Exposure Draft

ED 1 FIRST-TIME APPLICATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

Comments to be received by 31 October 2002

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Comments on the draft IFRS and its accompanying documents (see separate booklets) should be submitted in writing so as to be received by **31 October 2002**.

All replies will be put on the public record unless confidentiality is requested by the commentator. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@iasb.org.uk** or addressed to:

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Contents

[Draft] International Financial Reporting Standard IFRS X

First-time Application of International Financial Reporting Standards

INVITATION TO COMMENT	**page 5**
INTRODUCTION	**paragraphs I1–I6**
SCOPE	**1–5**
Subsidiaries	**5**
OVERVIEW OF THE TRANSITION TO IFRSs	**6**
ACCOUNTING POLICIES	**7-9**
OPENING IFRS BALANCE SHEET	**10-24**
Compliance with IFRSs	**11-12**
Exemptions from requirements in other IFRSs	**13-24**
Fair value	15
Property, plant and equipment	16-18
Event-driven fair value measurement as deemed cost	19
Business combinations	20-21
Employee benefits	22
Cumulative translation differences	23
Financial instruments	24
ESTIMATES	**25-27**

PRESENTATION AND DISCLOSURE **28-37**

Comparative information **29**

Explanation of transition to IFRSs **30-37**

Use of fair value as deemed cost 35

Historical summaries 36

Interim financial reports 37

EFFECTIVE DATE **38**

APPENDICES

A DEFINED TERMS **page 23**

B BUSINESS COMBINATIONS **paragraphs B1-B2**

C HEDGE ACCOUNTING **C1-C4**

D AMENDMENTS TO OTHER IFRSs **D1-D2**

GLOSSARY **page 33**

BASIS FOR CONCLUSIONS *see separate booklet* **paragraphs BC1–BC97**

IMPLEMENTATION GUIDANCE *see separate booklet* **paragraphs IG1–IG52**

INVITATION TO COMMENT

The International Accounting Standards Board invites comments on any aspect of this Exposure Draft of its proposed IFRS *First-time Application of International Financial Reporting Standards*. It would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than **31 October 2002**.

Until an IFRS based on this Exposure Draft becomes effective, SIC-8 *First-time Application of IASs as the Primary Basis of Accounting* remains effective.

Question 1

The proposed IFRS would apply when an entity first adopts International Financial Reporting Standards (IFRSs) as its new basis of accounting, by an explicit and unreserved statement of compliance with all IFRSs (paragraphs 1-5 and paragraphs BC4-BC10 of the Basis for Conclusions).

Is this an appropriate description of the circumstances when this proposed IFRS should apply? If not, what changes would you suggest, and why?

Question 2

The proposed IFRS proposes a requirement that an entity shall prepare its opening IFRS balance sheet using accounting policies that comply with each IFRS effective at the reporting date for its first IFRS financial statements. Paragraphs 13-24 propose limited exemptions from this requirement.

Are all of these exemptions appropriate? Should the Board amend any of these exemptions or create any further exemptions (paragraphs BC11-BC89)? If so, why?

Question 3

Paragraphs 28-37 of the proposed IFRS deal with presentation and disclosure requirements (see also paragraphs BC90-BC97). Are all of these disclosures appropriate? Should the Board require any further disclosures or eliminate or amend any of the proposed disclosure requirements? If so, why?

Question 4

Do you have any other comments on the Exposure Draft?

[Draft] International Financial Reporting Standard X *First-time Application of International Financial Reporting Standards* ([draft] IFRS X) is set out in paragraphs 1-38, Appendices A-D and the Glossary. All the paragraphs have equal authority. The scope and authority of IFRSs are explained in the *Preface to International Financial Reporting Standards*. Terms listed in Appendix A are defined in the Glossary and are set in *italics* the first time they appear in the [draft] IFRS. [Draft] IFRS X is accompanied by a Basis for Conclusions and implementation guidance. [Draft] IFRS X should be read in the context of its objective and the *Framework for the Preparation and Presentation of Financial Statements,* which provide a basis for selecting and applying accounting policies in the absence of explicit guidance.

