from the period when it makes that change in estimate (paragraph 31 of the HKFRS and paragraph 94 of ~~SSAP 29~~ HKAS 38). However, in some cases, an entity's amortisation methods and rates under previous GAAP may differ from those that would be acceptable under HKFRSs (for example, if they were adopted solely for tax purposes and do not reflect a reasonable estimate of the asset's useful life). If those differences have a material effect on the financial statements, the entity adjusts the accumulated amortisation in its opening HKFRS balance sheet retrospectively so that it complies with HKFRSs (paragraph 31 of the HKFRS).

~~SSAP 24 Accounting for Investments in Securities~~

~~IG51A An entity applies SSAP 24 when accounting and reporting for investments in debt and equity securities, except those held either solely for the purpose of recovering advances, or as investments in subsidiaries, associates or joint ventures which are dealt with in accordance with SSAP 32, SSAP 10 and SSAP 21 respectively.~~

~~IG51B In preparing its opening HKFRS balance sheet, an entity applies the criteria in SSAP 24 to identify those securities that are measured at amortised cost, those that are measured at cost and those that are measured at fair value. In particular:~~

- ~~(a) to comply with SSAP 24, paragraph 10, classification of securities as held-to-maturity securities relies on a designation made by the entity in applying SSAP 24 reflecting the entity's intention and ability at the date of transition to HKFRSs. It follows that sales or transfers of held-to-maturity~~

~~securities before the date of transition to HKFRSs do not trigger the 'tainting' rules in SSAP 24, paragraph 14.~~

~~(b) to comply with SSAP 24, paragraph 19, an entity adopting the benchmark treatment under SSAP 24 classifies an investment other than a held-to-maturity security in its opening HKFRS balance sheet as an investment security if, and only if:~~

~~(i) the security is held for an identified long term purpose;~~

~~(ii) that purpose was documented at the date of acquisition or change of purpose; and~~

~~(iii) the security held for the documented purpose is clearly identifiable.~~

~~————— If the security does not meet the above criteria, it should be treated as other investment.~~

~~(c) to comply with SSAP 24, paragraph 27, an entity adopting the alternative treatment under SSAP 24 classifies an investment other than a held-to-maturity security in its opening HKFRS balance sheet as a security held for trading purposes if, and only if the security was acquired principally for the purpose of generating a profit from short-term fluctuation in price or dealer's margin. If the security does not meet the criteria for classifying as a security held for trading purposes, it should be treated as a security that is not held for trading purposes.~~

~~IG51C For held-to-maturity securities measured at amortised cost, and for investment securities carried at cost under the benchmark treatment for investments other than held-to-maturity securities, in the opening HKFRS balance sheet an entity determines their cost on the basis of circumstances existing when the securities first satisfied the recognition criteria in SSAP 24. However, if the entity acquired those securities in a past business combination, their carrying amount under previous GAAP immediately following the business combination is their deemed cost under HKFRSs at that date (paragraph B2(e) of the HKFRS).~~

~~IG51D For those securities measured at fair value with the changes in fair value being recognised in equity (i.e. securities that are not held for trading purposes under the alternative treatment of SSAP 24), an entity recognises the cumulative changes in their fair value at the date of transition to HKFRSs in a separate component of equity, rather than in retained earnings. On subsequent sale, collection, disposal or impairment of the securities, the entity transfers to the income statement the cumulative gain or loss previously recognised in equity (paragraph 28(b) of SSAP 24.)~~

~~IG51E An entity applies SSAP 24, paragraphs 31 to 39 in:~~

~~(a) determining whether any impairment loss exists in respect of the securities measured at amortised cost or cost at the date of transition to HKFRSs; and~~

~~(b) measuring any impairment loss that exists in respect of those securities at that date, and reversing any impairment loss that no longer exists at that date.~~

~~IG51F An entity's estimates of impairments of those securities measured at amortised cost or cost at the date of transition to HKFRSs are consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 31 of the HKFRS). The entity treats the impact of any later~~

