Overview

Objective

- To explain how an entity's first-time IFRS financial statements should be prepared and presented in accordance with IFRS 1 *First-Time Adoption of International Financial Reporting Standards*.

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1 Introduction

1.1 Background

- SIC-8: *First-time Application of IASs as the Primary Basis of Accounting* required full retrospective application unless a standard required otherwise or amounts could not be determined.

Commentary

This was insufficient guidance for the many entities throughout the world adopting IFRS and has been withdrawn.

- The European Union's requirement that all listed companies in the European Economic Area publish their consolidated financial statements in accordance with International Financial Reporting Standards by 2005, meant that entities with a financial year end of 31 December must have an IFRS statement of financial position as at 1 January 2004 (for comparative purposes).

Commentary

The demand for detailed implementation guidance therefore became an immediate priority for the IASB. The EEA is the 25 member states of the EU plus Iceland, Norway and Leichtenstein.

- One of the main differences between SIC-8 and IFRS 1 is that the IFRS permits certain exemptions from recognition and measurement requirements where compliance would otherwise cause undue cost or effort in application.

Commentary

However, there are NO exemptions from IFRS 1's enhanced disclosure requirements, detailing how the change to IFRSs has affected financial position, performance and cash flows.

1.2 Objective

- To ensure that an entity's first IFRS contain high quality information that is:
  - transparent for users;
  - comparable over all period presented;
  - a starting point for accounting under IFRS; and
  - generated at a cost that does not exceed the benefit (to users).

Commentary

A first time adopter uses the provisions of IFRS 1 and not the transitional provisions of other standards unless IFRS 1 specifies otherwise.

1.3 Scope

- This standard applies to:
  - first IFRS financial statements; and
  - any interim financial statements presented under IAS 34 for any part of the period covered by the first IFRS financial statements.

Commentary

So, for example, if first IFRS financial statements are prepared to 31 December 2008, interim financial statements for 6 months to 30 June 2008 also fall within the scope of IFRS 1.

1.4 Definitions

- *First IFRS financial statements* – the first annual financial statements in which IFRSs are adopted by an explicit and unreserved statement of compliance with IFRS.

Commentary

That is compliance with all IFRSs (issued by IASB) and IASs (adopted by IASB from predecessor body IASC) and applicable standing committee interpretations (IFRICs and SICs).

- *First IFRS reporting period* – the latest reporting period covered by first IFRS financial statements.

- *First-time adopter* – an entity that presents first IFRS financial statements. If an explicit and unreserved statement of compliance has already been made an entity is NOT a first-time adopter.

Commentary

That is even if there was non-compliance and the auditor's report carried a qualified opinion.

- *Opening IFRS statement of financial position* – an entity's statement of financial position at the date of transition to IFRSs.

- *Previous GAAP* – the basis of accounting used immediately before the adoption of IFRS.

- *Date of transition* – the beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements.

- *Deemed cost* – an amount used as a surrogate for cost or depreciated cost at a given date.

Illustration 1

An entity with a 31 December year end presenting its financial statements for 2009 will have a date of transition as 1 January 2008.

Commentary

IAS 1 requires an entity's first IFRS financial statements to include at least three statements of financial position and at least two of each of the other statements (see Session 3).

1.5 Stages in transition to IFRSs

1.5.1 Accounting policies

- Select accounting policies that will comply with IFRSs.
- The same accounting policies are used for all periods presented including the opening IFRS statement of financial position.
- The version of an IFRS that is extant at the end of the first IFRS reporting period (i.e. 31 December 2009 in *Illustration 1*) is used subject to the exemptions permitted under IFRS 1 (see later).

Commentary

Different versions effective at earlier dates must not be applied.

- If a new IFRS permits early application then a first-time adopter may adopt that standard early, but it is not required to do so.
- The transitional arrangements in other IFRSs apply to entities that already use IFRSs. They do not apply to first time adopters except in relation to the derecognition of financial assets and financial liabilities and hedge accounting in accordance with IAS 39.

1.5.2 Opening IFRS statement of financial position

- Prepare and present an opening IFRS statement of financial position (i.e. at the date of transition).

Commentary

This is the starting point to accounting under IFRS.

1.5.3 Estimates

- Make estimates in accordance with IFRSs for the opening statement of financial position and all other periods covered by the financial statements.

Commentary

These must be consistent with estimates made as at the same date under previous GAAP, after adjustments to reflect different accounting policies, unless there is objective evidence that those estimates were in error.

- Information received after the date of transition relevant to estimates made under previous GAAP is treated as for non-adjusting events (IAS 10).

Illustration 2

An entity's date of transition to IFRSs is 1 January 2008.