INTRODUCTION

Objective

I1 The objective of [draft] IFRS X *First-time Application of International Financial Reporting Standards* is to ensure that an entity's first IFRS 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 the entity's subsequent accounting under IFRSs; and

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

Main features of this [draft] IFRS

I2 The [draft] IFRS applies when an entity adopts IFRSs for the first time as its basis of accounting, by an explicit and unreserved statement of compliance with IFRSs.

I3 In general, the [draft] IFRS requires an entity to comply with each IFRS effective at the reporting date for its first IFRS financial statements. The [draft] IFRS permits limited exemptions from this requirement in specified areas, notably where the cost of complying with this requirement would exceed the benefits to users of financial statements.

I4 The [draft] IFRS requires disclosures that explain how the transition from previous GAAP to IFRSs affected the entity's reported financial position, financial performance and cash flows.

I5 An entity shall apply the [draft] IFRS if its first IFRS financial statements are for a period beginning on or after 1 January 2003. Earlier application is [proposed to be] encouraged. [Until the IFRS based on this Exposure Draft becomes effective, SIC-8 *First-time Application of IASs as the Primary Basis of Accounting* remains effective.]

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Changes to previous requirements

I6 The [draft] IFRS [would] replace[s] SIC-8 *First-time Application of IASs as the Primary Basis of Accounting*. Like SIC-8, the [draft] IFRS requires retrospective application in most areas. The [draft] IFRS differs from SIC-8 in:

(a) creating targeted exemptions, notably in specified areas where retrospective application is likely to cause undue cost or effort. SIC-8 contained less specific exemptions that applied when retrospective application would be impracticable.

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

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

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

(e) requiring enhanced disclosure about how the transition to IFRSs affected an entity's reported financial position, financial performance and cash flows.

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[DRAFT] INTERNATIONAL FINANCIAL REPORTING STANDARD IFRS X

First-time Application of International Financial Reporting Standards

SCOPE

1 An entity shall apply this [draft] IFRS in:

(a) its *first IFRS financial statements*; and

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

2 An entity's first IFRS financial statements are the first annual financial statements in which the entity adopts *International Financial Reporting Standards (IFRSs)* as its basis of accounting, by an explicit and unreserved statement in those financial statements of compliance with IFRSs. Financial statements are an entity's first IFRS financial statements if, for example, the entity:

(a) presented its most recent previous financial statements:

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

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

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

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

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

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

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

3 This [draft] IFRS applies when an entity adopts IFRSs as a new basis of accounting. An entity does not adopt a new basis of accounting when, for example, the entity:

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

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

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

4 This [draft] IFRS does not apply to changes in accounting policies made by an entity that already applies IFRSs as its basis of accounting. Such changes are the subject of:

(a) requirements on changes in accounting policies in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*;[1] and

(b) specific transitional requirements in other IFRSs. Some of these IFRSs refer to their initial adoption. These references apply to changes in accounting policies made by an entity that already uses IFRSs as its basis of accounting; they do not apply to a *first-time adopter's* transition to IFRSs as a new basis of accounting.

Subsidiaries

5 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. In those first IFRS financial statements, the subsidiary shall comply with the disclosure requirements in paragraphs 29-37. However, to avoid

[1] The text reflects the proposed new name for IAS 8, as in the Exposure Draft *Proposed Improvements to International Accounting Standards*, published in May 2002.

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restatement of IFRS measurements already reported to the parent, the subsidiary is not treated as a first-time adopter for recognition and measurement purposes if:

(a) the subsidiary was consolidated in financial statements for the previous period and they contained an explicit and unreserved statement of compliance with IFRSs; and

(b) either the subsidiary is wholly-owned or the owners of the minority interests, including those not otherwise entitled to vote, unanimously agree that the subsidiary is not treated as a first-time adopter for recognition and measurement purposes.

OVERVIEW OF THE TRANSITION TO IFRSs

6 Transition to IFRSs involves:

(a) selection of accounting policies that comply with IFRSs (paragraphs 7-9).

(b) preparation of an *opening IFRS balance sheet* at *the date of transition to IFRSs* as the starting point for subsequent accounting under IFRSs (paragraphs 10-24). The date of transition to IFRSs is the beginning of the earliest comparative period presented in an entity's first IFRS financial statements.

(c) determination of estimates under IFRSs for both the opening IFRS balance sheet and other periods presented in an entity's first IFRS financial statements (paragraphs 25-27).