~~revisions to those estimates as impairment losses (or if the criteria in SSAP 24 are met, reversals of impairment losses) of the period in which it makes the revisions.~~

HKAS 39 Financial Instruments: Recognition and Measurement⁴

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

Recognition

IG53 ~~An entity recognises all financial assets and financial liabilities (including all derivatives) that qualify for recognition under IAS 39 and have not yet qualified for derecognition under IAS 39, except financial assets or financial liabilities derecognised under previous GAAP in a financial year beginning before 1 January 2001 (see paragraph 27 of the HKFRS).~~ An entity recognises all financial assets and financial liabilities (including all derivatives) that qualify for recognition under HKAS 39 and have not yet qualified for derecognition under HKAS 39, except non-derivative financial assets and non-derivative financial liabilities derecognised under previous GAAP before 1 January 2004, to which the entity does not choose to apply paragraph 27A (see paragraphs 27 and 27A of the HKFRS). For example, an entity that does not apply paragraph 27A does not recognise assets transferred in a securitisation, transfer or other derecognition transaction that occurred before 1 January 2004 if those transactions qualified for derecognition under previous GAAP. However, if the entity uses the same securitisation arrangement or other derecognition arrangement for further transfers after 1 January 2004, those further transfers qualify for derecognition only if they meet the derecognition criteria of HKAS 39.

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

Embedded derivatives

IG55 ~~When IAS 39 requires an entity to separate an embedded derivative from a host contract, their initial carrying amounts at the date when the instrument first satisfies the recognition criteria in IAS 39 reflect circumstances at that date (IAS 39, paragraph 23). If the entity cannot determine the initial carrying amounts of the embedded derivative and host contract reliably, it treats the entire combined contract as a financial instrument held for trading (IAS 39, paragraph 26). This results in fair value measurement (except when the entity cannot determine a reliable fair value, see IAS 39, paragraph 70), with changes in fair value recognised in the income statement.~~ When HKAS 39 requires an entity to separate an embedded derivative from a host contract, the initial carrying amounts of the components at the date when the instrument first satisfies the recognition criteria in HKAS 39 reflect circumstances at that date (HKAS 39, paragraph 11). If the entity cannot determine the initial carrying amounts of the embedded derivative and host contract reliably, it treats the entire combined contract as a financial instrument held for trading (HKAS 39, paragraph 12).

⁴ ~~At the time of issue of this HKFRS, a proposed SSAP based on the IASB's proposed revision to IAS 39 has been issued as an exposure draft. In accordance with paragraph 23 of SSAP 1, management should consider IAS 39 when accounting for a financial instrument other than a security that falls within the scope of SSAP 24 Accounting for Investments in Securities. Notwithstanding this, until the proposed SSAP based on IAS 39 becomes effective, IG51 to IG60 are only relevant to those first-time adopters that elect to follow IAS 39 in accounting for a financial instrument other than a security that falls within the scope of SSAP 24.~~

This results in fair value measurement (except when the entity cannot determine a reliable fair value, see HKAS 39, paragraph 46(c)), with changes in fair value recognised in profit or loss.

Measurement

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

- ~~(a) to comply with IAS 39, paragraph 90, classification of financial assets as held-to-maturity investments relies on a designation made by the entity in applying IAS 39 reflecting the entity's intent and ability at the date of transition to HKFRSs. It follows that sales or transfers of held-to-maturity investments before the date of transition to HKFRSs do not trigger the 'tainting' rules in IAS 39, paragraph 83.~~
- ~~(b) to comply with IAS 39, paragraph 10, the category of 'loans and receivables originated by the enterprise' refers to the circumstances at origination.~~
- ~~(c) under IAS 39, paragraph 10, derivative financial assets and derivative financial liabilities are always deemed held for trading. The result is that an entity measures all derivative financial assets and derivative financial liabilities at fair value.~~
- ~~(d) to comply with IAS 39, paragraph 107, an entity classifies a non-derivative financial asset or non-derivative financial liability in its opening HKFRS balance sheet as held for trading if, and only if, the asset or liability was:

 - ~~(i) acquired or incurred principally for the purpose of selling or repurchasing it in the near term; or~~
 - ~~(ii) at the date of transition to HKFRSs, 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.~~~~
- ~~(e) to comply with IAS 39, paragraph 10, available-for-sale financial assets are a residual category of financial assets that do not fall into any of the previous categories.~~

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

- (a) to comply with HKAS 39, paragraph 51, classification of financial assets as held-to-maturity investments relies on a designation made by the entity in applying HKAS 39 reflecting the entity's intention and ability at the date of transition to HKFRSs. It follows that sales or transfers of held-to-maturity investments before the date of transition to HKFRSs do not trigger the 'tainting' rules in HKAS 39, paragraph 9.
- (b) to comply with HKAS 39, paragraph 9, the category of 'loans and receivables' refers to the circumstances when the financial asset first satisfied the recognition criteria in HKAS 39.
- (c) under HKAS 39, paragraph 9, derivative financial assets and derivative financial liabilities are always deemed held for trading (except for a derivative

that is a financial guarantee contract or a designated and effective hedging instrument). The result is that an entity measures at fair value all derivative financial assets and derivative financial liabilities that are not financial guarantee contracts at fair value.

- (d) to comply with HKAS 39, paragraph 50, an entity classifies a non-derivative financial asset or non-derivative financial liability in its opening HKFRS balance sheet as at fair value through profit or loss if, and only if, the asset or liability was:
- (i) acquired or incurred principally for the purpose of selling or repurchasing it in the near term;
 - (ii) at the date of transition to HKFRSs, part of a portfolio of identified financial instruments that were managed together and for which there was evidence of a recent actual pattern of short-term profit-taking; or
 - (iii) designated as at fair value through profit or loss at the date of transition to HKFRSs, for an entity that presents its first HKFRS financial statements for an annual period beginning on or after 1 January 2006.
 - (iv) designated as at fair value through profit or loss at the start of its first HKFRS reporting period, for an entity that presents its first HKFRS financial statements for an annual period beginning before 1 January 2006 and applies paragraphs 11A, 48A, AG4B-AG4K, AG33A and AG33B and the 2005 amendments in paragraphs 9, 12 and 13 of HKAS 39. If the entity restates comparative information for HKAS 39 it shall restate the comparative information only if the financial assets or financial liabilities designated at the start of its first HKFRS reporting period would have met the criteria for such designation in paragraph 9(b)(i), 9(b)(ii) or 11A of HKAS 39 at the date of transition to HKFRSs or, if acquired after the date of transition to HKFRSs, would have met the criteria in paragraph 9(b)(i), 9(b)(ii) or 11A at the date of initial recognition. For groups of financial assets, financial liabilities or both that are designated in accordance with paragraph 9(b)(ii) of HKAS 39 at the start of the first HKFRS reporting period, the comparative financial statements should be restated for all the financial assets and financial liabilities within the groups at the date of transition to HKFRSs even if individual financial assets or liabilities within a group were derecognised during the comparative period.
- (e) to comply with HKAS 39, paragraph 9, available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale and those non-derivative financial assets that are not in any of the previous categories.

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

IG58 An entity's estimates of loan impairments at the date of transition to HKFRSs are consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 31 of the HKFRS). The entity treats the impact of any later revisions to those estimates as impairment losses

(or, if the criteria in HKAS 39 are met, reversals of impairment losses) of the period in which it makes the revisions.

