CONSULTATION PAPER

IASB PROPOSALS FOR FIRST-TIME APPLICATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

ACCOUNTING
STANDARDS
BOARD

Comments should be sent to the IASB by 31 October. All responses will be put on 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:

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH.
FAX: 020 7246 6411

The ASB would be pleased to receive copies of responses by UK commentators. For ease of handling, we prefer comments to be sent (in Word format) by email to:

conspaper2@asb.org.uk

Comments may also be sent in hard copy form to:

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STANDARDS
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PREFACE

1 This paper is issued by the Accounting Standards Board to set out, for UK consultation, an exposure draft of the International Accounting Standards Board ('IASB') on 'First-time Application of International Financial Reporting Standards'. The proposed standard specifies how entities that apply IFRSs* in full for the first time should restate their financial statements and what disclosures should be made in the first financial statements prepared under those standards.

2 This Consultation Paper includes all three parts of the IASB's publication:

- the Exposure Draft;
- the Basis for Conclusions; and
- the Implementation Guidance.

3 A recently published EU Regulation requires, with effect from 1 January 2005, all listed companies in the EU to prepare their consolidated financial statements in accordance with adopted international accounting standards. The intention is that IFRSs will form the basis of those adopted international accounting standards. Member States have the power to extend the Regulation to individual financial statements and unlisted companies from 2005 or later. Ministers intend to consult on this shortly.

** The IASB intends to designate its future standards as International Financial Reporting Standards, or IFRSs. Standards issued prior to 2002 are identified as International Accounting Standards, or IASs. In this Preface, the term IFRS is used to refer to both IFRSs and IASs.*

4 The proposed standard will, of course, apply whenever an entity adopts IFRSs for the first time and so, for example, will apply after 2005 for an entity outside Europe that adopts IFRSs at a later date.

5 The proposed standard is based on the general principle that the accounting policies required by IFRSs that are effective at the reporting date for the first IFRS financial statements are to be applied to all periods presented.

6 As the proposed standard addresses the application of IFRSs it would be inappropriate for the ASB to issue a UK standard based on IASB's exposure draft. However, the exposure draft is relevant to UK entities because:

(i) if they will be required to prepare their financial statements in accordance with IFRSs, they will have to apply the standard on first-time application; and

(ii) there are some exceptions to the general principle of retrospective application, and it is important that these strike an appropriate balance between avoiding excessive cost and providing high quality financial information.

7 The following paragraphs highlight points that respondents to this Consultation Paper may specifically wish to consider.

The "alternative approach"

8 As noted above, the principle in the standard is that the accounting policies required by IFRSs that are effective at the reporting date for the first IFRS financial statements are to be applied retrospectively. However, it is also proposed to permit an alternative approach, under which an entity may elect to apply all IFRSs that were in effect in each period. This would include superseded versions of an IFRS if later versions required prospective application (paragraph 13 of the exposure draft).

Exemptions are mandatory

9 Except where an entity has elected to use the alternative approach explained above, the exposure draft proposes that an entity will be *required* to use all of the exemptions from retrospective application, to the extent they apply (paragraph 14 of the exposure draft).

Property, plant and equipment

10 FRS 15 'Tangible Fixed Assets' contains transitional provisions that permit a company that had previously revalued assets but did not adopt a policy of revaluation on implementation of the standard for the first time to retain the book amounts of the assets which reflect previous revaluations (paragraph 104 of FRS 15). The draft standard 'Property, Plant and Equipment' contained in FRED 29, which is based on a proposed revision to IAS 16, contains an equivalent transitional provision. The current IASB exposure draft provides that revalued amounts may be treated as deemed cost under IFRSs, if the amount of the revaluation is broadly comparable to fair value under IFRSs (paragraph 17). In many cases, an entity that has taken advantage of the transitional provisions of FRS 15 will not be required to restate the amount of such assets at the date of application of IFRSs.

Intangible assets acquired in a business combination

11 The exposure draft sets out specific requirements for business combinations in paragraphs 20 and 21. In general the proposal is that assets and liabilities are to be reported at their carrying amounts under previous GAAP*. This has the implication that intangible assets that were not recognised under previous GAAP will continue not to be recognised on first-time application, even if they meet the recognition of criteria of IAS 38. Such assets will effectively continue to be included in goodwill (paragraph 20 of the exposure draft†).

Future IFRSs

12 The draft standard addresses first-time application of existing IFRSs. The IASB has stated that when future IFRSs are issued, it will consider whether prospective application by first-time adopters is appropriate, and, if so, amend the standard on first-time application (see Basis for Conclusions, paragraph 88).

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* *The term 'previous GAAP' is defined in the Glossary of to the exposure draft (page 40).*

† *For a fuller explanation, see also Appendix B, paragraph B52, example 4 of the exposure draft; and paragraph 40 of the Implementation Guidance.*

Implications for UK companies

13 After discussion with interested parties, the ASB is pursuing a programme of work to align UK standards with IFRSs wherever practicable. Both ASB and IASB have a general policy of requiring new accounting standards to be applied retrospectively. To the extent an entity has adopted a UK standard with the same requirements as an IFRS before its date of transition to IFRSs*, it will in general be able to comply with the proposed standard without restating its financial statements.

14 The proposed standard will, however, require restatement on first-time application of IFRSs where the requirements of UK standards differ from those of IFRSs effective at the reporting date for an entity's first IFRS financial statements, except where the matter is covered by an exemption from retrospective application. As noted above, IASB will consider whether such an exemption should be given for new standards; ASB will have regard to this in setting the implementation requirements of new UK standards.

Invitation to comment

15 IASB's invitation to comment is set out on pages 9 to 10. Comments are requested by 31 October 2002. The ASB would be pleased to receive copies of responses from UK commentators.

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* *The term 'date of transition to IFRSs' is defined in the Glossary of to the exposure draft (page 39).*

[Draft] International Financial Reporting Standard IFRS X

First-time Application of International Financial Reporting Standards

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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.]

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.

[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

(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.

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[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.

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 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.

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.

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.

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 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.

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

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.

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 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.

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

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]

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[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.

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;

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

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

continued...

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

continued...

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[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.

(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) 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

(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.

continued...

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 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.

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*).

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**.

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.

ED 1 First-time Application of International Financial Reporting Standards

Basis for Conclusions

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This Basis for Conclusions is not part of the draft IFRS. It summarises the Board's considerations in reaching the conclusions in the draft IFRS. Individual Board members gave greater weight to some factors than to others. Appendix A of the draft IFRS lists all defined terms.

REASONS FOR ISSUING THE EXPOSURE DRAFT

BC1 SIC-8 *First-time Application of IASs as the Primary Basis of Accounting,* issued in 1998, dealt with the issues that arise when an entity adopts IASs for the first time as its basis of accounting. In 2001, the Board began a project to review SIC-8.

BC2 This project took on added significance because of the requirement that listed companies in the European Union (around 7,000 companies at present) should adopt International Financial Reporting Standards (IFRSs) in their consolidated financial statements by 2005. However, the Board's aim in developing the Exposure Draft 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.

Changes to previous requirements

BC3 Like SIC-8, the Exposure Draft proposes retrospective application in most areas. The Exposure Draft differs from SIC-8 in:

(a) creating targeted exemptions, notably in specified areas where retrospective application is likely to cause undue cost or effort (see paragraphs BC11-BC78). 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 and specifying that the transitional provisions in other IFRSs do not apply to a first-time adopter (see paragraphs BC79-BC88);

(c) clarifying how a first-time adopter's estimates under IFRSs relate to the estimates it made for the same date under its previous GAAP (see paragraph BC89); and

(d) requiring enhanced disclosure about how the transition to IFRSs affected an entity's reported financial position, financial performance and cash flows (see paragraphs BC90-BC97).