(d) presentation and disclosure in an entity's first IFRS financial statements and interim financial reports (paragraphs 28-37).

ACCOUNTING POLICIES

7 An entity shall use the same accounting policies throughout all periods presented in its first IFRS financial statements, and also in its opening IFRS balance sheet. Those accounting policies shall comply with each IFRS effective at the *reporting date* for its first IFRS financial statements.

8 An entity shall not apply different versions of IFRSs that were effective at earlier dates, unless paragraph 13 applies.

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Example

BACKGROUND

The reporting date for entity A's first IFRS financial statements is 31 December 2005. Entity A decides to present comparative information in those financial statements for one year only (see paragraph 29). Therefore, its date of transition to IFRSs is the beginning of business on 1 January 2004 (or, equivalently, close of business on 31 December 2003). Entity A presented financial statements under its *previous GAAP* annually to 31 December each year up to, and including, 31 December 2004.

APPLICATION OF REQUIREMENTS

Entity A shall apply the IFRSs effective for periods ending on 31 December 2005 in:

(a) preparing its opening IFRS balance sheet at 1 January 2004; and

(b) preparing and presenting its balance sheet for 31 December 2005 (including comparative amounts for 2004), income statement, statement of changes in equity and cash flow statement for the year to 31 December 2005 (including comparative amounts for 2004) and disclosures (including comparative information for 2004).

If a new IFRS is not yet mandatory for periods ending on or before 31 December 2005 but permits early application, entity A is permitted, but not required, to apply that IFRS in its first IFRS financial statements.

9 The transitional requirements in some IFRSs specify prospective application. Nevertheless, except as specified in paragraphs 13-24, an entity shall apply those IFRSs retrospectively in its first IFRS financial statements.

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OPENING IFRS BALANCE SHEET

10 An entity shall prepare an opening IFRS balance sheet at the date of transition to IFRSs. The opening IFRS balance sheet is the starting point for the entity's subsequent accounting under IFRSs, both in its first IFRS financial statements and in its financial statements prepared under IFRSs for subsequent periods. This [draft] IFRS does not require an entity to present its opening IFRS balance sheet in its first IFRS financial statements.

Compliance with IFRSs

11 Paragraph 7 requires an entity's opening IFRS balance sheet to comply with all the recognition and measurement requirements of IFRSs. In consequence, except as described in paragraphs 13-24, an entity shall, in its opening IFRS balance sheet:

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

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

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

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

12 In preparing its opening IFRS balance sheet, an entity will typically need to adjust the amounts that it reported previously for the same date using its previous GAAP. An entity shall recognise those adjustments directly in equity rather than in its income statement.

Exemptions from requirements in other IFRSs

13 The principle in paragraph 7 requires full retrospective application of all IFRSs effective at the reporting date for an entity's first IFRS financial statements. Paragraphs 14-24 permit limited exemptions from that principle, but do not require an entity to use those exemptions. If an entity does not use the exemptions, paragraphs 14-24 do not apply and, in addition, the entity shall apply the IFRSs that were effective in each period and may, therefore, need to consider superseded versions of IFRSs if later versions required prospective application. By contrast,

if an entity uses the exemptions, it shall apply only the latest version of IFRSs (paragraph 8).

14 If an entity uses the exemptions in paragraphs 16-24, it shall use them all, to the extent that they are applicable. An entity shall not apply these limited exemptions to other items. The exemptions fall into the following three categories.

(a) IFRSs require or permit *cost-based measurements* of some assets or liabilities. Determining a cost-based measurement under IFRSs at the date of transition to IFRSs may involve undue cost or effort for some assets or liabilities. Therefore, this [draft] IFRS requires an entity to measure some assets, liabilities and components of equity on a different basis and use that measurement as a *deemed cost*. This requirement applies only to:

(i) property, plant and equipment (paragraph 16);

(ii) goodwill and other assets and liabilities acquired in business combinations recognised before the date of transition to IFRSs (paragraphs 20 and 21);

(iii) net employee benefit assets or liabilities under defined benefit plans (paragraph 22); and

(iv) cumulative translation differences relating to a net investment in a foreign operation (paragraph 23).