Transition adjustments

- IG58A An entity shall treat an adjustment to the carrying amount of a financial asset or financial liability as a transition adjustment to be recognised in the opening balance of retained earnings at the date of transition to HKFRSs only to the extent that it results from adopting HKAS 39. Because all derivatives, other than those that are financial guarantee contracts or are designated and effective hedging instruments, are classified as held for trading, the differences between the previous carrying amount (which may have been zero) and the fair value of the derivatives shall be recognised as an adjustment of the balance of retained earnings at the beginning of the financial year in which HKAS 39 is initially applied (other than for a derivative that is a financial guarantee contracts or a designated and effective hedging instrument).
- IG58B HKAS 8 applies to adjustments resulting from changes in estimates. If an entity is unable to determine whether a particular portion of the adjustment is a transition adjustment or a change in estimate, it treats that portion as a change in accounting estimate under HKAS 8, with appropriate disclosures (HKAS 8, paragraphs 32-40).
- IG59 An entity may, under its previous GAAP, have measured investments at fair value and recognised the revaluation gain directly in equity. If an investment is classified as at fair value through profit or loss, the pre-HKAS 39 revaluation gain that had been recognised in equity is reclassified into retained earnings on initial application of HKAS 39. If, on initial application of HKAS 39, an investment is classified as available for sale, then the pre-HKAS 39 revaluation gain is recognised in a separate component of equity. Subsequently, the entity recognises gains and losses on the available-for-sale financial asset in that separate component of equity until the investment is impaired, sold, collected or otherwise disposed of. On subsequent derecognition or impairment of the available-for-sale financial asset, the entity transfers to profit or loss the cumulative gain or loss remaining in equity (HKAS 39, paragraph 55(b)).

Hedge accounting

- IG60 Paragraphs 28-30 of the HKFRS deal with hedge accounting. The designation and documentation of a hedge relationship must be completed on or before the date of transition to HKFRSs if the hedge relationship is to qualify for hedge accounting from that date. Hedge accounting can be applied prospectively only from the date that the hedge relationship is fully designated and documented.
- IG60A An entity may, under its previous GAAP, have deferred or not recognised gains and losses on a fair value hedge of a hedged item that is not measured at fair value. For such a fair value hedge, an entity adjusts the carrying amount of the hedged item at the date of transition to HKFRSs. The adjustment is the lower of:
- (a) that portion of the cumulative change in the fair value of the hedged item that reflects the designated hedged risk and was not recognised under previous GAAP; and

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

IG60B An entity may, under its previous GAAP, have deferred gains and losses on a cash flow hedge of a forecast transaction. If, at the date of transition to HKFRSs, the hedged forecast transaction is not highly probable, but is expected to occur, the entire deferred gain or loss is recognised in equity. Any net cumulative gain or loss that has been reclassified to equity on initial application of HKAS 39 remains in equity until (a) the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, (b) the forecast transaction affects profit or loss or (c) subsequently circumstances change and the forecast transaction is no longer expected to occur, in which case any related net cumulative gain or loss that had been recognised directly in equity is recognised in profit or loss. If the hedging instrument is still held, but the hedge does not qualify as a cash flow hedge under HKAS 39, hedge accounting is no longer appropriate starting from the date of transition to HKFRSs.

SSAP 13 HKAS 40 Accounting for Investment Properties

IG61 An entity that adopts the fair value model in ~~SSAP 13~~ HKAS 40 measures its investment property at fair value at the date of transition to HKFRSs.

IG62 An entity that applies ~~the exemption from open market value~~ the cost model in ~~SSAP 13~~ HKAS 40 applies paragraphs IG7-IG13 on property, plant and equipment.

