First Time Adoption of IFRSs

(IFRS 1)

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Today's Agenda

Simple and Comprehensive

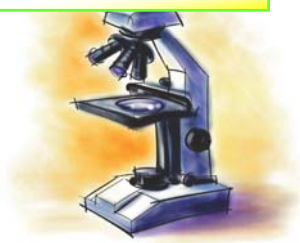
Real Cases and Examples

Introduction

1. Objective and Scope
2. Recognition and Measurement
   a. Opening IFRS Balance Sheet
   b. Accounting Policies
   c. Exemption from Other IFRSs
   d. Exceptions to Retrospective Application
3. Presentation and Disclosure
   a. Comparative Information
   b. Explanation of Transition to IFRSs

Implementation Issues

Implementation Issues



Final Remarks

Introduction

- Today's prerequisite
  - adequate knowledge on full set of IFRSs
- IFRS 1
  - As a summary and checklist of some complicated IFRSs and IASs
  - Provides some exemptions and compulsory for the entity adopting full set of IFRSs the first time
- Maybe …… too difficult and demanding in some areas

Today's Agenda

Introduction

1. Objective and Scope

1. Objective and Scope

1. Objective and Scope

- To ensure that an entity's first IFRS financial statements (and its related interim financial reports) contain high quality information that:
  a) is transparent for users and comparable over all periods presented;
  b) provides a suitable starting point for accounting under IFRSs; and
  c) can be generated at a cost that does not exceed the benefits to users

1. Objective and Scope

An entity shall apply IFRS 1 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.

First IFRS Financial Statements

– the first annual financial statements in which the entity adopts IFRSs, by an explicit and unreserved statement in those financial statements of compliance with IFRSs

1. Objective and Scope

Example

Are the following first time adoption of IFRS?

- Financial statements that comply with some (but not all) IFRSs
- Financial statements in "Country A" GAAP with reconciliation to IFRSs
- Financial statements that comply SME Financial Reporting Framework and Standard

1. Objective and Scope

Example

Are the following first time adoption of IFRS?

- Financial statements that comply with some (but not all) IFRSs ✕
- Financial statements in "Country A" GAAP with reconciliation to IFRSs ✕
- Financial statements that comply SME Financial Reporting Framework and Standard ✕

1. Objective and Scope

Example

Examples of financial statements under IFRSs

- An entity's first IFRS financial statements if the entity presented its most recent previous financial statements:
  - i) under other accounting 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 other accounting requirements inconsistent with IFRSs, using some individual IFRSs to account for items for which other accounting requirements did not exist; or
  - v) under other accounting requirements, with a reconciliation of some amounts to the amounts determined under IFRSs.

1. Objective and Scope

Example

Examples of financial statements under IFRSs

- An entity's first IFRS financial statements if the entity
  a) prepared financial statements under IFRSs for internal use only, without making them available to the entity's owners or any other external users;
  b) prepared a reporting package under IFRSs for consolidation purposes without preparing a complete set of financial statements as defined in IAS 1 *Presentation of Financial Statements*; or
  c) did not present financial statements for previous periods.

1. Objective and Scope

What are the requirements?

Retrospective Application

- IFRS 1 does not apply to changes in accounting policies made by an entity that already applies IFRSs.
- Such changes are the subject of:
  a) requirements on changes in accounting policies in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; and
  b) specific transitional requirements in other IFRSs.

To have the following 3 steps under IAS 8:

- as if that policy had always been applied
- restate opening balance of retained earnings
- restate comparative figures

Today's Agenda

Introduction

1. Objective and Scope
2. Recognition and Measurement
   a. Opening IFRS Balance Sheet
   b. Accounting Policies
   c. Exemption from Other IFRSs
   d. Exceptions to Retrospective Application

2. Recognition and Measurement

a. Opening IFRS Balance Sheet

b. Accounting Policies

c. Exemption from Other IFRSs

d. Exceptions to Retrospective Application of IFRSs

2. Recognition and Measurement

a. Opening IFRS Balance Sheet

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

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

2. Recognition and Measurement

Example

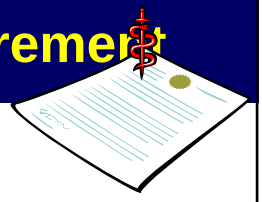
a. Opening IFRS Balance Sheet

- The reporting date of Company A's first IFRS financial statements is 31 Dec. 2007
- It prepares to present comparative information in the statements for 1 year only
- It also discloses its five year's financial summary.