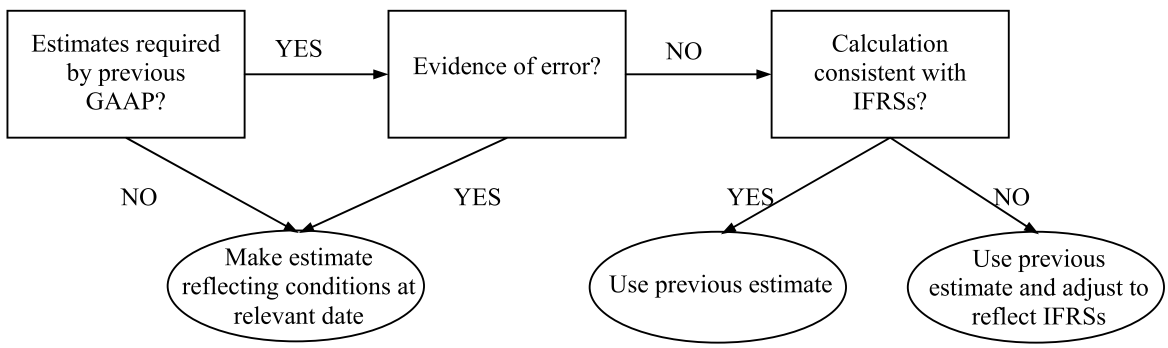
New information on 15 July 2008 requires an increase in the estimate of the allowance for slow-moving inventory made under previous GAAP at 31 December 2007.

The entity does not reflect that new information in its opening IFRS statement of financial position. The increase in estimate will be reflected as an additional expense in the statement of comprehensive income for the year ended 31 December 2008.

- An entity may need to make estimates under IFRSs at the date of transition that were not required at that date under previous GAAP (e.g. if there was no requirement to state inventory at the lower of cost and net realisable value). Such estimates must reflect conditions that existed *at the date of transition* to IFRSs.

Commentary

For example, market prices, interest rates, foreign exchange rates, etc.



- These same principles apply to estimates made for any comparative period presented in first IFRS financial statements.

1.5.4 Presentation and disclosure

- Make presentation and disclosure requirements in accordance with IFRS 1.

Commentary

IFRS 1 does not provide any exemptions from the presentation and disclosure requirements of other accounting standards.

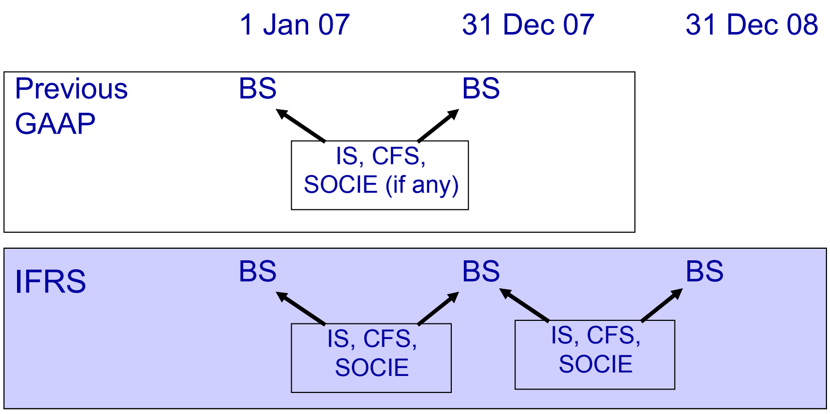
- Include comparative information – at least three statements of financial position and at least two of each of the other statements (IAS 1).

- Historical summaries of selected data need not comply with recognition and measurement requirements of IFRS 1. However, such summaries and comparative information under previous GAAP must be clearly labelled as not being prepared under IFRS and the *nature* of the main adjustments to comply with IFRS disclosed.

Commentary

The adjustments are not required to be quantified.

1.6 Transition overview



Commentary

The financial statements to 31 December 2007 are published under previous GAAP. The financial statements to 31 December 2008 are prepared under IFRS with the comparative information restated.

2 Opening IFRS statement of financial position

2.1 Recognition and measurement principles

- Recognise all assets and liabilities required by IFRSs (e.g. assets held under finance leases and lease obligations).

- Do not recognise assets and liabilities that are not allowed to be recognised under IFRSs (e.g. "provisions" which do not meet the definition of a liability).

- Reclassify items as current/non-current, liability/equity in accordance with IFRSs as necessary (e.g. preferred shares with fixed maturity as debt rather than equity).

- Measure all recognised assets and liabilities in accordance with IFRSs (e.g. at cost, "fair value" or a discounted amounted).

Commentary

Because the adjustments that result from changes in accounting policy on transition arise from events and transactions before the date of transition they are recognized directly in retained earnings (or, if appropriate, elsewhere in the statements of changes in equity) at the date of transition.