Explanation of transition to HKFRSs

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

IG Example 11: Reconciliation of equity and profit or loss

BACKGROUND

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

APPLICATION OF REQUIREMENTS

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

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

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

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

RECONCILIATION OF EQUITY AT 1 JANUARY 2004 (DATE OF TRANSITION TO HKFRSS)				
<i>Note</i>		<i>Previous GAAP</i>	<i>Effect of transition to HKFRSS</i>	<i>HKFRSSs</i>
1	Property, plant and equipment	8,299	100	8,399
2	Goodwill	1,220	150	1,370
2	Intangible assets	208	(150)	58
3	Financial assets	<u>3,471</u>	<u>420</u>	<u>3,891</u>
	Total non-current assets	<u>13,198</u>	<u>520</u>	<u>13,718</u>
	Trade and other receivables	3,710	0	3,710
4	Inventories	2,962	400	3,362
5	Other receivables	333	431	764
	Cash and cash equivalents	<u>748</u>	<u>0</u>	<u>748</u>
	Total current assets	<u>7,753</u>	<u>831</u>	<u>8,584</u>
	Total assets	<u>20,951</u>	<u>1,351</u>	<u>22,302</u>
	Interest-bearing loans	9,396	0	9,396
	Trade and other payables	4,124	0	4,124
6	Employee benefits	0	66	66
7	Restructuring provision	250	(250)	0
	Current tax liability	42	0	42
8	Deferred tax liability	<u>579</u>	<u>460</u>	<u>1,039</u>
	Total liabilities	<u>14,391</u>	<u>276</u>	<u>14,667</u>
	Total assets less total liabilities	<u>6,560</u>	<u>1,075</u>	<u>7,635</u>
	Issued capital	1,500	0	1,500
3	Revaluation reserve	0	294	294
5	Hedging reserve	0	302	302
9	Retained earnings	<u>5,060</u>	<u>479</u>	<u>5,539</u>
	Total equity	<u>6,560</u>	<u>1,075</u>	<u>7,635</u>

NOTES TO THE RECONCILIATION OF EQUITY AT 1 JANUARY 2004:

- 1 Depreciation was influenced by tax requirements under previous GAAP, but under HKFRSs reflects the useful life of the assets. The cumulative adjustment increased the carrying amount of property, plant and equipment by 100.
- 2 Intangible assets under previous GAAP included 150 for items that are transferred to goodwill because they do not qualify for recognition as intangible assets under HKFRSs.
- 3 Financial assets are all classified as available-for-sale under HKFRSs and are carried at their fair value of 3,891. They were carried at cost of 3,471 under previous GAAP. The resulting gains of 294 (420, less related deferred tax of 126) are included in the revaluation reserve.
- 4 Inventories include fixed and variable production overhead of 400 under HKFRSs, but this overhead was excluded under previous GAAP.
- 5 Unrealised gains of 431 on unmatured forward foreign exchange contracts are recognised under HKFRSs, but were not recognised under previous GAAP. The resulting gains of 302 (431, less related deferred tax of 129) are included in the hedging reserve because the contracts hedge forecast sales.
- 6 A pension liability of 66 is recognised under HKFRSs, but was not recognised under previous GAAP, which used a cash basis.
- 7 A restructuring provision of 250 relating to head office activities was recognised under previous GAAP, but does not qualify for recognition as a liability under HKFRSs.
- 8 The above changes increased the deferred tax liability as follows:

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

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

- 9 The adjustments to retained earnings are as follows:

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

RECONCILIATION OF PROFIT OR LOSS FOR 2004			
<i>Note</i>	<i>Previous GAAP</i>	<i>Effect of transition to HKFRSs</i>	<i>HKFRSs</i>
	Revenue	20,910	20,910
1,2,3	Cost of sales	<u>(15,283)</u>	<u>(15,380)</u>
	Gross profit	5,627	5,530
1	Distribution costs	(1,907)	(1,937)
2	Intangible assets	208	58
1,4	Administrative expenses	(2,842)	(3,142)
	Finance income	1,446	1,446
	Finance costs	<u>(1,902)</u>	<u>(1,902)</u>
	Profit before tax	422	(5)
5	Tax expense	<u>(158)</u>	<u>(30)</u>
	Net profit (loss)	<u><u>264</u></u>	<u><u>(35)</u></u>

NOTES TO THE RECONCILIATION OF PROFIT OR LOSS FOR 2004:

- A pension liability is recognised under HKFRSs, but was not recognised under previous GAAP. The pension liability increased by 130 during 2004, which caused increases in cost of sales (50), distribution costs (30) and administrative expenses (50).
- Cost of sales is higher by 47 under HKFRSs because inventories include fixed and variable production overhead under HKFRSs but not under previous GAAP.
- Depreciation was influenced by tax requirements under previous GAAP, but reflects the useful life of the assets under HKFRSs. The effect on the profit for 2004 was not material.
- A restructuring provision of 250 was recognised under previous GAAP at 1 January 2004, but did not qualify for recognition under HKFRS until the year ended 31 December 2004. This increases administrative expenses for 2004 under HKFRSs.
- Adjustments 1-4 above lead to a reduction of 128 in deferred tax expense.