Not full comparative

• Opening IFRS balance sheet	–	1 Jan. 2006
• Date of transition to IFRSs	–	1 Jan. 2006
• First reporting date	–	31 Dec. 2007

2. Recognition and Measurement

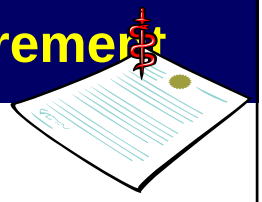


b. Accounting Policies

- An entity shall use the same accounting policies in
  - its opening IFRS balance sheet and
  - throughout all periods presented in its first IFRS financial statements
- Those accounting policies shall comply with each IFRS effective at the reporting date for its first IFRS financial statements
  - except for some exemptions stated in IFRS 1 (to be discussed)

Reporting date is defined as
- the end of the latest period covered by financial statements or by an interim financial report.

2. Recognition and Measurement



b. Accounting Policies

- An entity shall not apply different versions of IFRSs that were effective at earlier dates
- An entity may apply a new IFRS that is not yet mandatory if it permits early application

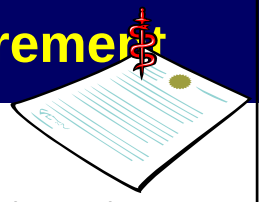
2. Recognition and Measurement

Example

- IFRS 3 *Business Combinations* shall apply to the accounting for business combinations for which the agreement date is on or after 1 January 2005.
- Before that, the accounting for business combinations is within the scope of IAS 22 *Business Combinations*.
- GV Macao Limited (GVM) is going to adopt IFRSs for its first IFRS financial statements for the year ended 31 December 2005 and present 1 year full comparative (i.e. both 2004 and 2005 would be presented).
- Can GVM apply IAS 22 for the business combinations agreed before 1 January 2005?

No
- GVM shall not apply different versions of IFRSs that were effective at earlier dates
- GVM should apply IFRS 3 for both 2004 and 2005

2. Recognition and Measurement



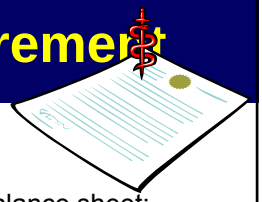
b. Accounting Policies

- The transitional provisions in other IFRSs apply to changes in accounting policies made by an entity that already uses IFRSs
  - They do not apply to a first-time adopter's transition to IFRSs

First-time adopter is
- an entity that presents its first IFRS financial statements

Transitional provisions
(in each IFRS/IAS)
are not applicable to first-time adopter

2. Recognition and Measurement



b. Accounting Policies

Recognise

Not Recognise

Reclassify

Measure

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 it recognised under previous GAAP as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under IFRSs; and

d. apply IFRSs in measuring all recognised assets and liabilities

Can you give some examples?

2. Recognition and Measurement

Example

b. Accounting Policies

Recognise

Not Recognise

Reclassify

Measure

Selected examples:

- Derivatives, deferred tax, actuarial gain or loss under defined benefit plan, environmental or decommissioning costs
- Research, start-up and pre-operating costs, staff training, deferred advertising cost, relocation costs
- Some intangible assets from goodwill, some preference shares reclassified to debts, compound financial instruments, some investments that meet the definitions of a subsidiary
- Deferred tax can't be discounted, derivatives at fair value

Can you give some examples?

2. Recognition and Measurement

Example

- Trident, a public limited company just listed on the Hong Kong Stock Exchange,
  - operates in the financial services sector and
  - is planning to prepare its first financial statements under IFRSs as at 31 December 2007.
- The Generally Accepted Accounting Practices (GAAP) used by Trident are very similar to IFRS but there are some differences.
- The Group is currently preparing its local GAAP financial statements for the year ending 31 December 2006.
- Based on the information, draft a memorandum to the Directors of Trident setting out the general principles behind IFRS 1 *First-time Adoption of Hong Kong Financial Reporting Standards*.