SCOPE

BC4 The Exposure Draft applies to an entity that presents its first IFRS financial statements (a first-time adopter). In most cases, it is clear whether an entity's financial statements are its first IFRS financial statements. However, difficulties arise if an entity's previous IFRS financial statements:

(a) complied with some, but not all, requirements of IFRSs; or

(b) contained erroneous or misleading statements of compliance with IFRSs.

The following paragraphs discuss the Board's approach to these difficulties.

Partial compliance with IFRSs

BC5 Some have 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. Supporters of this view 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 considered that this argument is 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.

BC6 In particular, some took the view that an entity has adopted IFRSs as its basis of accounting if its financial statements comply with IFRSs in all respects, except that they do not contain the explicit statement of compliance with IFRSs that IAS 1 *Presentation of Financial Statements* requires. Proponents of this view considered that omission of this one disclosure does not undermine the use of IFRSs as the basis of accounting.

BC7 To support a conclusion that IFRSs are the basis of accounting in the event of partial non-compliance, it would be necessary to establish how many departures are needed—and how serious they must be—before IFRSs are no longer regarded as the basis of accounting. Some suggested that the test for concluding whether the basis was IFRSs should be similar to an auditor's thought process in deciding whether to issue an 'except for' opinion or an adverse opinion. In other words, if the departures were so pervasive that an auditor would issue an adverse opinion, an entity would conclude that its basis of accounting was not IFRSs.

BC8 The Board considered the arguments discussed in paragraphs BC5-BC7, but concluded that any attempt to distinguish IFRS-compliant aspects of an entity's accounting would lead to complexity and, possibly, opportunities for accounting arbitrage. Also, an entity's basis of accounting should not be regarded as IFRSs if it does not give the disclosures required by IFRSs, because that approach would diminish the importance of disclosures and undermine efforts to promote full compliance with IFRSs.

BC9 In the Board's view, the simplest and most workable approach refers solely to an explicit and unreserved statement of compliance with IFRSs, as required by IAS 1 (paragraph 2 of the Exposure Draft). This test gives an unambiguous answer: if financial statements do not contain this statement, the basis of accounting is not IFRSs, regardless of how similar the accounting is to IFRSs. Drawing the line anywhere else would cause uncertainty and ambiguity.

Erroneous or misleading statements of compliance with IFRSs

BC10 Some suggested that an entity should be regarded as a first-time adopter if its previous financial statements contained material disclosed or undisclosed departures from IFRSs, despite an explicit and unreserved statement of compliance with IFRSs. However, in the Board's view, it would cause too much uncertainty to make a distinction based on whether financial statements actually complied in full with IFRSs. If an entity's financial statements in previous years contained an explicit and

unreserved statement that they complied with IFRSs, any material disclosed or undisclosed departures from the recognition and measurement requirements of IFRSs are errors and the entity applies IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in correcting them.

BASIC CONCEPTS

BC11 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.

BC12 The *Framework* identifies four qualitative characteristics that make information in financial statements useful to users, and notes the need for a balancing, or trade-off, between these four characteristics. In summary, the information should be:

(a) readily understandable by users.

(b) relevant to the decision-making needs of users. Information is relevant to their decision-making needs when it helps them to evaluate past, present or future events or confirm, or correct, their past evaluations. For example, information about the current financial position and past performance and cash flows has value to users when they evaluate the ability of an entity to generate cash and cash equivalents.

(c) reliable, in other words it should:

(i) represent faithfully the transactions and other events it either purports 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.

Benefits and costs

BC13 The *Framework* recognises that the provision of relevant and reliable information may be constrained by the need for timely reporting and for a balance between the benefits of the information and the cost of providing it. 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's benchmark was an entity that plans the transition well in advance and is able to collect most of the information needed for its opening IFRS balance sheet at, or very soon after, the date of transition to IFRSs. When the Exposure Draft uses the term 'undue cost or effort', it is in this context.

Comparability

BC14 Ideally, a regime for first-time application 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.

BC15 SIC-8 gave priority to ensuring comparability between a first-time adopter and entities that already apply IASs. It was based on the principle that a first-time adopter should comply with the same Standards as an entity that already applies IASs.

BC16 However, the Board concluded that the Exposure Draft should concentrate on achieving 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 desirable, but is a secondary objective.

OPENING IFRS BALANCE SHEET

BC17 An entity's opening IFRS balance sheet plays a vital role because it is the starting point for the entity's subsequent 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

BC18 The Board considered a suggestion that the Exposure Draft 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 argue that this would be a practical way for a first-time adopter to prepare an opening IFRS balance sheet that gives a high level of transparency and comparability, without incurring the cost of investigating very old transactions.

BC19 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, with specified and strictly limited exceptions:

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

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

BC20 The Board considered 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 (paragraph 172(g)).

(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.

BC21 The Board decided not to apply these precedents for a first-time adopter, as they could lead to an unjustifiable omission of material assets or liabilities from the opening IFRS balance sheet. Furthermore, these precedents are inconsistent with the June 2002 Exposure Draft of improvements to IAS 39. That Exposure Draft proposes reinstatement of previously derecognised financial assets and financial liabilities if the original transaction did not qualify for derecognition under the revised criteria proposed in that Exposure Draft.

Measurement

BC22 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 argue that this would result in information that is more relevant than an aggregation of costs incurred at different dates, or of costs incurred at different dates together with fair values established at the date of transition to IFRSs.

BC23 However, the Board concluded that requiring a first-time adopter to measure all assets and liabilities at fair value in the opening balance sheet would impose unreasonable costs, given that:

(a) IFRSs permit or require a cost-based approach for some items; and

(b) some first-time adopters may have previously followed accounting that was very close to IFRSs. It would be unreasonable to require a first-time adopter to incur the cost of determining the fair value of assets (and liabilities) at the date of transition to IFRSs if the first-time adopter used an IFRS-compliant cost-based measurement up to that date and will continue to use a cost basis after that date.

BC24 Because the Board's policy is not to issue IFRSs that permit options, the Board decided not to permit an option for an entity to measure all assets and liabilities at fair value in its opening IFRS balance sheet.

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 approach allows an entity's first IFRS financial statements to present information that possesses the qualitative characteristics of useful financial information set out in the *Framework* (paragraph BC12).

BC26 However, the Board acknowledged the need to limit this general principle on cost-benefit grounds. In assessing cost-benefit issues, the Board considered two types of measurement:

(a) measurements at fair value, net realisable value or other forms of current value that reflect explicit current projections of future cash flows; and

(b) cost-based measurements.

Fair value and other forms of current value

BC27 IFRSs require an entity to measure some assets and liabilities at fair value, and some others (for example, pension liabilities) at net realisable value or other forms of current value that reflect explicit current projections of future cash flows. The Board saw no reason to require or permit first-time adopters to measure these assets and liabilities differently in their opening IFRS balance sheet, given the Board's assumption that first-time adopters will begin planning on a timely basis for the transition to IFRSs (paragraph BC13).

Cost-based measurements

BC28 Some measurements under IFRSs are based on an accumulation of past costs or other transaction data. If an entity has not previously collected such data, it may sometimes be costly or burdensome to collect or estimate the data retrospectively. Similar costs and burdens may arise if an entity collected cost data that differ materially from the amounts required to comply with IFRSs. The Board considered the following approaches to mitigate the resulting practical problems:

(a) use existing cost-based balances determined using previous GAAP as deemed cost under IFRSs at the date of transition to IFRSs (see paragraphs BC29-BC31); or

(b) measure particular assets or liabilities at fair value at the date of transition to IFRSs if determining cost-based IFRS measurements would involve undue cost or effort (see paragraphs BC32-BC37).

Previous GAAP balances as deemed cost

BC29 The Board considered whether it should require or permit an entity to use amounts determined using previous GAAP as deemed cost for IFRSs at the date of transition to IFRSs. This would be simple, minimise administrative costs and burdens, and maintain continuity with previously reported data. However, extensive use of previous GAAP cost-based measurements as deemed cost under IFRSs could result in an unacceptable lack of comparability. For example, in an extreme case, previous GAAP might have permitted or required a cash basis, in which case it could be argued that the cost basis would be zero.