2.2 Exemptions from other IFRSs

- IFRS 1 basically requires full retrospective application of all extant IFRSs on first-time adoption with limited exemptions for:

  - property, plant and equipment (also investment property and intangible assets);
  - business combinations;
  - employee benefits;
  - cumulative translation differences;
  - compound financial instruments;
  - assets and liabilities of subsidiaries, associates and joint ventures;
  - designation of previously recognised financial instruments;
  - share-based payment transactions;
  - insurance contracts;
  - decommissioning liabilities included in the cost of property, plant and equipment;
  - leases;
  - fair value measurement of financial assets and liabilities;
  - service concession arrangements; and
  - borrowing costs.

Commentary

A first-time adopter may elect to use any one or more of the available exemptions. Only those exemptions that relate to the DipIFR syllabus are detailed below.

2.3 Property, plant and equipment

- Cost based measurement of some items of property, plant and equipment may involve undue cost or effort, especially if the entity has not kept up-to-date fixed asset registers.

- Items of property, plant and equipment can therefore be measured at their fair value at the date of transition and that value deemed to be cost (i.e. "deemed cost").

- If an entity has revalued assets under its previous GAAP and the revaluation is broadly in line with IFRSs then that revalued amount can be taken to be the deemed cost.

Commentary

These exemptions are also available for investment property accounted for under IAS 40's cost model and intangible assets meeting IAS 38's criteria for asset recognition and revaluation.

- If an entity has carried out a fair value exercise of all (or some) of its assets and liabilities for a particular event (e.g. an initial public offering or privatisation) then that fair value may be as the deemed cost at the event date.

Commentary

Comparing revaluation under IFRS 1 with that under IAS 16:

- ❑ *for IFRS 1 it is a "one-off" exercise – under IAS 16 revaluations must be kept up-to-date; and*
- ❑ *the IFRS 1 exemption can be applied to any item(s) – under IAS 16 all items in the same class must be revalued.*

2.4 Business combinations

2.4.1 Electing not to apply IFRS 3

- A first-time adopter does not have to apply IFRS 3 *Business Combinations* retrospectively to past business combinations (i.e. business combinations that occurred before the date of transition to IFRSs).
- If, however, a first-time adopter restates *any* business combination to comply with IFRS 3, all later business combinations *must* be restated and IAS 36 (Revised) and IAS 38 (Revised) applied.

Illustration 3

A first-time adopter reporting at 31 December 2009 elects to restate a business combination that occurred on 30 June 2006. It must restate all business combinations that occurred between 30 June 2006 and 1 January 2008.

Commentary

This exemption also applies to past acquisitions of investments in associates and of interests in joint ventures.

2.4.2 Consequences of not applying IFRS 3 retrospectively

- The classification (as an acquisition, reverse acquisition or a "uniting of interests") in its previous GAAP financial statements is not changed.

- All assets and liabilities acquired or assumed are recognised at the date of transition except:

  - some financial assets and financial liabilities derecognised under previous GAAP (as above); and

  - assets, including goodwill, and liabilities that were not recognised in the acquirer's consolidated statement of financial position under previous GAAP and also would not qualify for recognition under IFRSs in the separate statement of financial position of the acquiree.

Commentary

Any resulting change is adjusted against retained earnings (or, if appropriate, another category of equity), unless it results from the recognition of an intangible asset that was previously subsumed within goodwill (see adjustments below).

- The opening IFRS statement of financial position must exclude any item recognised under previous GAAP that does not qualify for recognition as an asset or liability under IFRSs:

  - An intangible asset that does not qualify for recognition under IAS 38 is reclassified (together with any related deferred tax and non-controlling interests) as goodwill;

  Commentary

  That is unless goodwill was deducted directly from equity under previous GAAP, in which case goodwill is not recognised in the opening statement of financial position.

  - All other resulting changes are adjusted in retained earnings.

- Where IFRS requires subsequent measurement of assets and liabilities on a basis that is not based on original cost (e.g. fair value) such assets and liabilities must be measured on that basis in the opening IFRS statement of financial position.

Commentary

That is, even if they were acquired or assumed in a past business combination – any resulting change in the carrying amount is adjusted against retained earnings, not goodwill.

- Immediately after the business combination, the carrying amounts determined under previous GAAP are deemed cost under IFRSs at that date.

Commentary

This is used for cost-based depreciation or amortisation from the date of the business combination.

- An item not recognised under previous GAAP but recognized under IFRS does not have a deemed cost of zero. It is measured in the consolidated statement of financial position on the basis that IFRSs would require in the separate statement of financial position of the acquiree.

Illustration 4

Finance leases acquired in a past business combination must be capitalised in the consolidated financial statements as IAS 17 *Leases* would require in the acquiree's separate IFRS statement of financial position.