Modified from ACCA

2. Recognition and Measurement

Example

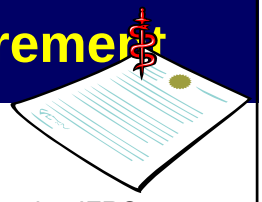
- The IFRS applies when a company adopts IFRSs for the first time by an explicit and unreserved statement of compliance with IFRSs.
- The opening balance sheet for the purpose of IFRS1 and the date of transition will be as at 1 January 2006 as this is the beginning of the comparative period.
- As of that date the company will have to:
  - i) recognise and derecognise assets and liabilities as required by IFRSs
  - ii) reclassify items recognised under local GAAP as an asset, liability or equity that are treated differently under IFRSs
  - iii) apply IFRSs in measuring all recognised assets and liabilities
  - iv) recognise any adjustments required to move from previous GAAP to IFRS directly in retained earnings or an appropriate category of equity.

2. Recognition and Measurement

Example

- IFRS1 grants limited exemptions from these requirements.
- The IFRS requires retrospective action in some areas but also prohibits this where judgment would be required by management about past conditions after the outcome of the transaction is already known.
- The transitional provisions in IFRS generally do not apply and the latest version of the IFRS at the date of the first financial statements (31 December 2007) shall apply to its opening balance sheet (1 January 2006) and throughout all periods presented in its first financial statements.
- Thus Trident will have to prepare its opening balance sheet retrospectively, which may cause problems in terms of the collection of the information required as at 1 January 2006.

2. Recognition and Measurement

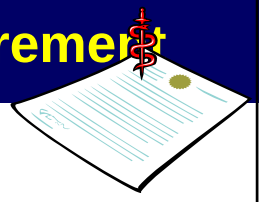


b. Accounting Policies

- The accounting policies that an entity uses in its opening IFRS balance sheet may differ from those that it used for the same date using its previous GAAP.
- The resulting adjustments arise from events and transactions before the date of transition to IFRSs.

- Therefore, an entity shall recognise those adjustments
  - directly in retained earnings
    (or, if appropriate, another category of equity, say revaluation surplus for property, plant and equipment)
  - at the date of transition to IFRSs.

2. Recognition and Measurement



b. Accounting Policies

Any exemptions from particular IFRSs?

- IFRS 1 establishes two categories of exceptions to the principle that an entity's opening IFRS balance sheet shall comply with each IFRS:
  a) grant exemptions from some requirements of other IFRSs.
  b) prohibit retrospective application of some aspects of other IFRSs.

c. Exemptions from Other IFRSs

d. Exceptions to Retrospective Application of IFRSs

2. Recognition and Measurement

c. Exemptions from Other IFRSs

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

- An entity may elect to use one or more of some exemptions

1. Business combinations
2. Fair value or revaluation as deemed cost
3. Employee benefits
4. Cumulative translation differences
5. Compound financial instruments
6. Assets and liabilities of subsidiaries, associates and joint ventures
7. Designation of previously recognised financial instruments
8. Share-based payment transactions
9. Insurance contracts

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

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

- An entity may elect to use one or more of some exemptions

10. Decommissioning liabilities included in the cost of property, plant and equipment
11. Leases
12. Fair value measurement of financial assets or financial liabilities at initial recognition
13. A financial asset or an intangible asset accounted for in accordance with IFRIC 12.