BC30 The Board noted that some amounts determined under previous GAAP might be based on a revaluation that may be more relevant to users than original cost. In such cases, it would not be reasonable to require time-consuming and expensive reconstruction of a cost that complies with IFRSs, but is less relevant than the more recent revaluation. In consequence, the Board decided to permit (and for (b) below, require) an entity to use amounts determined using previous GAAP as deemed cost for IFRSs in the following cases:

(a) if an entity revalued an item of property, plant and equipment using its previous GAAP, by applying, for example, a general or specific price index to a cost that is broadly comparable to cost determined under IFRSs, or revalued an item to an amount that is broadly comparable to fair value determined under IFRSs (paragraph 17); and

(b) if an entity 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 (paragraph 19).

BC31 For reasons discussed below, the Board also decided to permit the use of previous GAAP carrying amounts as deemed cost for business combinations (paragraphs BC38-BC45) and cumulative translation adjustments (paragraphs BC51 and BC52). The Board concluded that cost-benefit considerations did not justify this approach in other areas.

Fair value as deemed cost

BC32 In some cases, the cost of reconstructing an IFRS-compliant cost might exceed the benefits to users. The Board concluded that an entity should use fair value at the date of transition to IFRSs as deemed cost at that date in some of these cases, as discussed below. In assessing when this would be appropriate, the Board concentrated on both costs and benefits. The reconstruction of cost data might be costly and difficult. Furthermore, reconstructed cost data might be less relevant to users, and less reliable, than current fair value data. For these reasons, the Board concluded that it should not place excessive restrictions on the use of fair value as deemed cost.

BC33 SIC-8 provided 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" and (b) provision of comparative information when it is "impracticable" to provide such information. However, the Board noted that in some cases reconstruction of IFRS-compliant costs might be costly and disproportionate to the benefits to users, but not impracticable. Accordingly, the Board decided to set a criterion based on 'undue cost or effort', rather than 'impracticability'.

BC34 Some may regard the reference to 'undue cost or effort' as creating an implicit option to use fair value rather than an IFRS-compliant cost-based measurement. However, cost is generally equivalent to fair value at the date of acquisition. Therefore, the use of fair value as deemed cost means that an entity will report the same cost data as if it had acquired some assets (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 concluded that this approach is justified to solve the unique problem of bringing entities onto IFRSs in a cost-effective way without damaging transparency.

BC35 Some suggested an alternative approach intended to avoid a practical problem that could arise in cross-border securities filings if one regulator accepts that determining a cost-based measure would involve undue cost or effort but another regulator subsequently reaches the opposite conclusion. They suggested that the Board should permit an explicit option to use fair value as deemed cost, without restricting this approach to cases of undue cost or effort. However, the Board concluded that the targeted use of the criterion of undue cost or effort was more appropriate than an unrestricted option to use fair value as deemed cost.

BC36 The Board did not accept that determining a cost-based measurement would ever involve undue cost or effort for some types of asset or liability—for example, inventories, construction contract balances or financial instruments—because, in the Board's view, the benefits of reporting such a measurement for these assets and liabilities would typically exceed the cost of providing it. Therefore, the Board decided to

restrict the use of fair value as deemed cost to those classes of asset for which reconstructing costs is likely to be particularly onerous and of limited benefit to users: property, plant and equipment and (when an entity elects to use the cost method in IAS 40 *Investment Property*) investment property (paragraphs 16 and 18 of the Exposure Draft).

BC37 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 'cherry-picking'—selective revaluation of only those assets whose revaluation would lead to a particular result. Some have suggested a similar restriction on the use of fair value as deemed cost. However, the Board concluded that such a restriction is not needed, for the following reason. Although some see a requirement based on 'undue cost or effort' as an implicit option, it is not totally unrestricted. An entity will need to be consistent in concluding whether cost-based measurements involve undue cost or effort. This limits the scope for cherry-picking.

Business combinations

BC38 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) the use of amounts assigned under previous GAAP as deemed cost (paragraph BC39);

(b) whether an entity should restate amounts assigned using a previous GAAP method that brings forward unchanged the pre-combination carrying amounts of the combining entities (paragraphs BC40 and BC41);

(c) whether an entity should restate amounts assigned under previous GAAP for business combinations that occurred during a look-back period before the date of transition to IFRSs (paragraph BC42); and

(d) whether an entity should restate goodwill for adjustments made in its opening IFRS balance sheet to the carrying amounts of assets and liabilities acquired in past business combinations (paragraphs BC43-BC45).

BC39 The principle in paragraph 7 of the Exposure Draft would require a first-time adopter to apply the most recent version of IAS 22 *Business Combinations* retrospectively to past business combinations when it prepares its opening IFRS balance sheet. Some have argued that the Board should follow this approach, to increase comparability. However, retrospective application 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, the Board concluded that the costs of restatement would be likely to exceed the benefits. As a result, the Exposure Draft treats amounts an entity assigned under previous GAAP to goodwill and other assets and liabilities acquired in a past business combination as their deemed cost under IFRSs at the date of the business combination (paragraph 20).

BC40 Under previous GAAP, an entity might have used a method of accounting that brings forward unchanged the pre-combination carrying amounts of the combining entities. Some argued that it would be inconsistent to use these carrying amounts as deemed cost under IFRSs, given that the Board rejected the use of similar carrying amounts as deemed cost for assets and liabilities that were not acquired in a business combination. However, the Board was unable to identify any specific form of past business combination, or any specific form of accounting for past business combinations, for which it would not be appropriate to bring forward cost-based measurements made under previous GAAP. Therefore, the Exposure Draft would prohibit restatement of cost-based measurements for assets and liabilities that an entity acquired through any past business combination.[1]

[1] Except when an entity elects not to use any of the exemptions in paragraphs 14-24 of the Exposure Draft (see paragraph 13).

BC41 If an entity did not recognise a particular asset or liability under previous GAAP at the date of the business combination, its deemed cost under IFRSs will be zero. As a result, the entity's opening IFRS balance sheet will not include that asset or liability if IFRSs permit or require a cost-based measurement. The Board acknowledges that this result is a departure from the principle that the opening IFRS balance sheet should include all assets and liabilities. However, the most likely assets to remain unrecognised because of this departure are goodwill and intangible assets and these are assets that often remain unrecognised in other circumstances, namely if they were generated internally.

BC42 Some suggested that IAS 22 should be applied in full not only for the periods presented in the primary financial statements, but also for an additional look-back period of, perhaps, three to five years. Using that approach, an entity would restate amounts assigned under previous GAAP at the date of the business combination. However, the Board concluded that the costs of restating past business combinations, even for a limited period, would exceed the benefits to users.

BC43 Although the Exposure Draft treats amounts assigned under previous GAAP to goodwill and other assets and liabilities acquired 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 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) Items that do not qualify for recognition as assets and liabilities under IFRSs: eliminated from the opening IFRS balance sheet.

BC44 The Board considered whether a first-time adopter should recognise the resulting adjustments by restating goodwill. This would be consistent with retrospective application of IAS 22 *Business Combinations*.[2] Because intangible assets and goodwill are closely related, the Board decided to require the restatement of goodwill on eliminating an item that was recognised under previous GAAP (in a business combination classified as an acquisition) as an intangible asset but does not qualify for separate recognition under IFRSs. However, the Board decided to prohibit restatement of goodwill for other adjustments reflected in the opening IFRS balance sheet, because of the Board's conclusion that full restatement of past business combinations would involve undue cost or effort (paragraph BC39).

BC45 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 Board decided that an entity should carry out an impairment test on goodwill recognised in its opening IFRS balance sheet (paragraph 20(b)(ii) of the Exposure Draft). This could 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 involve undue cost or effort.

Employee benefits

BC46 If an entity elects to use the 'corridor' approach in IAS 19 *Employee Benefits*, full retrospective application of IAS 19 would, in principle, 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 exercise would involve undue cost or effort. Therefore, the Board decided to require a 'fresh start' approach that eliminates unrecognised actuarial gains or losses at that date (paragraph 22).