EXPLANATION OF MATERIAL ADJUSTMENTS TO THE CASH FLOW STATEMENT FOR 2004:

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

HKFRS 2 Share-based Payment

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

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

HK(IFRIC) Interpretations

HK(IFRIC)-Int 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities

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

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

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

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

BACKGROUND

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

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

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

APPLICATION OF REQUIREMENTS

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

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

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

Decommissioning cost included in cost of plant	_67
Accumulated depreciation	_(5)
Decommissioning liability	_(77)
Net assets/retained earnings	(15)

HK(IFRIC)-Int 4 Determining whether an Arrangement contains a Lease

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

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

IG Example 202: Determining whether an arrangement contains a lease**BACKGROUND**

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

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

APPLICATION OF REQUIREMENTS

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

Appendix

Amendments resulting from other Implementation Guidance

The following sets out amendments required for this Guidance resulting from other newly issued HKFRSs that are not yet effective. Once effective, the amendments set out below will be incorporated into the text of this Guidance and this appendix will be deleted. In the amended paragraphs shown below, new text is underlined and deleted text is struck through.

HKAS 23 *Borrowing Costs* (issued in June 2007) – effective for annual periods beginning on or after 1 January 2009

Paragraphs IG23 and IG24 are amended as follows. Paragraph IG25 is deleted.

IG23 ~~On first adopting HKFRSs, an entity adopts a policy of begins capitalising borrowing costs (HKAS 23 as revised in 2007) allowed alternative treatment) or not capitalising them (HKAS 23 benchmark treatment). The entity applies that policy consistently in its opening HKFRS balance sheet and in all periods presented in its first HKFRS financial statements. In accordance with paragraph 25I of the HKFRS, an entity:~~

(a) capitalises borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after 1 January 2009 or the date of transition to HKFRSs (whichever is later);

(b) may elect to designate any date before 1 January 2009 or the date of transition to HKFRSs (whichever is later) and to capitalise borrowing costs relating to all qualifying assets for which the commencement date for capitalisation is on or after that date.

However, if the entity established a deemed cost for an asset, the entity does not capitalise borrowing costs incurred before the date of the measurement that established the deemed cost.

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

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

HKAS 1 *Presentation of Financial Statements* (issued in December 2007) – effective for annual periods beginning on or after 1 January 2009

The Guidance on Implementing HKFRS 1 is amended as described below.

In IG Examples 1–4, 201 and 202, ‘Entity [X]’s [An entity’s] first HKFRS financial statements have a reporting date of’ is amended to ‘Entity [X]’s [An entity’s] first HKFRS financial statements are for a period that ends on’.

In IG Examples 1–4, 6–11 and 201, references to the years ‘2001’ to ‘2007’ are amended to ‘20X1’ to ‘20X7’ respectively.

In the heading above paragraph IG2 and in IG Example 1 (Assumption 2), 'HKAS 10 *Events after the Balance Sheet Date*' is amended to 'HKAS 10 *Events after the Reporting Period*'.

In paragraph IG2(b), 'balance sheet' is deleted.

In paragraph IG21, 'the reporting date' is amended to 'the end of the first HKFRS reporting period'.

In paragraph IG31, 'post-balance sheet events review' is amended to 'review of events after the reporting period'.

In paragraph IG36, 'reporting date for its first HKFRS financial statements' is amended to 'end of its first HKFRS reporting period'.

IG Example 10 is amended as follows:

IG Example 10 Interim financial reporting

Background

Entity R's first HKFRS financial statements ~~have~~ ~~are~~ ~~for~~ ~~a~~ ~~reporting~~ ~~date~~ ~~of~~ ~~period~~ ~~that~~ ~~ends~~ ~~on~~ 31 December ~~20X5~~ 2005, and its first interim financial report under HKAS 34 is for the quarter ended 31 March ~~20X5~~ 2005. Entity R prepared previous GAAP annual financial statements for the year ended 31 December ~~20X4~~ 2004, and prepared quarterly reports throughout ~~20X4~~ 2004.