Hold on ……

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

2. Recognition and Measurement

IFRSs adopted in Macao include:

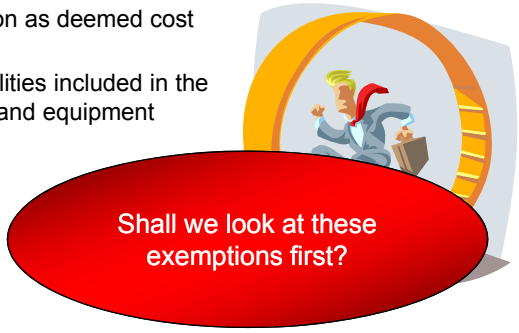
- IFRS 1 First-time Adoption of International Financial Reporting Standards
- IAS 1 Presentation of Financial Statements
- IAS 2 Inventories
- IAS 7 Cash Flow Statements
- IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors
- IAS 10 Events after the Balance Sheet Date
- IAS 11 Construction Contracts
- IAS 12 Income Taxes
- IAS 16 Property, Plant and Equipment
- IAS 17 Leases
- IAS 18 Revenue
- IAS 21 The Effects of Changes in Foreign Exchange Rates
- IAS 23 Borrowing Costs
- IAS 36 Impairment of Assets
- IAS 37 Provisions, Contingent Liabilities and Contingent Assets
- IAS 38 Intangible Assets

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

- An entity may elect to use one or more of some exemptions
  2. Fair value or revaluation as deemed cost
  10. Decommissioning liabilities included in the cost of property, plant and equipment
  11. Leases



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

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

2. Fair value or revaluation as deemed cost

- An entity may elect to
  - measure an item of property, plant and equipment (PPE) at the date of transition to IFRSs at its fair value and
  - use that fair value as its deemed cost at that date.

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

2. Fair value or revaluation as deemed cost

- A first-time adopter may use a previous GAAP revaluation of an item of PPE at, or before, the date of transition to IFRSs
  - as deemed cost at the date of the revaluation,

    if the revaluation was, at the date of the revaluation, broadly comparable to

    a) fair value; or

    b) cost or depreciated cost under IFRSs, adjusted to reflect, for example, changes in a general or specific price index.

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

2. Fair value or revaluation as deemed cost

- The above elections (IFRS 1.16 and 1.17) are also available for:
  a) investment property, if an entity elects to use the cost model in IAS 40 *Investment Property*; and
  b) intangible assets that meet:
     i) the recognition criteria in IAS 38 *Intangible Assets* (including reliable measurement of original cost); and
     ii) the criteria in IAS 38 for revaluation (including the existence of an active market).

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

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

2. Fair value or revaluation as deemed cost

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

2. Recognition and Measurement

Case

2005 Annual Report

- HSBC has elected to
  - measure individual items of property at fair value at the date of transition to IFRSs and use that fair value as deemed cost at that date.
- If HSBC had continued to revalue properties,
  - this would have led to increases in tangible fixed assets at 31 December 2004 and 31 December 2005 with corresponding increases in other reserves (net of deferred tax liabilities).
  - There would have been a slightly increased depreciation charge and reduced net income going forward.
- If HSBC had reverted to original cost as the basis for carrying properties,
  - net income under IFRSs would have been higher for 2004 and 2005 owing to a reduced depreciation charge, and shareholders' equity would have been lower.

2. Recognition and Measurement

Example

- On 30 October 2004, Trident
  - revalued its tangible non-current assets and
  - incorporated these values into its financial statements.
- Before using IFRSs, Trident
  - uses a straight line method to depreciate its tangible non-current assets.
  - developed computer software which was to be used as a financial modelling tool
    - the software cost had not been capitalised but charged to the income statement.
- Based on the information above, draft a memo. setting out the specific accounting implications of IFRS1 for the Trident Group at the date of transition to IFRS.

Modified from ACCA

2. Recognition and Measurement

Example

- Under IFRS 1, a company can elect to
  - measure its tangible non-current assets at fair value at the date of transition to IFRSs and
  - use that value as 'deemed cost' at that date.
- Additionally, a first time adopter can elect to
  - use a local GAAP valuation of tangible non-current assets as deemed cost at the transition date (if conditions are met).
    - Trident could use this latter election if it so wishes.
- As the straight line method of depreciation is acceptable under IFRSs it can continue to be used.
- In terms of the software development costs,
  - if the costs meet the recognition and measurement criteria in IAS 38 *Intangible Assets*, then they will have to be capitalised.
  - if they do not meet the criteria, then they will remain expensed.