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[2] IAS 22 prohibits restatement of goodwill for most adjustments made after the end of the first annual accounting period beginning after acquisition. However, that restriction applies to an entity that already applies IFRSs. It is, arguably, not relevant when considering the appropriate treatment when an entity first adopts IFRSs.

BC47 An entity may previously have accounted for post-employment benefit costs in a way that is identical (or virtually identical) to the basis required by IAS 19. If the entity elects to use the 'corridor' approach in IAS 19, it will almost certainly have unrecognised actuarial gains or losses at the date of transition to IFRSs. The 'fresh start' in the Exposure Draft eliminates previously unrecognised actuarial gains or losses. To avoid a discontinuity at this point, some would permit or require the entity to continue the IFRS-compliant aspects of its previous accounting, without applying the 'fresh start'. However, the Board concluded that it would take an arbitrary decision to determine when the previous accounting was sufficiently similar to that required by IAS 19 for a fresh start to be inappropriate. The Exposure Draft would require the 'fresh start', except when an entity elects not to use any of the exemptions in paragraphs 14-24 of the Exposure Draft (see paragraph BC60).

BC48 The 1999 revision of IAS 19 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, as explained in paragraph BC83, the Board confirmed in paragraph 21 of the *Preface to International Financial Reporting Standards* that it has no general policy of exempting transactions occurring before a specific date from the requirements of new IFRSs. Therefore, the Board decided not to include a similar transitional requirement for first-time adopters.

BC49 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 involve undue cost or effort. Therefore, they proposed that the Board should permit an entity to use one 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.

BC50 The Board concluded that a general exemption from the principle of measurement at each date would conflict with the objective of providing useful and transparent 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).

Cumulative translation differences

BC51 IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires an entity to classify some cumulative translation differences (CTD) relating to a net investment in a foreign operation as a separate component of equity. The entity transfers the CTD to the income statement on subsequent disposal of the foreign operation.

BC52 The Board concluded that the benefits of this separate classification (and transfer to the income statement on subsequent disposal) are not sufficient to justify the cost and effort that could be involved in reconstructing CTD on a basis that complies with IAS 21 if, under previous GAAP, the entity did not track CTD or determined CTD on a different basis. Therefore, if determining CTD for a foreign operation would involve undue cost or effort, the Exposure Draft would require a first-time adopter to use the CTD, if any, determined for the foreign operation at the date of transition to IFRSs under previous GAAP as the deemed CTD under IFRSs at that date.

Retrospective designation

BC53 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) the treatment of cumulative fair value changes on available-for-sale financial assets at the date of transition to IFRSs; and

(b) hedge accounting.

Available-for-sale financial assets

BC54 Retrospective application of IAS 39 to available-for-sale financial assets requires first-time adopters to recognise the cumulative fair value changes in a separate component of equity in the opening IFRS balance sheet, and recycle those fair value changes into 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 recycling on disposal) and assets with cumulative losses as held for trading (with no recycling).

BC55 The Board's proposed improvements to IAS 39[3] would create an extra ingredient that did not exist when IAS 39 became effective and that could increase the scope for selective classification of this kind by first-time adopters. That ingredient is the proposed option to designate any financial asset as held for trading on first adopting the proposed improvements to IAS 39. However, the Board noted that an entity could also 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.

Hedging: financial instruments

BC56 It is unlikely that most entities would have adopted IAS 39's criteria for documenting hedges at their inception and testing the hedges for effectiveness before they adopted IAS 39 (or a local standard based on IAS 39), 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.

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[3] See Exposure Draft *Amendments to IAS 32, Financial Instruments: Disclosure and Presentation, and IAS 39, Financial Instruments: Recognition and Measurement*, published in June 2002.

BC57 To overcome these problems, the transitional requirements in IAS 39 require prospective application of the hedging requirements when an entity adopts IAS 39. The Board decided that prospective application is also appropriate for a first-time adopter.

BC58 The transitional requirements in IAS 39 are complex and may be difficult to interpret in practice. The IAS 39 Implementation Guidance Committee issued extensive guidance on them in the form of Questions and Answers (Q&A). To help readers of the Exposure Draft, the Board decided to include a redrafted version of those transitional requirements and related Q&A (paragraph 24 and Appendix C of the Exposure Draft). The Board did not intend the redrafting to create substantive changes to those existing transitional requirements and Q&A.

Continuation of existing accounting

BC59 Paragraph 13 of the Exposure Draft would permit some first-time adopters to continue existing accounting that complied in full with the recognition and measurement requirements of IFRSs. For example, consider an entity that has been preparing IFRS data internally without presenting financial statements that contain an explicit and unreserved statement of compliance with IFRSs. In the absence of paragraph 13, paragraph 20 would require the entity to carry forward previous GAAP carrying amounts of assets and liabilities acquired in a past business combination as deemed cost under IFRSs, even if the entity has the data needed to apply the version of IAS 22 that was effective at the date of the business combination.

BC60 The Board concluded that this would be unreasonable and not beneficial to users. Therefore, paragraph 13 states that an entity would not be required to use the exemptions in paragraphs 14-24 of the Exposure Draft. However, to prevent selective application of some exemptions to achieve a desired result, paragraph 13 states that an entity must use either all the exemptions that are applicable or none of them. If an entity does not use the exemptions, the most significant consequences are that it:

(a) accounts for past business combinations in accordance with IAS 22 *Business Combinations*, instead of using amounts determined under previous GAAP as deemed cost (see paragraphs BC38-BC45);

(b) does not eliminate unrecognised actuarial gains and losses arising from defined benefit plans (see paragraphs BC46-BC50); and

(c) uses earlier versions of IFRSs if subsequent versions contained transitional provisions that permitted or required prospective application (see paragraphs BC79 and BC80).

BC61 Even if an entity does not use the exemptions in paragraphs 14-24 of the Exposure Draft, it must still give the same disclosures as other first-time adopters about the effect of the transition from previous GAAP.

BC62 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. The Board concluded that it would be burdensome—and not be beneficial to users—to compel the subsidiary to keep two parallel sets of accounting records based on different dates of transition to IFRSs.

BC63 Under paragraph 13 of the Exposure Draft, the subsidiary could elect not to use any of the exemptions in paragraphs 14-24. For example, consider a parent that presents its first IFRS financial statements in 2005 (with 1 January 2004 as the date of transition to IFRSs) and has a foreign subsidiary that reports to the parent under IFRSs from 2005 but does not present its own first IFRS financial statements until 2007. Paragraph 13 would permit the subsidiary to present its own first IFRS financial statements in 2007 as if it had always applied IFRSs. However, although 1 January 2004 is the subsidiary's date of transition to IFRSs for reporting to the parent, paragraph 13 would not permit the subsidiary to use 1 January 2004 as the date of transition to IFRSs when it presents its own first IFRS financial statements. Thus, paragraph 13 would not necessarily solve the problem discussed in paragraph BC62. Therefore, paragraph 5 of the Exposure Draft proposes that the subsidiary would not be treated as a first-time adopter for recognition and measurement in 2007, subject to various conditions. However, the subsidiary must still give the same disclosures as other first-time adopters about the effect of the transition from previous GAAP.

Other possible exemptions rejected

BC64 Paragraphs BC65-BC78 discuss other limited exemptions that the Board considered, but rejected, for borrowing costs, decommissioning and site restoration costs, depreciation, hyperinflation, intangible assets and finance lease income. Each such exemption would have moved the Exposure Draft away from a principle-based approach, and the Board found no compelling reason for exemptions in these areas.

Borrowing costs

BC65 Some argued that restatement of past borrowing costs may be costly, and that the benefit to users of such restatements is questionable. Indeed, IAS 23 *Borrowing Costs* permitted entities following the allowed alternative treatment in IAS 23 (capitalisation of borrowing costs) not to capitalise borrowing costs incurred before the effective date of IAS 23, although IAS 23 did encourage retrospective adoption. However, the Board concluded that prospective application of IAS 23 by first-time adopters would diminish transparency for users and create additional complexity, and that any cost savings would not outweigh these disadvantages.