- The converse also applies. An item subsumed in goodwill under previous GAAP that would have been recognised separately under IFRS 3 remains in goodwill unless IFRSs would require its recognition in the separate financial statements of the acquiree.

2.4.3 Goodwill adjustments

- The carrying amount of goodwill in the opening IFRS statement of financial position is the same as under previous GAAP at the date of transition after the following two adjustments (if applicable):
  - increasing the carrying amount of goodwill for an item previously recognised as an intangible asset that does not meet IFRS criteria;

    Commentary

    Similarly, decreasing the carrying amount of goodwill if an intangible asset previously subsumed in recognised goodwill meets IFRS criteria for recognition. (If applicable, deferred tax and non-controlling interests will be adjusted also.)

  - an impairment test at the date of transition. Any impairment loss is adjusted in retained earnings (or revaluation surplus if required by IAS 36).

    Commentary

    This is regardless of whether there are any indication that the goodwill may be impaired.

- No other adjustments are made to the carrying amount of goodwill at the date of transition.

2.4.4 Exclusion from consolidation

- If a subsidiary was not previously consolidated, the carrying amounts of the subsidiary's assets and liabilities are adjusted to the amounts that IFRSs would require in the subsidiary's separate statement of financial position.
- The deemed cost of goodwill is the difference at the date of transition between:
  - the parent's interest in the adjusted carrying amounts; and
  - the cost of its investment in the subsidiary in the parent's separate financial statements.

Activity 1

Suggest three reasons why a subsidiary may not have been consolidated under previous GAAP.

Solution

■

■

■

2.4.5 Deferred tax and non-controlling interests

- The measurement of deferred tax and non-controlling interests follows from the measurement of other assets and liabilities.

Commentary

All the above adjustments to recognised assets and liabilities therefore affect non-controlling interests and deferred tax.

2.5 Employee benefits

- At the transition date the net employee benefit liability (or asset) is measured in accordance with IAS 19 *Employee Benefits.*
- A first-time adopter can elect to recognise all cumulative actuarial gains and losses at the date of transition (that is, reset any "corridor" recognised under previous GAAP to zero).

Commentary

The IAS 19 corridor approach can still be applied to actuarial gains and losses that arise after first-time adoption of IFRS.

2.6 Cumulative translation differences

- All translation adjustments arising on the translation of the financial statements of foreign entities can be recognised in retained earnings at the date of transition (i.e. any translation reserve included in equity under previous GAAP is reset to zero).
- The gain or loss on subsequent disposal of the foreign entity will then be adjusted only by those accumulated translation adjustments arising after the first IFRS reporting period.

Commentary

If this exemption is not used, an entity must restate the translation reserve for all foreign entities since they were acquired or created.

2.7 Compound financial instruments

- The "split-accounting" provisions of IAS 32 need not be applied where the liability component of a compound financial instrument is no longer outstanding at the date of transition.

Commentary

That is, the original equity component of the compound instrument does not have to be reclassified out of retained earnings and into other equity.

2.8 Assets and liabilities of subsidiaries

Commentary

These exemptions apply also to associates and joint ventures.

- A subsidiary who adopts later than its parent may measure assets/liabilities at carrying amounts determined for:
  - its own transition; or
  - the parents consolidated financial statements at an earlier transition.

Commentary

A parent who adopts later than a subsidiary must measure assets/liabilities based on the same carrying amounts determined for that subsidiary's transition.

2.9 Designation of previously recognised financial instruments

- IAS 39 *Financial Instruments: Recognition and Measurement* allows that any financial instrument be designation on initial recognition as:
  - at fair value through profit or loss; or
  - available for sale.
- This designation is permitted at the date of transition also.

2.10 Share-based payment transactions

2.10.1 Equity instruments

- Application of IFRS 2 "Share-based Payment Transactions" is encouraged for equity instruments granted:
  - on or before 7 November 2002;
  - after 7 November 2002 that vested before the later of:
    - the date of transition; and
    - 1 January 2005.
- However, this election can only be made if the fair value determined at the measurement date has been publicly disclosed.
- Where IFRS 2 is not applied the minimum disclosure requirements that enable users to understand the nature and extent of share-based payment transactions that existed during the period must still be made.

2.10.2 Liabilities

- Application of IFRS 2 is encouraged for liabilities arising from share-based payment transactions that were settled before:
  - the date of transition; and
  - 1 January 2005.

Commentary

Restatement of comparative information is not required to the extent that it relates to a period or date earlier than 7 November 2002.

2.11 Decommissioning liabilities

- IFRIC 1 "Changes in Existing Decommissioning, Restoration and Similar Liabilities" requires that:
  - specified changes be added to or deducted from the cost of the related asset;
  - the adjusted depreciable amount be depreciated prospectively over the assets remaining useful life.
- A first-time adopter need not comply with these requirements for changes in such liabilities that occurred before the date of transition.