(b) Some amounts determined under previous GAAP may be based on a valuation and some of these valuations may be more relevant to users than original cost. Therefore, paragraphs 17-19 permit an entity to use some valuations as deemed cost, even if the entity could establish a cost-based measurement under IFRSs without undue cost or effort.

(c) If an accounting measurement relies on designation by management, retrospective designation (or retrospective reversal of a designation) could cause practical implementation problems. To avoid these problems, paragraph 24 prohibits the full retrospective application of

IAS 39 *Financial Instruments: Recognition and Measurement* in one area that relies on designation by management, namely hedge accounting.

Fair value

15 Some of the limited exemptions below refer to *fair value*. IAS 22 *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 [draft] IFRS, unless another IFRS contains more specific guidance on the determination of fair values for the asset or liability in question. Those fair values shall reflect conditions that existed at the date of transition to IFRSs.

Property, plant and equipment

16 Determining a cost-based measurement under IFRSs for an item of property, plant and equipment at the date of transition to IFRSs may involve undue cost or effort. For example, if an entity did not maintain a register of property, plant and equipment, reconstructing reliable cost-based measurements for all or some items may involve undue cost or effort. If so, an entity shall measure those items at the date of transition to IFRSs at their fair value and use that fair value as their deemed cost at that date (unless paragraph 17 or 19 applies).

17 Using its previous GAAP, an entity may have revalued an item of property, plant and equipment at or before the date of transition to IFRSs by applying, for example, a general or specific price index to a cost that is broadly comparable to cost determined under IFRSs, or have revalued the items to an amount that is broadly comparable to fair value determined under IFRSs. This [draft] IFRS permits an entity to treat such revalued amounts as deemed cost under IFRSs at the date of the revaluation.

18 If an entity elects to use the cost model in IAS 40 *Investment Property*, paragraphs 16 and 17 apply to investment property. An entity shall not apply these paragraphs to assets other than property, plant and equipment (including investment property) or to liabilities.

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Event-driven fair value measurement as deemed cost

19 In some cases, an entity 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. Such event-driven measurements shall establish a deemed cost at that date for subsequent accounting under IFRSs.

Business combinations

20 An entity shall not apply IAS 22 *Business Combinations* retrospectively to business combinations that the entity recognised under previous GAAP before the date of transition to IFRSs. As explained more fully in Appendix B, this has the following consequences.

(a) Immediately following the business combination, the carrying amount under previous GAAP of assets and liabilities acquired in that business combination shall be their deemed cost under IFRSs at that date if IFRSs require a cost-based measurement of those assets and liabilities at a later date.

(b) The carrying amount of goodwill in an entity's opening IFRS balance sheet shall be its carrying amount under previous GAAP at the date of transition to IFRSs, after making the following two adjustments:

(i) if, under previous GAAP, the entity classified a business combination as an acquisition and recognised as intangible assets items that do not qualify for recognition as assets under IAS 38 *Intangible Assets*, the entity shall reclassify those items (and, if any, the related deferred tax and minority interests) as part of goodwill; and

(ii) regardless of whether there is any indication that the goodwill may be impaired, the entity shall apply IAS 36 *Impairment of Assets* in testing the goodwill for impairment at the date of transition to IFRSs and in recognising any resulting impairment loss.

21 For those assets and liabilities acquired in a past business combination for which IFRSs require a subsequent measurement that is not a cost-based measurement, the entity shall restate the asset or liability on that basis. The entity shall recognise any resulting change in the carrying amount against retained earnings (or, if appropriate, another category of equity), rather than against goodwill. The same applies to any adjustment resulting from the recognition of an asset or

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liability not recognised under previous GAAP, or the exclusion from the opening IFRS balance sheet of an item recognised under previous GAAP as an asset or liability (except for the reclassification to goodwill of items recognised as intangible assets under previous GAAP, as described in paragraph 20(b)(i)).

Employee benefits

22 At the date of transition to IFRSs, an entity shall measure net employee benefit assets or liabilities under defined benefit plans in accordance with IAS 19 *Employee Benefits*, except that no actuarial gains or losses shall remain unrecognised.

Cumulative translation differences

23 IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires an entity to classify as a separate component of equity some exchange differences relating to the translation of a net investment in a foreign operation.[2] An entity may be unable to determine, without undue cost and effort, the cumulative amount of these translation differences for a foreign operation at the date of transition to IFRSs. If so, the entity shall deem the cumulative translation difference under IFRSs to be equal to the cumulative translation difference at that date, if any, determined under the entity's previous GAAP.