Decommissioning and site restoration costs

BC66 A first-time adopter may have an obligation for decommissioning costs, site restoration costs or similar items that qualifies for recognition as a liability under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, but was not recognised under previous GAAP. Under the Exposure Draft, the amount recognised as a provision in the opening IFRS balance sheet differs from the amount capitalised as part of the cost of the related asset. Reasons for the difference include depreciation of the asset and the unwinding of the discount because of the passage of time.

BC67 Some argued that it may be onerous to determine the effect of these differences. They suggested that the Board should permit or require entities to capitalise as part of the cost of the asset an amount that equals the amount recognised as a provision at the date of transition to IFRSs. They noted that the use of fair value as deemed cost might also have the same effect, although this would require a first-time adopter to determine the fair value of all components of the asset, and not just of the component represented by these particular costs.

BC68 The transitional requirements in IAS 37 do not contain such an exemption, and the Board saw no reason to include such an exemption for first-time adopters.

Depreciation

BC69 In some cases, accumulated depreciation under previous GAAP at the date of transition to IFRSs differs materially from accumulated depreciation at that date under IFRSs. This is most likely to occur in countries where depreciation rates or methods are heavily influenced by tax considerations. Some argued that the Board should permit or require a first-time adopter to measure the asset in its opening IFRS balance sheet at the carrying amount determined under previous GAAP. This is consistent with the treatment of changes in useful life or depreciation pattern under IAS 16 *Property, Plant and Equipment*. Supporters of this treatment argue that restatement of past depreciation under IAS 16 would be costly, involve hindsight and be of limited relevance to users.

BC70 In the Board's view, retaining the accumulated depreciation under previous GAAP without restatement would damage comparability and transparency. Therefore, the Exposure Draft would require restatement of accumulated depreciation. In many cases, an entity may conclude that the difference is not material, in which case restatement is not required. Also, if restatement of an item of property, plant and equipment would cause undue cost or effort, an entity can use fair value at the date of transition to IFRSs as deemed cost at that date.

Hyperinflation

BC71 Some argued that restating financial statements for the effects of hyperinflation in periods before the date of transition to IFRSs might involve undue cost or effort, 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

BC72 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 administrative cost and effort 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.

BC73 In many cases intangible assets do not qualify for recognition under IAS 38 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.

BC74 In other cases, an entity may have accumulated and retained sufficient information about costs and future economic benefits to determine which internally generated intangible assets qualify under IAS 38 for recognition in its opening IFRS balance sheet. In such cases, the information is available without undue cost or effort and no exclusion is justified.

BC75 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). However, this would require an exemption from IAS 38. In the Board's view, such an exemption would cause costs for preparers and additional complexity that are not justified by possible benefits to users. Also, IAS 38 permits intangible assets to be measured at fair value only if fair value is determined by reference to a (strictly defined) active market, except in a business combination.

BC76 IAS 38 prohibits the recognition of intangible assets for which cost cannot be determined reliably, even if an entity can determine their fair value reliably. Moreover, the Exposure Draft would not permit the use of fair value as deemed cost for intangible assets. Therefore, a first-time adopter cannot recognise intangible assets if it cannot determine their cost reliably.

Finance lease income

BC77 Some entities may have recognised finance lease income under previous GAAP on a basis that does not comply with IAS 17 *Leases*. Some argued that it would be burdensome for a lessor to apply a new pattern of lease income recognition retrospectively for existing leases. They noted that IAS 17 permitted prospective application when it was revised in 1997 to eliminate the net cash investment method for recognising finance income of lessors.

BC78 However, the Board concluded that reporting finance lease income on one basis for old leases and a different basis for new leases would diminish the relevance and reliability of a lessor's financial statements. Therefore, the Exposure Draft would not permit prospective application of any aspect of IAS 17. Among other things, this means that a finance lessor measures finance lease receivables in its opening IFRS balance sheet as if the net cash investment method had never been permitted.

Different versions of an IFRS

BC79 Some suggested that retrospective application requires a first-time adopter to apply different versions of an IFRS in its first IFRS financial statements if a new or amended version of the IFRS required prospective application by entities that already applied IFRS at the time of its introduction. In other words, a first-time adopter might have two different conversions in its first financial statements—from previous GAAP to an old version of an IFRS and then from the old version to a new version of the IFRS. However, the Board decided that an entity should apply a single version of IFRSs in its opening IFRS financial statements, without considering superseded or amended versions of IFRSs. In the Board's view, 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 for preparers.

BC80 As discussed in paragraphs BC59-BC61, the Board decided that a first-time adopter could elect not to use any of the exemptions in paragraphs 14-24 of the Exposure Draft, in order to continue to apply IFRS recognition and measurement requirements. To achieve this objective, if a first-time adopter makes this election, paragraph 13 of the Exposure Draft would require it to continue to apply the IFRSs that were effective in each period. Therefore, the first-time adopter may need to consider superseded versions of IFRSs if later versions require prospective application.

BC81 The transitional requirements of some IFRSs require or permit prospective application. The Board considered whether it should require prospective application by first-time adopters in these cases. Requirements for prospective application generally reflect a conclusion that one or more of the following factors is present in a particular case:

(a) retrospective application may be difficult or involve costs exceeding the likely benefits;

(b) there is a danger of abuse if retrospective application would require decisions by management about past conditions at a time when the outcome of a particular transaction is already known; or

(c) retrospective application may lead to difficult distinctions between changes in estimates and changes in the basis for making estimates.

BC82 The Board decided that the Exposure Draft should specify a particular accounting treatment in specified cases where the Board concluded that retrospective application might involve undue cost or effort (paragraphs BC32-BC52), or where retrospective designation by management could lead to abuse (paragraphs BC53-BC58).

BC83 When a new IFRS introduces a new basis of measurement, it may be difficult to distinguish changes in estimates from changes in the basis for making estimates. For this reason, some existing Standards required prospective application by entities that already apply IFRSs. For example:

(a) IAS 36 *Impairment of Assets* required prospective application because of the difficulty in determining whether an impairment loss results from a change in accounting policies or a change in circumstances. Most additional impairment losses resulting from the adoption of IAS 36 are recognised in the income statement.

(b) IAS 39 *Financial Instruments: Recognition and Measurement* required an entity to introduce fair value measurements prospectively at the beginning of the financial year in which the entity adopted IAS 39. This requirement reflects the difficulty of determining fair values retrospectively.

(c) IAS 40 *Investment Property* required an entity adopting the fair value model to do so prospectively at the beginning of the financial year in which the entity adopted the Standard. IAS 40 permitted retrospective application if, and only if, the entity had previously disclosed publicly (in financial statements or otherwise) the fair value of its investment property in earlier periods.

BC84 As explained in paragraph BC13, the Board's benchmark for cost-benefit assessments was an entity that collects most of the information needed for its opening IFRS balance sheet at, or very soon after, the date of transition to IFRSs. Accordingly, when a first-time adopter prepares its opening IFRS balance sheet, it should be able to distinguish changes in estimates from changes in the basis of making estimates. Therefore, the Board concluded that the need for such distinctions does not create obstacles to retrospective application by first-time adopters.

BC85 Some suggested a further reason for permitting or requiring prospective application: to alleviate consequences of a new IFRS that were not foreseen when an entity finalised a contract or agreement if another party uses financial statements to monitor compliance with the contract or agreement. For example, covenants in banking and loan agreements may impose limits based on amounts in a borrower's financial statements. 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, the manner in which it might be renegotiated to reflect changes in reporting rather than changes in the underlying financial condition (paragraph 21 of the *Preface to International Financial Reporting Standards*).