Commentary

Retrospective application of IFRIC 1 at the date of transition would require construction of a historical record of adjustments that would have been made in the past. This will not be practicable in many cases.

- A first-time adopter using this exemption:
  - measures the liability at the date of transition in accordance with IAS 37;
  - estimates the amount that would have been included in the cost of the related asset when the liability first arose (by discounting the liability to that date using its best estimate of the applicable historical risk-adjusted discount rate); and
  - calculates accumulated depreciation on that amount, as at the date of transition, based on the current estimate of the useful life of the asset.

Worked example 1

Omega's first IFRS financial statements are for the year to 31 December 2009 and include comparative information for 2008.

Omega acquired an oil rig on 1 January 2003, with an estimated useful life of 35 years.

As 1 January 2008 (the date of transition), Omega estimates:

- Decommissioning cost in 30 years' time – \$605,000
- Appropriate risk-adjusted discount rate 5% (unchanged since 1 January 2003).

Required:

Summarise the amounts to be recognised in the opening IFRS statement of financial position as at 1 January 2008.

Worked solution 1

Decommissioning liability recognised at transition date: \$140,000

Commentary

Discounting 30 years at 5%:

$$\$605{,}000 \times \frac{1}{1.05^{30}} = \$605{,}000 \times 0.231 = \$140{,}000$$

Decommissioning cost of asset (and estimated liability) at acquisition: \$109,800

Commentary

Discounting the liability for a further five years to 1 January 2003:

$$\$140{,}000 \times \frac{1}{1.05^{5}} = \$140{,}000 \times 0.784 = \$109{,}800$$

In summary

	$000
Decommissioning cost included in cost of plant	109.8
Accumulated depreciation ($109,800 × 5/35)	(15.7)
Decommissioning liability	(140.0)
Net assets/retained earnings	(45.9)

2.12 Mandatory exceptions to retrospective application

- As well as the optional exemptions, there are five mandatory exceptions, concerning:
  - ❑ derecognition of financial assets and financial liabilities;
  - ❑ hedge accounting;
  - ❑ estimates (see earlier in this Session);
  - ❑ assets classified as held for sale and discontinued operations; and
  - ❑ non-controlling interests.

2.12.1 Derecognition of financial assets and financial liabilities

- A first-time adopter must apply the derecognition requirements in IAS 39 *Financial Instruments: Recognition and Measurement* prospectively from 1 January 2004 (the effective date of IAS 39).

Commentary

This means that financial assets or financial liabilities derecognised under previous GAAP in a financial year beginning before 1 January 2004 cannot be recognised under IFRS.

2.12.2 Hedge accounting

- The hedging requirements of IAS 39 must be applied prospectively from the date of transition. This means that the hedge accounting practices, if any, used in periods prior to the date of transition may not be retrospectively changed.

Commentary

So an entity cannot designate a transaction as a hedge if it was not designated as such under previous GAAP and any designated hedges under previous GAAP will be recognised and measured under IAS 39 (irrespective of whether there is hedge documentation or hedge effectiveness).

2.12.3 Held for sale classification and discontinued operations

- The classification requirements of IFRS 5 are required to be applied prospectively from the effective date of IFRS 5 (i.e. 1 January 2005).
- Early application is permitted provided the valuations and other information needed to apply the IFRS were obtained when the classification criteria were originally met.
- If the date of transition is before 1 January 2005 the transitional provisions of IFRS 5 are applied.
- IFRS 5 is applied retrospectively if the date of transition is on or after 1 January 2005.

Commentary

These transitional provisions are not examinable.

2.12.4 Non-controlling interests

- Total comprehensive income must be split between owners of the parent and non-controlling interests even if this results in a deficit balance for non-controlling interests.
- Any change in control status between the owners of the parent and non-controlling interests is to be accounted for from the date of transition unless the adopter has elected to apply IFRS 3 retrospectively to past business combinations.

Commentary

In this case IAS 27 requirements must also be applied retrospectively to the past business combinations.

3 Presentation and disclosure

3.1 Comparative information

- At least one year's comparative information must be included to comply with IAS 1 *Presentation of Financial Statements.*
- Entities adopting IFRS before 1 January 2006 are exempt from the requirement to present comparative information in respect of:
  - financial instruments;
  - insurance contracts
  - exploration and evaluation assets.

Commentary

This provides transitional relief to entities adopting the related standards early.

3.2 Explanation of transition

- An entity must explain how the transition to IFRSs has affected its reported financial position, performance and cash flows.

Commentary

This is achieved through reconciliation and disclosure and there are no exemptions to the requirements for these.