Application of requirements

In each quarterly interim financial report for ~~20X5~~ 2005, entity R includes reconciliations of:

- (a) its equity under previous GAAP at the end of the comparable quarter of ~~20X4~~ 2004 to its equity under HKFRSs at that date; and
- (b) its total comprehensive income (or, if it did not report such a total, profit or loss) under previous GAAP for the comparable quarter of ~~20X4~~ 2004 (current and year-to-date) to its total comprehensive income ~~profit or loss~~ under HKFRSs.

In addition to the reconciliations required by (a) and (b) and the disclosures required by HKAS 34, entity R's interim financial report for the first quarter of ~~20X5~~ 2005 includes reconciliations of (or a cross reference to another published document that includes these reconciliations):

- (a) its equity under previous GAAP at 1 January ~~20X4~~ 2004 and 31 December ~~20X4~~ 2004 to its equity under HKFRSs at those dates; and
- (b) its total comprehensive income (or, if it did not report such a total, profit or loss) for ~~20X4~~ 2004 under previous GAAP to its ~~profit or loss~~ total comprehensive income for ~~20X4~~ 2004 under HKFRSs. ...

In paragraph IG43, 'the income statement' is amended to 'profit or loss'.

Paragraphs IG52, IG59 and IG60B are amended as follows:

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

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

IG60B An entity ... Any net cumulative gain or loss that has been reclassified to equity on initial application of HKAS 39 remains in equity until (a) the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, (b) the forecast transaction affects profit or loss or (c) subsequently circumstances change and the forecast transaction is no longer expected to occur, in which case any related net cumulative gain or loss ~~that had been recognised directly in equity~~ is recognised in is reclassified from equity to profit or loss. If ...

Paragraph IG63 and IG Example 11 are amended as follows:

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

IG Example 11 Reconciliation of equity and profit or loss total comprehensive income			
...			
Reconciliation of profit or loss total comprehensive income for 200420X4			
Note	Previous GAAP	Effect of transition to HKFRSs	HKFRSs
	Revenue	20,910	20,910
1,2,3	Cost of sales	(15,283)	(15,380)
	Gross profit	5,627	5,530
1	Distribution costs	(1,907)	(1,937)
1,4	Administrative expenses	(2,842)	(3,142)
	Finance income	1,446	1,446
	Finance costs	(1,902)	(1,902)
	Profit before tax	422	(5)
5	Tax expense	(158)	(30)
	Profit (loss) for the year	264	(35)
6	Available-for-sale financial assets	0	150
7	Cash flow hedges	0	(40)
8	Tax relating to other comprehensive income	0	(29)
	Other comprehensive income	0	81
	Total comprehensive income	264	46
Notes to the reconciliation of profit or loss total comprehensive income for 2004 20X4:			
...			
6	Available-for-sale financial assets carried at fair value under HKFRSs increased in value by 180 during 20X4. They were carried at cost under previous GAAP. The entity sold available-for-sale financial assets during the year, recognising a gain of 40 in profit or loss. Of that realised gain 30 had been included in the revaluation reserve as at 1 January 20X4 and is reclassified from revaluation reserve to profit or loss (as a reclassification adjustment).		
7	The fair value of forward foreign exchange contracts that are effective hedges of forecast transactions decreased by 40 during 20X4.		
8	Adjustments 6 and 7 above lead to an increase of 29 in deferred tax expense.		

In IG Example 202, references to '1995' are amended to '20X5' and references to the years '2000' to '2007' are amended to '20Y0' to '20Y7' respectively.

HKAS 27 *Consolidated and Separate Financial Statements* (issued in March 2008) - effective for annual periods beginning on or after 1 July 2009

References to 'minority interests' are amended to 'non-controlling interests' in paragraphs IG Example 4, IG Example 5, IG Example 6 and IG 28.