BC86 Some suggested that transitional requirements of other existing or future IFRSs should give a first-time adopter the same accounting options as an entity that already applies IFRSs. This approach was apparent in SIC-8. For example, under IAS 22 *Business Combinations* an entity already applying IASs was permitted to charge goodwill that arose before 1995 directly to equity, without capitalising it. SIC-8 granted first-time adopters the same option for pre-1995 goodwill, regardless of the treatment adopted for previous GAAP.

BC87 However, as noted in paragraph BC16, the Board's primary objective was to achieve comparability over time within an entity's first IFRS financial statements. Permitting prospective application by a first-time adopter would conflict with that primary objective, even if prospective application were available to entities already applying IFRSs. Therefore, the Board decided not to 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.

BC88 The Board also decided that it will consider case by case whenever 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 [draft] IFRS on first-time application of IFRSs. As a result, this [draft] IFRS will contain all material on first-time application and other IFRSs will not refer to first-time adopters (except, when needed, in the Basis for Conclusions and consequential amendments).

ESTIMATES

BC89 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 correct those estimates. Some of those events might qualify as adjusting events under IAS 10 *Events After the Balance Sheet Date*. However, provided that the entity made those estimates on a basis consistent with IFRSs, the Board concluded that it would be more helpful to users—and more consistent with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*—to recognise the revision of those estimates as income or expense in the period when the entity made the revision, rather than in preparing the opening IFRS balance sheet (paragraphs 25-27 of the Exposure Draft).

PRESENTATION AND DISCLOSURE

Comparative information

BC90 IAS 1 *Presentation of Financial Statements* requires an entity to disclose comparative information 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.

BC91 Nevertheless, the Board decided not to 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.

Reconciliation to previous GAAP

BC92 Some argued that the Exposure Draft should not require disclosures about the effect of the transition from previous GAAP to IFRSs. In their view, such disclosures include information about another basis of accounting that is not relevant in IFRS financial statements. Others argued that a disclosure requirement would be redundant, because market pressure will compel entities to release such information.

BC93 However, 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 preparers, auditors and users because the opening IFRS balance sheet is the starting point for accounting under IFRSs.

BC94 Paragraph 31(a) and (b) requires reconciliations of equity and reported 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 Exposure Draft would require disclosure of narrative information about these adjustments, as well as about adjustments to the cash flow statement (paragraph 32).

BC95 For impairment losses (and reversals) recognised in preparing the opening IFRS balance sheet, paragraph 31(c) 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.

BC96 IAS 34 *Interim Financial Reports* states that the "interim financial report is intended to provide an update on the latest complete set of annual financial statements" (paragraph 6 of IAS 34). 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 (paragraph 37).

Historical summaries

BC97 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 Exposure Draft would require disclosure of adjustments that would be needed to make historical summaries included in financial statements or interim financial reports compatible with IFRSs (paragraph 36 of the Exposure Draft). Historical summaries published outside financial statements or interim financial reports are beyond the scope of the Exposure Draft.

ED 1 First-time Application of International Financial Reporting Standards

[Draft] Implementation Guidance

IAS 10 Events After the Balance Sheet Date	**paragraphs IG1–2**
IAS 16 Property, Plant and Equipment	**IG3–10**
IAS 17 Leases	**IG11-13**
IAS 18 Revenue	**IG14**
IAS 19 Employee Benefits	**IG15-18**
IAS 22 Business Combinations	**IG19**
IAS 23 Borrowing Costs	**IG20-24**
IAS 29 Financial Reporting in Hyperinflationary Economies	**IG25-26**
IAS 32 Financial Instruments: Disclosure and Presentation	**IG27-28**
IAS 34 Interim Financial Reporting	**IG29-30**
IAS 36 Impairment of Assets and	
IAS 37 Provisions, Contingent Liabilities and Contingent Assets	**IG31-35**
IAS 38 Intangible Assets	**IG36-41**
IAS 39 Financial Instruments: Recognition and Measurement	**IG42-50**
Recognition	IG43-44
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INTERNATIONAL FINANCIAL REPORTING STANDARD IFRS X First-time Application of International Financial Reporting Standards

[Draft] Implementation Guidance

This [draft] guidance is not part of the [draft] IFRS. It explains how the requirements of the [draft] IFRS interact with the requirements of some other IFRSs.

IAS 10 Events After the Balance Sheet Date

IG1 Except as described in paragraph IG2, an entity applies IAS 10 in determining whether:

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

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

IG2 Paragraphs 25-27 of the [draft] IFRS require some modifications to the principles in IAS 10 when a first-time adopter determines whether changes in estimates are adjusting or non-adjusting events at the date of transition to IFRSs (or, when applicable, the end of the comparative period). Cases 1 and 2 below illustrate those modifications. In case 3 below, paragraphs 25-27 of the [draft] IFRS do not require modifications to the principles in IAS 10.

(a) Case 1—Previous GAAP required estimates of similar items for the date of transition to IFRSs, using an accounting policy that is consistent with IFRSs. In this case, the estimates under IFRSs need to be consistent with estimates made for that date under previous GAAP, unless there is objective evidence that those estimates were in error

(see IAS 8 *Accounting Policies, Changes in Estimates and Errors*).[1] The entity reports later revisions to those estimates as events of the period in which it makes the revisions, rather than as adjusting events resulting from the receipt of further evidence about conditions that existed at the date of transition to IFRSs.

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

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

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

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[1] The IASB proposes to replace the concept of fundamental errors in IAS 8 with a concept of material errors (see Exposure Draft *Improvements to International Accounting Standards,* published in May 2002).

Example

BACKGROUND

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

(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 J was required to pay 1,000 and paid this on 10 July 2005.

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

APPLICATION OF REQUIREMENTS

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

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

continued...

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

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

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

IAS 16 Property, Plant and Equipment

IG3 An entity that adopts the benchmark treatment in IAS 16 measures its property, plant and equipment at the date of transition to IFRSs at depreciated cost, less accumulated impairment losses, if any. In some cases, this may involve undue cost or effort for one or more items of property, plant and equipment. 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 measures those items at the date of transition to IFRSs at their fair value and uses that fair value as their deemed cost at that date, unless paragraph 17 or 19 applies (paragraph 16 of the [draft] IFRS). Subsequent depreciation is based on that deemed cost.

IG4 If an entity's depreciation methods and rates under previous GAAP are acceptable under IFRSs, the entity does not restate accumulated depreciation in its opening IFRS balance sheet. Instead, the entity accounts for any change in estimated useful life or depreciation pattern prospectively from the period when it makes that change in estimate (paragraph 25 of the [draft] IFRS and paragraph 52 of IAS 16). However, in some cases, an entity's depreciation methods and rates under previous GAAP 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). If so, the entity adjusts accumulated depreciation in its opening IFRS balance sheet retrospectively so that it complies with IFRSs.

IG5 In some cases, an asset is made up of components that have different useful lives or provide benefits to the entity in different patterns. Under IAS 16, the entity accounts for these components as separate assets (see IAS 16, paragraphs 12 and 27, and SIC-23 *Property, Plant and Equipment – Major Inspection or Overhaul Costs*).

IG6 If an entity adopts the allowed alternative treatment in IAS 16 for some or all classes of property, plant and equipment, the entity measures those classes at fair value in its opening IFRS balance sheet. If it can determine, without undue cost and effort, the amounts that would have been included in the opening IFRS balance sheet under the benchmark treatment, the entity presents the cumulative revaluation surplus as a separate component of equity. If determining these amounts would involve undue cost or effort, the entity treats the fair value at the date of transition to IFRSs as deemed cost (paragraph 16 of the [draft] IFRS) and gives the disclosures required by paragraph 35 of the [draft] IFRS.

IG7 Using its previous GAAP, an entity may have revalued items of property, plant and equipment, 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. Paragraph 17 of the [draft] IFRS permits an entity to treat such revalued amounts as deemed cost under IFRSs—even if the entity could establish an IFRS-compliant measurement based on original cost without undue cost or effort. Paragraph 17 applies only to property, plant and equipment (and investment property, if an entity elects to use the cost model in IAS 40 *Investment Property*).