Illustration 5

Adoption of International Financial Reporting Standards (IFRS)

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CONSISTENTLY FIRST IN RENEWABLE INGREDIENTS

Illustration 6

Key changes in accounting policies (extracts)
The following notes highlight the main differences between UK GAAP and IFRS that had a material effect on the financial statements of the Group.
(a) Share-based payment
Under UK GAAP, the Group recognised a charge in respect of employee share options based on the difference between the exercise price of the option and the market value of a Tate & Lyle share at the grant date. Accordingly, only grants made under the Tate & Lyle 2003 Performance Share Plan attracted a charge under UK GAAP, based on their intrinsic value. Under IFRS2 the Group recognises a charge reflecting the fair value of all employee share options granted since 7 November 2002 that had not vested by 1 January 2005.
The UK GAAP charge for the year to 31 March 2005 totalled £2 million, reflecting expense for two years of option grants. The impact of IFRS on profit before taxation for the year to 31 March 2005 is an additional charge of £2 million. In the year to 31 March 2006, the IFRS charge increased to reflect expense covering three years of option grants.
Net assets increased by £3 million at 31 March 2005 reflecting the deferred taxation impact.

(g) Other
Events after the balance sheet date
Under UK GAAP, the Group recognised a provision for the dividend declared within its financial statements. IFRS specifically states that dividends approved by the relevant authority after the reporting date do not meet the definition of a present obligation and should not therefore be recognised. The impact of this is to increase net assets at 31 March 2005 by £65 million (1 April 2004 – £62 million).

Tate & Lyle Annual Report 2006

TATE & LYLE
CONSISTENTLY FIRST IN RENEWABLE INGREDIENTS

3.3 Reconciliations

- The following are required to enable users to understand the material adjustments to the statement of financial position and statement of comprehensive income:

  - A reconciliation of equity under IFRSs and previous GAAP as at:

    – the transition date; and
    – the end of the latest period presented under previous GAAP.

Commentary

That would be 1 January 2007 and 31 December 2007 for the transition overview shown at section 1.6.

  - A reconciliation to its total comprehensive income under IFRSs for the latest period in the most recent annual financial statements. The starting point is total comprehensive income under previous GAAP (or profit or loss under previous GAAP if such a total was not reported).

Commentary

That would be total comprehensive income (or profit or loss) for the year to 31 December 2007 for the transition overview.

Illustration 7

2. FIRST TIME ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

Reconciliation and explanatory notes on how the transition to IFRS has affected profit/(loss) and net assets previously reported under UK Generally Accepted Accounting Principles (UK GAAP) are given below. No Balance Sheet Reconciliation as at 1 July 2005 has been shown due to there being no measurement changes from the adoption of IFRS:

INCOME STATEMENT RECONCILIATION FOR THE YEAR ENDED 30 JUNE 2006	**Sub-note**	**RESTATED UK GAAP £**	**CONSOLIDATED Adjustments £**	**IFRS £**
Revenue		-	-	-
Cost of sales		-	-	-
GROSS PROFIT/(LOSS)		-	-	-
Other operating income		10,613	-	10,613
Administrative expenses		(1,655,986)	-	(1,655,986)
Share based payments	i	-	(545,033)	(545,033)
LOSS FROM OPERATIONS		(1,655,373)	(545,033)	(2,200,406)
Finance income		67,826	-	67,826
LOSS ON ORDINARY ACTIVITIES BEFORE TAX		(1,587,547)	(545,033)	(2,132,580)
Taxation		-	-	-
LOSS FOR THE YEAR		(1,587,547)	(545,033)	(2,132,580)

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CHURCHILL MINING PLC

Commentary

The directors confirm, in the Directors' Report that, after making enquiries, they have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing these accounts. Interestingly although the "basis of preparation" note to the financial statements specifies that the accounts have been prepared on a going concern basis there is no further comment on the issue.

- These reconciliations must distinguish between changes in accounting policies and errors. IAS 8 disclosure requirements do not apply.

Commentary

Similar reconciliations are required for interim financial reports for part of the period covered by the first IFRS financial statements.

Illustration 8

Consolidated Balance Sheet as at 31 March 2005 (extract)

	UK GAAP in IFRS format £m	Employee benefits Note (b) £m	Intangible assets Note (c) £m	Business combinations Note (d) £m	Joint Ventures Note (e) £m	Taxation Note (f) £m	Other Note (g) £m	IFRS £m
ASSETS								
Non-current assets								
Intangible assets	**173**	–	11	5	9	(4)	–	**194**
Property, plant and equipment	**1 111**	–	(4)	–	150	–	7	**1 264**
Investments in associates	**2**	–	–	–	1	–	–	**3**
Investments in joint ventures	**211**	–	–	–	(211)	–	–	–
Trade and other receivables	**60**	(51)			4	–		**13**
Other non-current assets	**16**	–	–	–	–	–	–	**16**
	1 573	(51)	7	5	(47)	(4)	7	**1 490**
Current assets								
Inventories	**288**	–	–	–	85	–	(1)	**372**
Trade and other receivables	**361**	–	–	–	56	–	1	**418**
Cash and cash equivalents	**59**	–	–	–	30	–	295	**384**
Current asset investments	**296**	–	–	–	–	–	(295)	**1**
	1 004	–	–	–	171	–	–	**1 175**
TOTAL ASSETS	**2 577**	**(51)**	**7**	**5**	**124**	**(4)**	**7**	**2 665**

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3.4 Other disclosures

- If a statement of cash flows was presented under previous GAAP, material adjustments must be explained.