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

10. Changes in existing decommissioning liabilities included in PPE cost

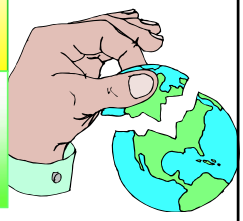
- IFRIC Interpretation 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* requires
  - specified changes in a decommissioning, restoration or similar liability to be added to or deducted from the cost of the asset to which it relates;
  - the adjusted depreciable amount of the asset is then depreciated prospectively over its remaining useful life.

Remember what is decommissioning liabilities or costs?

2. Recognition and Measurement

In IAS 16, the cost of PPE comprises:

1. Purchase price
2. Directly attributable costs (DAC)
3. Initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either
   - when the item is acquired, or
   - as a consequence of having used the item during a particular period for purposes, other than to produce inventories during that period *(also refer IAS 37)* *(New in IAS 16)*



e.g. air-condition plant are installed in leasehold head office or a showroom
- In addition to the normal removal cost, the original restoring cost is also estimated for damage or pollution incurred during the lease term

2. Recognition and Measurement

c. Exemptions from Other IFRSs — Optional – entities can choose

10. Changes in existing decommissioning liabilities included in PPE cost

- A first-time adopter need not comply with these requirements for changes in such liabilities that occurred before the date of transition to IFRSs.
- Briefly, if a first-time adopter uses this exemption, it shall:
  - measure the liability as at the date of transition to IFRSs in accordance with IAS 37;
  - estimate the amount by discounting the liability using its best estimate of the historical risk-adjusted discount rate(s); and
  - calculate the accumulated depreciation on that amount, as at the date of transition to IFRSs,
    - on the basis of the current estimate of the useful life of the asset, using the depreciation policy adopted by the entity under IFRSs.

2. Recognition and Measurement

Example

- An entity's first IFRS financial statements have a reporting date of 31 Dec. 2007 and include comparative information for 2006 only.
  - Its date of transition to IFRSs is therefore 1 Jan. 2006.
- The entity acquired an energy plant on 1 Jan. 2003, with a life of 40 years.
  - As at the date of transition to IFRSs, the entity estimates the decommissioning cost in 37 years' time to be $470, and estimates that the appropriate risk-adjusted discount rate for the liability is 5%.
  - It judges that the appropriate discount rate has not changed since 1 Jan. 2003.

2. Recognition and Measurement

Example

- The decommissioning liability recognised at the transition date is $77 ($470 discounted for 37 years at 5%).
- Discounting this liability back for a further three years to 1 Jan. 2003 gives an estimated liability at acquisition, to be included in the cost of the asset, of $67.
  - Accumulated depreciation on the asset is $67 ÷ 40 × 3 = $5.
- The amounts recognised in the opening IFRS balance sheet on the date of transition to IFRSs (1 Jan. 2006) are, in summary:

Decommissioning cost included in cost of plant	$ 67
Accumulated depreciation	(5)
Decommissioning liability	(77)
Net assets/retained earnings	(15)

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

11. Leases

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

Today's Agenda

Introduction

1. Objective and Scope
2. Recognition and Measurement
   a. Opening IFRS Balance Sheet
   b. Accounting Policies
   c. Exemption from Other IFRSs

Implementation Issues

PPE and Leases first …..

Implementation – IAS 16

- The cost of an item of PPE shall be recognised as an asset if, and only if:
  a) it is *probable* that *future economic benefits* associated with the item will *flow to* the entity; and
  b) the *cost* of the item can be *measured reliably*.

Recognition Criteria

- Major spare parts, servicing equipment, replacement and inspection can also be qualified as PPE.

If the recognition criteria is met, such cost is recognised; the carrying amount of the replaced parts or previous inspection is derecognised.