Financial instruments

24 As more fully explained in Appendix C, an entity shall apply the hedging requirements of IAS *39 Financial Instruments: Recognition and Measurement* prospectively from the date of transition to IFRSs.

ESTIMATES

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

26 Paragraph 25 applies when an entity made estimates under previous GAAP. However, an entity may need to make estimates under IFRSs at the date of transition to IFRSs that were not required at that date under previous GAAP. To comply with IAS 10 *Events After the Balance Sheet Date*, those estimates under IFRSs shall not reflect conditions that arose after the date of transition to IFRSs. In particular, estimates of market prices, interest rates or foreign exchange rates at the date of transition to IFRSs shall reflect market conditions at that date.

27 Paragraphs 25 and 26 apply to the opening IFRS balance sheet. They also apply to a comparative period presented in an entity's first IFRS financial statements, in which case the references to the date of transition to IFRSs are replaced by references to the end of that comparative period.

[2] The term 'foreign operation' has the same meaning as in the May 2002 Exposure Draft of revisions to IAS 21.

PRESENTATION AND DISCLOSURE

28 This [draft] IFRS does not provide exemptions from the presentation and disclosure requirements in other IFRSs.

Comparative information

29 To comply with IAS 1 *Presentation of Financial Statements*, an entity's first IFRS financial statements shall include at least one year of comparative information under IFRSs. If the first IFRS financial statements include more than one year of comparative information, that additional comparative information shall comply with IFRSs.

Explanation of transition to IFRSs

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

31 To comply with paragraph 30, an entity's first IFRS financial statements shall include:

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

(i) the date of transition to IFRSs; and

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

(b) a reconciliation of the profit or loss reported under previous GAAP for the latest period in the entity's most recent annual financial statements to its profit or loss under IFRSs for the same period; and

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

32 The reconciliations required by paragraph 31(a) and (b) shall give sufficient detail to enable users to understand the material adjustments to the balance sheet and income statement and shall distinguish changes in accounting policies from changes in estimates and from the correction of errors. An entity shall also explain the material adjustments to the cash flow statement.

33 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* does not deal with changes in accounting policies that occur when an entity adopts IFRSs as the basis of accounting for the first time. Therefore, IAS 8's requirements for disclosures about changes in accounting policies do not apply in an entity's first IFRS financial statements.

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

Use of fair value as deemed cost

35 If an entity uses fair value as deemed cost for some items of property, plant and equipment or investment property in its opening IFRS balance sheet because a cost-based measurement required by IFRSs would involve undue cost or effort (see paragraph 16), the entity's first IFRS financial statements shall, for each line item in the opening IFRS balance sheet:

(a) disclose:

(i) the aggregate of those fair values; and

(ii) the aggregate adjustment to the carrying amounts reported under previous GAAP; and

(b) explain why the measurement required by IFRSs would involve undue cost or effort.

Historical summaries

36 Some entities present historical summaries of selected data for periods before the first period for which they present full comparative

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information. This [draft] IFRS does not require such summaries to comply with the recognition and measurement requirements of IFRSs. However, in any financial statements containing such summaries, an entity shall disclose the nature of the main adjustments that would make the data comply with IFRSs. This [draft] IFRS does not require an entity to quantify those adjustments.

Interim financial reports

37 To comply with paragraph 30, if an entity presents an interim financial report under IAS 34 *Interim Financial Reporting* for part of the period covered by its first IFRS financial statements, the following requirements apply in addition to the requirements of IAS 34.

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

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

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

(b) In addition to the reconciliations required by (a), an entity's first interim financial report under IAS 34 for part of the period covered by its first IFRS financial statements shall include the reconciliations described in paragraph 31(a) and (b) (supplemented by the details required by paragraph 32) or a cross-reference to another published document that includes these reconciliations.

EFFECTIVE DATE

38 An entity shall apply this [draft] IFRS if its first IFRS financial statements are for a period beginning on or after 1 January 2003. Earlier application is encouraged. If an entity's first IFRS financial statements are for a period beginning before 1 January 2003 and the entity applies this [draft] IFRS instead of SIC-8 *First-time Application of IASs as the Primary Basis of Accounting*, it shall disclose that fact.