- If an entity uses fair value as deemed cost for any items of property, plant and equipment (or investment property or intangible asset) as an alternative to cost-based measurement, the following must be disclosed for each line item:

  - the aggregate of those fair values; and
  - the aggregate adjustment to carrying amounts reported under previous GAAP.

Activity 2

Statement of Financial Position at 1 January 2008

	Previous GAAP £m
Property, plant and equipment	8,000
Goodwill	2,000
Intangible assets	1,000
Financial assets	7,000
Total non-current assets	18,000
Trade and other receivables	3,000
Inventories	5,000
Other receivables	600
Cash and cash equivalents	700
Total current assets	9,300
Total assets	27,300
Interest-bearing loans	9,000
Trade and other payables	4,000
Restructuring provision	30
Current tax liability	40
Deferred tax liability	600
Total liabilities	13,670
Total assets less total liabilities	13,630
Issued capital	6,500
Retained earnings	7,130
Total equity	13,630

Activity 2 continued

Notes

(i) Depreciation was influenced by tax requirements under previous GAAP. IFRS reflects the useful life of the assets. The cumulative adjustment increases the carrying amount of property, plant and equipment by £200 million.

(ii) Intangible assets acquired in a business combination included £300 million for items that do not qualify for recognition as intangible assets under IFRS.

(iii) Financial assets with a cost of £7,000 million are all classified as available-for-sale under IAS 39. Their fair value is £7,800 million.

(iv) Inventories are valued at direct manufacturing cost under previous GAAP. Fixed and variable production overhead of £1,000 million must be included to comply with IAS 2.

(v) Unrealised gains of £500 million on unmatured forward foreign exchange contracts which are not recognised under GAAP are recognised under IFRS.

(vi) A pension liability of £100 million is recognised under IFRS but was not recognised under GAAP. Tax base of pension liability is zero.

(vii) A restructuring provision of £30 million relating to head office activities was recognised under previous GAAP, but does not qualify for recognition as a liability under IFRS.

(viii) The tax rate is 30%.

Required:

Prepare a reconciliation of equity at 1 January 2008 (date of transition to IFRS).

Proforma solution

Reconciliation of Equity at 1 January 2008

	Previous GAAP	*Effect of transition to IFRS*	*IFRS*
	£m	£m	£m
Property, plant and equipment	8,000		
Goodwill	2,000		
Intangible assets	1,000		
Financial assets	7,000		
Total non-current assets	18,000		
Trade and other receivables	3,000		
Inventories	5,000		
Other receivables	600		
Cash and cash equivalents	700		
Total current assets	9,300		
Total assets	27,300		
Interest-bearing loans	9,000		
Trade and other payables	4,000		
Restructuring provision	30		
Current tax liability	40		
Deferred tax liability	600		
Total liabilities	13,670		
Total assets less total liabilities	13,630		
Issued capital	6,500		
Retained earnings	7,130		
Total equity	13,630		

4 Practical matters

4.1 Overview

- The finance director is most likely to be responsible for the conversion process. In large entities a steering committee may be formed to manage the process across the business.

- Key stakeholders within the entity need to be made aware how staff may be affected – particularly in respect of training.

- Matters to be considered when making a preliminary assessment of the impact of conversion will include:

  - the level of readily available IFRS competence of staff, internal audit and non-executive directors;

  - whether specialist help may be needed and, if so, who can provide it;

  Commentary

  Many entities will turn to their auditors, business consultants, etc to advise them. The skills and competence of professional advisors must be assessed.

  - identifying agreements, contracts and reports affected by the change in the financial reporting framework;

  - making an initial estimate of the financial effect of changes in key accounting policies;

  - assessing the significance of fair values (e.g. in relation to IASs 39 and 40);

  - reviewing any existing weaknesses in internal financial reporting systems;

  - deciding the extent to which previous year's financial information (prior to the date of transition) is to be restated.

Activity 3

Suggest FOUR contractual arrangements that could be affected by the change.