Implementation – IAS 16

Improvement is no longer a threshold

Recognition criteria (capitalisation) for		Initial Cost	Subsequent Expenditure
Previous	Criteria not the same	• Probable that future economic benefit of the asset will flow to the enterprise • Cost measured reliably	• Probable that future economic benefits in excess of the *originally assessed standard of performance* of the existing asset will flow to the entity
Now	Same criteria	• Probable that future economic benefit of the asset will flow to the entity • Cost measured reliably ***Same criteria applied to both costs***	

Expenditure not fulfilling the recognition criteria
– will be charged to income statement

Clearer approach on so-called **Component Accounting**

Implementation – IAS 16

An entity shall choose either:

Cost Model

After recognition as an asset, an item of PPE shall be carried at
- Its cost
- less
  - any accumulated depreciation and
  - any accumulated impairment losses

Revaluation Model

After recognition as an asset, an item of PPE shall be carried at
- a revalued amount, being its fair value at the date of the revaluation,
- Less
  - any subsequent accumulated depreciation and
  - subsequent accumulated impairment losses.

Depreciation

Depreciable amount

Depreciation method

Impairment

Implementation – IAS 16

- An entity may elect to use one of the following amounts as the deemed cost of an item of property, plant and equipment:
  a) fair value at the date of transition to IFRSs (IFRS 1.16), in which case the entity gives the disclosures required by IFRS 1.44;
  b) a revaluation under previous GAAP that meets the criteria in IFRS 1.17 (as previously discussed); or
  c) fair value at the date of an event such as a privatisation or initial public offering (IFRS 1.19).
- Subsequent depreciation
  - is based on that deemed cost and
  - starts from the date for which the entity established the fair value measurement or revaluation.

Implementation – IAS 16

- If an entity chooses as its accounting policy **the revaluation model** in IAS 16 for some or all classes of property, plant and equipment,
  - ➢ it presents the cumulative revaluation surplus as a separate component of equity.
- The revaluation surplus at the date of transition to IFRSs is based on a comparison of
  - the carrying amount of the asset at that date with
  - its cost or deemed cost.
- If the deemed cost is the fair value at the date of transition to IFRSs, the entity gives the disclosures required by IFRS 1.44.

Implementation – IAS 16

- If revaluations under previous GAAP did not satisfy the criteria in IFRS 1.17 or 19 (as discussed), an entity measures the revalued assets in its opening balance sheet on one of the following bases:
  a) **cost (or deemed cost)**
     less any accumulated depreciation and
     any accumulated impairment losses under the cost model in IAS 16;
  b) **deemed cost**,
     being the fair value at the date of transition to IFRSs (IFRS 1.16); or
  c) **revalued amount**,
     if the entity adopts the revaluation model in IAS 16 as its accounting policy under IFRSs for all items of property, plant and equipment in the same class

Implementation – IAS 16

- If an entity's depreciation methods and rates under previous GAAP are acceptable under IFRSs,
  - it accounts for any change in estimated useful life or depreciation pattern prospectively from when it makes that change in estimate (IFRS 1.31 and 32 and IAS 16.61).
- However, in some cases, an entity's depreciation methods and rates under previous GAAP may differ from those that would be acceptable under IFRSs (for example, if they were adopted solely for tax purposes and do not reflect a reasonable estimate of the asset's useful life)
  - If those differences have a material effect on the financial statements, the entity adjusts accumulated depreciation in its opening IFRS balance sheet **retrospectively** so that it complies with IFRSs.

Common in Macao?

2. Recognition and Measurement

c. Exemptions from Other IFRSs

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

- An entity may elect to use one or more of some exemptions

1. Business combinations
3. Employee benefits
4. Cumulative translation differences
5. Compound financial instruments
6. Assets and liabilities of subsidiaries, associates and joint ventures
7. Designation of previously recognised financial instruments
8. Share-based payment transactions
9. Insurance contracts
12. Fair value measurement of financial assets or financial liabilities at initial recognition
13. A financial asset or an intangible asset accounted for in accordance with IFRIC 12.

Other exemptions?