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Appendix A
Defined terms

This appendix is an integral part of the [draft] IFRS. It lists the terms that are used in this [draft] IFRS with a specific meaning, as defined in the Glossary.

cost-based measurement

date of transition to IFRSs

deemed cost

fair value

first IFRS financial statements

first-time adopter

International Financial Reporting Standards (IFRSs)

opening IFRS balance sheet

previous GAAP

reporting date

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Appendix B
Business Combinations

This appendix is an integral part of the [draft] IFRS.

B1 Paragraph 20 of this [draft] IFRS prohibits an entity from applying IAS 22 *Business Combinations* retrospectively to business combinations that the entity recognised under previous GAAP before the date of transition to IFRSs. This requirement has the following consequences:

(a) an entity 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) immediately following the business combination, the carrying amount under previous GAAP of assets and liabilities acquired in that business combination shall be their deemed cost under IFRSs at that date if IFRSs require a cost-based measurement of those assets and liabilities at a later date. That deemed cost shall be the basis for cost-based depreciation or amortisation from the date of the business combination.

(c) the carrying amount of goodwill in an entity's opening IFRS balance sheet shall be its carrying amount under previous GAAP at the date of transition to IFRSs, after making the following two adjustments:

(i) if, under previous GAAP, the entity classified a business combination as an acquisition and recognised as intangible assets items that do not qualify for recognition as assets under IAS 38 *Intangible Assets*, the entity shall reclassify those items (and, if any, the related deferred tax and minority interests) as part of goodwill; and

(ii) regardless of whether there is any indication that the goodwill may be impaired, the entity shall apply IAS 36 *Impairment of Assets* in testing the goodwill for impairment at the date of transition to IFRSs and in recognising any resulting impairment loss.

(d) for those assets and liabilities acquired in that business combination for which IFRSs require a subsequent measurement that is not a cost-based measurement, the entity shall restate the asset or liability on that basis. The entity shall recognise any resulting change in the carrying amount against retained earnings

(or, if appropriate, another category of equity), rather than against goodwill. The same applies to any adjustment resulting from the recognition of an asset or liability not recognised under previous GAAP, or the exclusion from the opening IFRS balance sheet of an item recognised under previous GAAP as an asset or liability (except for the reclassification to goodwill of items recognised as intangible assets under previous GAAP, as described in paragraph B1(c)(i)).

(e) an entity shall not recognise negative goodwill in its opening IFRS balance sheet.[3]

B2 The following examples illustrate these requirements.

Example 1

BACKGROUND

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

(a) classified the business combination as an acquisition;

(b) assigned initial carrying amounts of:

(i) 300 to intangible assets that would not have qualified for recognition under IAS 38 *Intangible Assets*;

(ii) 500 to other net identifiable assets less liabilities (including some intangible assets that do qualify for separate recognition under IAS 38); and

(iii) 200 to goodwill;

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

continued …

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

[3] The statement that an entity shall not recognise negative goodwill in its opening IFRS balance sheet reflects a proposal in phase I of the IASB's project on business combinations, for which the IASB plans to publish an exposure draft later this year.

(i) intangible assets that would not have qualified for separate recognition under IAS 38: 250;

(ii) pension liability (for which the present value of the defined benefit obligation measured under IAS 19 *Employee Benefits* is 130 and the fair value of plan assets is 100): nil (because previous GAAP required a pay-as-you-go cash method of accounting for pensions);

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

(iv) goodwill: 180.

APPLICATION OF REQUIREMENTS

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

(a) classify the business combination as an acquisition by entity B even if the business combination would have qualified under IAS 22 as a reverse acquisition by subsidiary C or a uniting of interests.

(b) transfer to goodwill the carrying amount of the intangible assets not qualifying for separate recognition under IAS 38 (250), resulting in goodwill with a carrying amount of 430 (250 + 180).[4]

(c) test the goodwill for impairment under IAS 36 *Impairment of Assets* and recognise any resulting impairment loss.

(d) for those net identifiable assets acquired for which IFRSs require cost-based measurement at a date subsequent to the business combination, treat their carrying amount under previous GAAP

continued …

immediately after the business combination as their deemed cost at that date.