IG8 If an entity carried out revaluations under previous GAAP that did not satisfy the criteria in the previous paragraph, the entity measures the revalued assets in its opening balance sheet on one of the following bases:

(a) cost less any accumulated depreciation and any accumulated impairment losses under the IAS 16 benchmark treatment;

(b) deemed cost, being the fair value at the date of transition to IFRSs, if determining the measurement in (a) would involve undue cost or effort (paragraph 16 of the [draft] IFRS); or

(c) revalued amount, if the entity adopts the IAS 16 allowed alternative treatment as its accounting policy under IFRSs for all assets in the same class.

IG9 In some cases, an entity may have established a deemed cost under previous GAAP for an item of property, plant and equipment (or other assets and liabilities) by measuring it at fair value at one particular date because of an event such as a privatisation or initial public offering. Such event-driven measurements establish a deemed cost for subsequent accounting under IFRSs (paragraph 19 of the [draft] IFRS).

IG10 In some cases, the construction or commissioning of an asset results in an obligation for an entity to dismantle or remove the asset and restore the site on which the asset stands. An entity applies IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* in recognising and measuring any resulting provision. The entity applies IAS 16 in determining the resulting amount included in the cost of the asset, before depreciation and impairment losses. Items such as depreciation and, when applicable, impairment losses cause differences between the carrying amount of the provision and the amount included in the carrying amount of the asset.

IAS 17 Leases

IG11 At the date of transition to IFRSs, a lessee or lessor classifies leases as operating leases or finance leases on the basis of circumstances existing at the inception of the lease (IAS 17, paragraph 10). 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 IAS 17 had the changed terms been in effect at the inception of the lease. If so, the revised agreement is considered as a new agreement over its term. However, changes in estimates (for example, changes in estimates of the economic life or of 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.

IG12 When IAS 17 was revised in 1997, the net cash investment method for recognising finance income of lessors was eliminated. IAS 17 permits finance lessors to eliminate this method prospectively. However, the transitional provisions in IAS 17 do not apply to an entity's opening IFRS balance sheet. Therefore, the [draft] IFRS requires a finance lessor to measure finance lease receivables in its opening IFRS balance sheet as if the net cash investment method had never been permitted.

IG13 SIC-15 *Operating Leases—Incentives* applies to lease terms beginning on or after 1 January 1999. However, under the [draft] IFRS, an entity applies SIC-15 to all leases, whether they start before or after that date.

IAS 18 Revenue

IG14 If an entity has received amounts that do not yet qualify for recognition as revenue under IAS 18 (for example, the proceeds of a sale that does not qualify for revenue recognition), the entity recognises the amounts received as a liability in its opening IFRS balance sheet and measures that liability at the amount received.

IAS 19 Employee Benefits

IG15 At the date of transition to IFRSs, an entity measures net employee benefit assets or liabilities under defined benefit plans in accordance with IAS 19 *Employee Benefits*, except that no actuarial gains or losses remain unrecognised (paragraph 22 of the [draft] IFRS). The transitional provisions in IAS 19 do not apply to an entity's opening IFRS balance sheet (paragraph 9 of the [draft] IFRS).

IG16 An entity's actuarial assumptions at the date of transition to IFRSs are consistent with actuarial assumptions made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 25 of the [draft] IFRS). The entity treats the impact of any later revisions to those assumptions as actuarial gains or losses of the period in which it makes the revisions.

IG17 An entity may need to make actuarial assumptions at the date of transition to IFRSs that were not necessary under its previous GAAP. Such actuarial assumptions do not reflect conditions that arose after the date of transition to IFRSs. In particular, discount rates and the fair value of plan assets at the date of transition to IFRSs reflect market conditions at that date. Similarly, the entity's actuarial assumptions at the date of transition to IFRSs about future employee turnover rates do not reflect a significant increase in estimated employee turnover rates as a result of a curtailment of the pension plan that occurred after the date of transition to IFRSs (paragraph 26 of the [draft] IFRS).

IG18 In many cases, an entity's first IFRS financial statements will reflect measurements of employee benefit obligations at three dates: the reporting date, the date of the comparative balance sheet and the date of transition to IFRSs. To minimise costs, an entity may obtain a full actuarial valuation at one or two of these dates and roll the valuation(s) forward or back to the other date(s). Any such roll forward or roll back reflects any material transactions and other material events (including changes in market prices and interest rates) between those dates (IAS 19, paragraph 57).

IAS 22 Business Combinations

IG19 See Appendix B of the [draft] IFRS.

IAS 23 Borrowing Costs

IG20 On first adopting IFRSs, an entity adopts a policy of capitalising borrowing costs (IAS 23 allowed alternative treatment) or not capitalising them (IAS 23 benchmark treatment). The entity applies that policy consistently in its opening IFRS balance sheet and in all periods presented in its first IFRS financial statements.

IG21 If an entity capitalised borrowing costs under previous GAAP, but adopts a policy under the IAS 23 benchmark treatment of not capitalising borrowing costs, it may involve undue cost or effort to quantify the amount of capitalised interest to be excluded from the carrying amount of some assets in the opening IFRS balance sheet. Similarly, if an entity adopts a policy under the IAS 23 allowed alternative treatment of capitalising borrowing costs, but adopted a different policy under its previous GAAP, determining a cost-based measurement for some qualifying assets (as defined in IAS 23) may involve undue cost or effort.

IG22 In both cases discussed in paragraph IG21, if determining a cost-based measurement for property, plant and equipment (including investment property) would involve undue cost or effort, an entity treats the fair value of those items at the date of transition to IFRSs as their deemed cost, unless paragraph 17 or 19 applies (paragraph 16 of the [draft] IFRS). The entity also gives the disclosures required by paragraph 35.

IG23 Under the allowed alternative treatment, IAS 23 requires disclosure of interest capitalised during the period. Neither IAS 23 nor the [draft] IFRS requires disclosure of the cumulative amount capitalised.

IG24 IAS 23 contains transitional provisions that encourage retrospective application, but permit an entity that adopts the allowed alternative treatment to capitalise (prospectively) only those borrowing costs incurred after the effective date that meet the criteria for capitalisation. However, if a first-time adopter adopts the IAS 23 allowed alternative treatment, the [draft] IFRS requires retrospective application of that treatment.

IAS 29 Financial Reporting in Hyperinflationary Economies

IG25 An entity complies with IAS 21 *The Effects of Changes in Foreign Exchange Rates* in determining its functional currency. When the entity prepares its opening IFRS balance sheet, it applies IAS 29 to any periods during which the economy of the functional currency was hyperinflationary.

IG26 If an entity cannot, without undue cost or effort, determine the impact of past hyperinflation on the measurement of items of property, plant and equipment (including investment property) in its opening IFRS balance sheet, it treats their fair value at that date as their deemed cost at that date (paragraph 16), unless paragraph 17 or 19 is relevant for a revalued amount or fair value determined after the hyperinflation ceased. The entity also gives the disclosures required by paragraph 35.

IAS 32 Financial Instruments: Disclosure and Presentation

IG27 In its opening IFRS balance sheet, an entity applies the criteria in IAS 32 to classify financial instruments issued (or components of compound instruments issued) as either financial liabilities or equity instruments in accordance with the substance of the contractual arrangement when the instrument first satisfied the recognition criteria in IAS 32 (paragraphs 18 and 26), without considering events after that date (other than changes to the terms of the instruments).

IG28 For compound instruments issued, 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 IFRS financial statements.

IAS 34 Interim Financial Reporting

IG29 IAS 34 applies if an entity is required, or elects, to present an interim financial report in accordance with IFRSs. Accordingly, neither IAS 34 nor the [draft] IFRS requires an entity to:

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

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

IG30 An entity applies the [draft] IFRS in each interim financial report that it presents under IAS 34 for part of the period covered by its first IFRS financial statements. In particular, paragraph 37 of the Exposure Draft would require an entity to disclose various reconciliations.