4.2 Making the transition

4.2.1 *Accounting*

- Accounting policies should be selected after a detailed review of the choices available (especially on transition).
- Changes may need to be made to the accounting system to collect the information necessary to meet disclosure requirements (e.g. of segment reporting).
- The group accounting manual should be updated to reflect changes in terminology as well as changes in accounting policies, measurement bases, etc.
- Accounting policies used for internal reporting (e.g. in budgeting systems) may need to be standardised or made compatible with those used for external financial reporting.

4.2.2 *Treasury*

- Treasury managers will need to review treasury policy and how they hedge risk.

Commentary

Some entities may not be able to hedge account in accordance IAS 39 even if they change their hedging strategy.

- Loan agreements may need to renegotiated to avoid breaching covenant limits.

4.2.3 *IT and systems*

- Accounting system changes may be required as a direct result of the change to IFRS.
- Changes in IT and systems may also be required in response to the identification of business improvement opportunities.

Commentary

A test run with prior period information may be advisable before the audit committee (if any) confirms management's choice of accounting policies.

4.2.4 *Human resources*

- Resource planning should take account of:
  - the impact of the change on long-term recruitment plans;
  - how day-to-day responsibilities of seconded staff will be covered;
  - temporary specialist assistance needed.
- Remuneration schemes will need to be reviewed and renegotiated.
- Staff will need to be trained.

4.2.5 Training

- Internal experts with specialist IFRS knowledge will need to be involved in the training of others in the organisation. This may require that they be trained as trainers.
- Subsidiary finance managers will need a broad understanding of the impact of IFRS on the entity and changes in policy and procedure.
- General business managers will need to be made aware of the impact of IFRS on the business, its reporting and planning processes.

4.2.6 Communication

- The financial effects of the change must be communicated to shareholders, analysts, employees, lenders, etc. This may require a public relations plan to advertise the adoption of IFRS.

Focus

You should now be able to:

- describe the procedures to be adopted on first time adoption of IFRSs;
- understand the need for an opening IFRS statement of financial position and appreciate the issues regarding the amendment of comparative figures;
- appreciate that the provisions of certain accounting standards (e.g. IAS 39) need only be applied prospectively;
- discuss the practical matters that entities need to address regarding first time implementation.

Activity solutions

Solution 1 – Exclusion from consolidation

- It was not regarded as a subsidiary under previous GAAP – the definition of subsidiary being based on legal ownership rather than control.
- Previous GAAP permitted that certain subsidiaries be excluded from consolidation (e.g. on the grounds that their activities are sufficiently different from those of the rest of the group).
- The parent did not prepare consolidated financial statements (e.g. in jurisdictions where financial statements are for legal entities only).

Solution 2 – Reconciliation of equity at 1 January 2008

		Previous GAAP	*Effect of transition to IFRS*	*IFRS*
		£m	£m	£m
Property, plant and equipment	(i)	8,000	200	8,200
Goodwill	(ii)	2,000	300	2,300
Intangible assets	(ii)	1,000	(300)	700
Financial assets	(iii)	7,000	800	7,800
Total non-current assets		18,000	1,000	19,000
Trade and other receivables		3,000	0	3,000
Inventories	(iv)	5,000	1,000	6,000
Other receivables	(v)	600	500	1,100
Cash and cash equivalents		700	0	700
Total current assets		9,300	1,500	10,800
Total assets		27,300	2,500	29,800
Interest-bearing loans		9,000	0	9,000
Trade and other payables		4,000	0	4,000
Employee benefits	(vi)	0	100	100
Restructuring provision	(vii)	30	(30)	0
Current tax liability		40	0	40
Deferred tax liability	(W2)	600	729	1,329
Total liabilities		13,670	799	14,469
Total assets less total liabilities		13,630	1,701	15,331
Issued capital		6,600	0	6,500
Revaluation surplus	70% × (iii)	0	560	560
Retained earnings	(W1)	7,130	1141	8,271
Total equity		13,630	1,701	15,331

WORKINGS

(1) Retained earnings

		£m
Depreciation	(i)	200
Production overhead	(iv)	1,000
Foreign exchange contract	(v)	500
Pension liability	(vi)	(100)
Restructuring provision	(vii)	30
		1,630
Tax effect of the above		(489)
Total adjustment to retained earnings		1141

(2) Deferred tax liability

		£m
Revaluation surplus	30% × (iii)	240
Retained earnings	30% × (W1)	489
Increase in deferred tax liability		729

Commentary

Because the tax base at 1 January 2008 of the items reclassified from intangible asset to goodwill equals their carrying amount at that date, the reclassification does not affect deferred tax liabilities.

Solution 3 – Arrangements affected

- Bank and other loan agreements (e.g. financial ratios specified in loan covenants may be adversely affected).
- Reporting to industry regulators.
- Remuneration schemes and profit-related pay. Negotiations with the tax authorities may be necessary to maintain tax efficient schemes.
- Performance related share option schemes.