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

(f) if there is any indication that any of the identifiable assets are impaired, test those assets for impairment.

(g) recognise the pension liability 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.

(h) recognise a net deferred tax liability of 6 (20 @ 30 per cent) arising from (i)—the taxable temporary difference of 50 (200 less 150) associated with the identifiable assets and non-pension liabilities acquired—less (ii)—the deductible temporary difference of 30 (30 less nil) associated with the pension liability. The entity shall recognise the resulting increase in the deferred tax liability as a debit to retained earnings. If amortisation of the goodwill is not deductible for income tax purposes, the entity shall not recognise the deferred tax liability resulting from the temporary difference associated with the goodwill (paragraph 15(a) of IAS 12 *Income Taxes*).

Example 2

BACKGROUND

Entity D's first IFRS financial statements have a reporting date of 31 December 2005 and include comparative information for 2004 only. On 1 July 2003, entity D acquired 100 per cent of subsidiary E. Under its previous GAAP, entity D recognised an (undiscounted)

continued …

restructuring provision of 100 that would not have qualified as an identifiable liability under IAS 22. The recognition of this restructuring provision increased goodwill by 100. At 31 December 2003 (date of transition to IFRSs), entity D:

(a) had paid restructuring costs of 60; and

[4] The transfer from intangible assets to goodwill shall also reflect related minority interests and deferred tax (paragraph 20(b)(i). For simplicity, this example assumes these amounts to be zero. See example 3 below.

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

APPLICATION OF REQUIREMENTS

In its opening IFRS balance sheet, entity D:

(a) shall not recognise a restructuring provision.

(b) shall not adjust the amount assigned to goodwill. However, entity D shall test the goodwill for impairment under IAS 36 *Impairment of Assets*, and recognise any resulting impairment loss.

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

Example 3

BACKGROUND

Entity F's first IFRS financial statements have a reporting date of 31 December 2005 and include comparative information for 2004 only. On 1 July 2001, entity F acquired 75 per cent of subsidiary G. Under its previous GAAP, entity F assigned an initial carrying amount of 200 to intangible assets that would not have qualified for recognition under IAS 38 *Intangible Assets*. The tax base of the intangible assets was nil, giving rise to a deferred tax liability (at 30 per cent) of 60. Under the allowed alternative treatment in IAS 22 *Business Combinations*, entity F measured minority interests at the

continued …

minority's share of the fair value of the identifiable assets and liabilities acquired.

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

APPLICATION OF REQUIREMENTS

Because the intangible assets do not qualify for recognition as separate assets under IAS 38, entity F shall transfer them to goodwill, together with the related deferred tax liability (48) and minority interest. The related minority interest is 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 interest (28).

Example 4

BACKGROUND

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

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

(b) did not recognise intangible assets that would have met the criteria for recognition under IAS 38.

APPLICATION OF REQUIREMENTS

In its opening IFRS balance sheet, entity H shall not recognise those intangible assets, as the amount assigned to them under previous GAAP was nil. Similarly, entity H shall not recognise the goodwill, as it did not recognise the goodwill as an asset under previous GAAP.

Appendix C
Hedge Accounting

This appendix is an integral part of the [draft] IFRS.

C1 Paragraph 24 of this [draft] IFRS requires an entity to apply the hedging requirements of IAS 39 prospectively from the date of transition to IFRSs. This requirement has the following consequences.

C2 If an entity did not designate a transaction as a hedge under previous GAAP, the entity shall not designate that transaction as a hedge retrospectively. If the entity designates the transaction as a hedge at the date of transition to IFRSs and it meets the other criteria in IAS 39, it will be eligible for hedge accounting prospectively from that date.

C3 For hedges designated under previous GAAP before the date of transition to IFRSs, an entity shall apply the recognition, derecognition, and measurement provisions of IAS 39 prospectively from the date of transition to IFRSs, regardless of whether the IAS 39 documentation criteria were met when the hedge was designated, and regardless of whether the hedge met the IAS 39 effectiveness criteria before the date of transition to IFRSs. In particular:

(a) if an entity designated a transaction as a hedge before the date of transition to IFRSs, the entity shall not reverse the designation of that hedge retrospectively.