Example

BACKGROUND

Entity K's first IFRS financial statements have a reporting date of 31 December 2005, and its first interim financial report under IAS 34 is for the quarter ended 31 March 2005. Entity K 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 K includes reconciliations of:

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

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

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

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

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

Each of the above reconciliations gives sufficient detail to enable users to understand the material adjustments to the balance sheet and income statement and distinguish changes in accounting policies from changes in estimates and from the correction of errors. Entity K also explains the material adjustments to the cash flow statement.

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

IG31 An entity applies IAS 36 in:

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

(b) measuring any impairment loss that exists at that date, and reversing any impairment loss that no longer exists at that date. An entity's first IFRS financial statements include the disclosures that IAS 36 would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition to IFRSs (paragraph 31(c) of the [draft] IFRS).

IG32 The estimates used to determine whether an entity recognises an impairment loss or provision (and to measure any such impairment loss or provision) at the date of transition to IFRSs are consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error (paragraph 25 of the [draft] IFRS). The entity reports the impact of any later revisions to those estimates as an event of the period in which it makes the revisions.

IG33 In assessing whether it needs to recognise an impairment loss or provision (and in measuring any such impairment loss or provision) at the date of transition to IFRSs, an entity may need to make estimates for that date that were not necessary under its previous GAAP. Such estimates and assumptions do not reflect conditions that arose after the date of transition to IFRSs (paragraph 26 of the [draft] IFRS).

IG34 The transitional provisions in IAS 36 and IAS 37 do not apply to an entity's opening IFRS balance sheet.

IG35 IAS 36 requires the reversal of impairment losses in some cases. If an entity's opening IFRS balance sheet reflects impairment losses, the entity recognises any later reversal of those impairment losses in the income statement (except when IAS 36 requires the entity to treat that reversal as a revaluation). This applies to both impairment losses recognised under previous GAAP and additional impairment losses recognised on transition to IFRSs.

IAS 38 Intangible Assets

IG36 An entity's opening IFRS balance sheet:

(a) excludes all intangible assets and other intangible items that do not meet the criteria for recognition under IAS 38; and

(b) includes all separately acquired intangible assets that meet the recognition criteria in IAS 38 at the date of transition to IFRSs.

IG37 Under paragraphs 53 and 59 of IAS 38, an entity capitalises the costs of creating internally generated intangible assets prospectively from the date when the recognition criteria are met. Those criteria 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 enterprise; and

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

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

IG38 IAS 38 does not permit an entity to use hindsight to conclude retrospectively that the recognition criteria discussed in paragraph IG37 are met. Therefore, even if an entity concludes retrospectively that a future inflow of economic benefits is probable and is able to reconstruct the costs reliably, paragraph 53 of IAS 38 prohibits it from capitalising the costs incurred before the date when the entity both:

(a) concludes, based on an assessment made 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 system for accumulating the costs of internally generated intangible assets when, or shortly after, they are incurred.

IG39 If an internally generated intangible asset did not meet the criteria for recognition in the opening IFRS balance sheet, but does qualify for recognition under IAS 38 at a later date, its cost is the sum of the expenditure incurred from the date when the asset first meets the recognition criteria in IAS 38.

IG40 An entity's opening IFRS balance sheet includes an intangible asset if, and only if, it qualifies for recognition under IAS 38 at the date of transition to IFRSs (paragraph 11 of the [draft] IFRS). The deemed cost of an intangible asset acquired in a previous business combination is its carrying amount under previous GAAP immediately following the business combination (paragraph 20(a) of the [draft] IFRS). In consequence, if the entity did not assign an amount to an intangible asset at the date of the business combination, the entity does not recognise that intangible asset in its opening IFRS balance sheet.

IG41 If an entity's amortisation methods and rates under previous GAAP would be acceptable under IFRSs, the entity does not restate the accumulated amortisation in its opening IFRS balance sheet. Instead, the entity accounts for any change in estimated useful life or amortisation pattern prospectively from the period when it makes that change in estimate (paragraph 25 of the [draft] IFRS and paragraph 94 of IAS 38). However, in some cases, an entity's amortisation methods and rates under previous GAAP 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 clearly not a reasonable estimate of the asset's useful life). If so, the entity adjusts the accumulated amortisation in its opening IFRS balance sheet retrospectively so that it complies with IFRSs (paragraph 26 of the [draft] IFRS).

IAS 39 Financial Instruments: Recognition and Measurement

IG42 An entity recognises and measures all financial assets and financial liabilities in its opening IFRS balance sheet in accordance with the version of IAS 39 effective at the reporting date for the entity's first IFRS financial statements, except as specified in paragraph 24 and Appendix C of the [draft] IFRS, which address hedging.

Recognition

IG43 An entity recognises all financial assets and financial liabilities (including derivatives) that qualify for recognition under IAS 39 and have not yet qualified for derecognition under IAS 39.

IG44 An entity does not recognise financial assets and financial liabilities that do not qualify for recognition under IAS 39, or have already qualified for derecognition under IAS 39.

Embedded derivatives

IG45 When IAS 39, paragraph 23, requires the 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 those initial carrying amounts 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.

Measurement

IG46 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 reflects the entity's intent and ability at the date of transition to IFRSs. Furthermore, sales or transfers of held-to-maturity investments before the date of transition to IFRSs do not trigger the "tainting" rules in IAS 39, paragraph 83.

(b) to comply with IAS 39, paragraph 10, the category of "loans and receivables originated by the entity" necessarily 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 and (except for cash flow hedges) recognises changes in their fair value in the income statement.

(d) to comply with IAS 39, paragraph 107, an entity classifies a non-derivative financial asset or financial liability in its opening IFRS balance sheet as held for trading if, and only if:

   (i) the entity designates that asset at the date of transition to IFRSs as held for trading;[2] or

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

(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.

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[2] This proposal reflects the IASB's proposed improvements to IAS 39. Among other things, these permit an irrevocable designation (at inception or, if later, at the date of transition to IFRSs) of any financial instrument as held for trading (see Exposure Draft *Amendments to IAS 32, Financial Instruments: Disclosure and Presentation, and IAS 39, Financial Instruments: Recognition and Measurement*).

IG47 For those financial assets and financial liabilities measured at amortised cost in the opening IFRS balance sheet, an entity determines their cost on the basis of circumstances existing when the assets and liabilities first satisfied the recognition criteria in IAS 39. However, if the entity acquired those financial assets and financial liabilities in a past business combination, their carrying amount under previous GAAP immediately following the business combination is their deemed cost under IFRSs at the date of the business combination (paragraph 20(a) of the [draft] IFRS).

IG48 An entity's estimates of loan impairments at the date of transition to IFRSs are consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 25 of the [draft] IFRS). The entity treats the impact of any later revisions to those estimates as impairment losses (or, if the criteria in IAS 39 are met, reversals of impairment losses) of the period in which it makes the revisions.

IG49 On remeasuring an available-for-sale financial asset to fair value at the date of transition to IFRSs, an entity includes any resulting adjustment of the carrying amount determined under previous GAAP for that date in a separate component of equity, rather than in retained earnings. On subsequent derecognition or impairment of the available-for-sale financial asset, the entity transfers the related adjustment to the income statement[3] (paragraph 103(b)(ii) of IAS 39).

Hedge accounting

IG50 Paragraph 24 and Appendix C of the [draft] IFRS deal with hedge accounting.

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[3] Paragraph IG49 reflects the proposal in the June 2002 Exposure Draft of amendments to IAS 39. Among other things, this would remove the existing option in IAS 39 for an entity to recognise changes in the fair value of available-for-sale financial assets in the income statement.

IAS 40 Investment Property

IG51 An entity that adopts the fair value model in IAS 40 measures its investment property at fair value at the date of transition to IFRSs. The transitional requirements of IAS 40 do not apply.

IG52 An entity that adopts the cost model in IAS 40 applies paragraphs IG3-IG10 on property, plant and equipment

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