(b) for fair value hedges of assets and liabilities recognised in the opening IFRS balance sheet (including hedges of firm commitments), an entity shall:

(i) adjust the carrying amounts of hedged assets and liabilities (including hedges of firm commitments) at the date of transition to IFRSs to reflect the portion of the fair value of the hedging instrument at that date that reflects the risk hedged;

(ii) recognise in retained earnings any resulting net adjustment to the carrying amount of the hedging instrument and hedged item; and

(iii) in addition, if the hedge is still designated as a hedge and meets the conditions in paragraph 142 of IAS 39, apply hedge accounting under IAS 39 to gains and losses on the hedging instrument that occur after the date of transition to IFRSs.

(c) if an entity's hedge accounting policies under previous GAAP included deferral of gains or losses on cash flow hedges, the entity shall:

(i) reclassify those deferred gains and losses to retained earnings if the hedged transaction is no longer expected to occur.

(ii) classify those deferred gains and losses as a separate component of equity to the extent that the hedged transaction is still expected to occur and the other criteria in paragraph 142 of IAS 39 are met. For this purpose only, the requirement in paragraph 142 for designation and documentation at inception shall be assessed at the date of transition to IFRSs and there shall be no requirement to assess whether the IAS 39 criteria for hedge effectiveness were met before that date. The entity shall transfer the deferred gains and losses to the income statement when the hedged transaction affects the income statement, or when the hedged transaction is no longer expected to occur.

(iii) continue to apply hedge accounting under IAS 39 to gains and losses after the date of transition to IFRSs if the hedged transaction is still designated as a hedge and is still highly probable and the other criteria in paragraph 142 of IAS 39 are met.

C4 Paragraph C3(c) refers to deferral of gains and losses on cash flow hedges under previous GAAP. This reference includes both the following forms of deferral:

(a) treating deferred gains as if they were liabilities and deferred losses as if they were assets; and

(b) not recognising changes in the fair value of the hedging instrument.

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Appendix D
Amendments to other IFRSs

The amendments in this [draft] appendix become effective for accounting periods beginning on or after 1 January 2003. If an entity applies this [draft] IFRS for an earlier period, these amendments become effective for that earlier period.

D1 This [draft] IFRS supersedes SIC-8 *First-time Application of IASs as the Primary Basis of Accounting*.

D2 A new paragraph 2A is inserted as follows in [draft] IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. [The draft of IAS 8 was published in April 2002. Paragraphs 9-23 of the draft deal with changes in accounting policies]

> 2A Paragraphs 9-23 of this IFRS do not apply when an entity adopts IFRSs as its basis of accounting for the first time (see IFRS X *First-time Application of International Financial Reporting Standards*).

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Glossary

This Glossary is an integral part of the [draft] IFRS. It lists the terms that are used in this [draft] IFRS with a specific meaning. [When the final IFRS is included in the Bound Volume of IFRSs, this Glossary will be merged with the Glossary in the Bound Volume.]

cost-based measurement A measurement at:

(a) amortised cost, as described in IAS 39 *Financial Instruments: Recognition and Measurement*; or

(b) cost less, where applicable, depreciation or amortisation and any accumulated impairment losses.

date of transition to IFRSs The beginning of the earliest comparative period presented in an entity's **first IFRS financial statements**.

deemed cost An amount used as a surrogate for cost in determining a **cost-based measurement**. Subsequent depreciation or amortisation assumes that the entity had initially recognised the asset or liability at the given date and that its cost was equal to the deemed cost.

fair value The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

first IFRS financial statements The first annual financial statements in which an entity adopts **International Financial Reporting Standards** (**IFRSs**) as its basis of accounting, by an explicit and unreserved statement of compliance with IFRSs.

first-time adopter An entity that presents its **first IFRS financial statements**.

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International Financial Reporting Standards (IFRSs)	Standards and Interpretations adopted by the International Accounting Standards Board (IASB). They comprise: (a) International Financial Reporting Standards; (b) International Accounting Standards; and (c) Interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC), and adopted by the IASB.
opening IFRS balance sheet	An entity's balance sheet (published or unpublished) at the **date of transition to IFRSs**.
previous GAAP	The basis of accounting that a **first-time adopter** used immediately before adopting IFRSs as its basis of accounting for the first time.
reporting date	The end of the latest period covered by financial statements or by an interim financial report.

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