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

1. Business Combinations

Not required

- May elect not to apply IFRS 3 retrospectively to past business combinations (those occurred before the date of transition to IFRSs).
  - May not be required
    - to restate those business combinations accounted for in uniting of interest as acquisitions or
    - to restate the goodwill previously written off

If elected

- If elect to restate any business combination to comply with IFRS 3, it shall
  - restate all later business combinations and
  - apply IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets* from that same date

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

1. Business Combinations

- Regardless of whether there is any indication that the goodwill may be impaired, the first-time adopter 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 in retained earnings (or, if so required by IAS 36, in revaluation surplus).
- The impairment test shall be based on conditions at the date of transition to IFRSs.

2. Recognition and Measurement

Example

- Peter Inc.
  - firstly adopts IFRSs for the year ended 31 Dec. 2007.
  - had 3 business combinations in its history (their respective dates of acquisition are 15 May 2005, 1 Jun. 2006 and 5 Jan. 2007)
  - had not complied IFRS 3 before
  - would elect to present 1 year comparative in its first IFRS financial statements
- If Peter Inc. elects not to apply IFRS 3 retrospectively, which business combination(s) would not be restated retrospectively.

- Reporting date under IFRS 1 is 31 Dec. 2007 and the date of transition is 1 Jan. 2006.
- In consequence, the business combination before 1 Jan. 2006 (i.e. 15 May 2005) would not be restated retrospectively.

2. Recognition and Measurement

Example

- Group ABC's policy to test the impairment loss of goodwill.
- However, some goodwill had been totally written off against retained earnings on the acquisition of certain subsidiaries.
- As a first-time adopter of IFRSs, ABC sets out that,
  - on the disposal or closure of the business to which the goodwill related, goodwill previously eliminated against retained earnings is charged to the income statement.

- Goodwill cannot be recycled to the income statement on the disposal of a subsidiary whose goodwill had been written off equity in the year of acquisition.
- Goodwill recognised in the opening IFRS balance sheet will be the carrying amount under the GAAP used by ABC as amended for any wrongly classified intangible asset and any contingent consideration.
- Goodwill should also be impairment tested using IAS 36 *Impairment of Assets* at the date of transition to IFRS.

Modified from ACCA

2. Recognition and Measurement

Case

HSBC

2005 Annual Report

- In accordance with IFRS 1, HSBC has chosen not to restate
  - business combinations that took place prior to 1 January 2004, the date of transition to IFRSs ……
- Had this exemption not been taken the main effects would have been
  - to recognise additional deferred tax on fair value adjustments made at the date of acquisition and
  - to recognise additional intangible assets with consequential adjustments to the carrying value of goodwill and retained earnings as at 1 January 2004.
- The recognition of additional intangibles with a definite life would have given rise to an increased amortisation charge, which would have reduced IFRSs net income prospectively with a consequential reduction in total shareholders' equity.
- The restatement of goodwill would have had no impact on prospective net income unless it was written off following a subsequent impairment review.

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

3. Employee benefits (applicable to defined benefit plans)

- What is defined benefit plan (under IAS 19 *Employee Benefits*)?

- Defined benefit plan is one of the two post-employment benefit plans defined under IAS 19.
- Under defined benefit plans:
  a) the entity's obligation is to provide the agreed benefits to current and former employees; and
  b) actuarial risk (that benefits will cost more than expected) and investment risk fall, in substance, on the entity.
  If actuarial or investment experience are worse than expected, the entity's obligation may be increased.

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

3. Employee benefits (applicable to defined benefit plans)

- What is defined benefit plan (under IAS 19 *Employee Benefits*)?

- Accounting for defined benefit plans is complex because
  - actuarial assumptions are required to measure
    - the obligation (of the employer) and the expense and
  - there is a possibility of actuarial gains and losses.
- Moreover, the obligations are measured on a discounted basis because they may be settled many years after the employees render the related service.

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

3. Employee benefits (applicable to defined benefit plan)

- Under IAS 19,
  - an entity may elect to use a "corridor" approach for its defined benefit plans that leaves some actuarial gains and losses unrecognised
    - unless such cumulative actuarial gains and losses beyond this "corridor"
  - Retrospective application of this approach requires an entity to split the cumulative actuarial gains and losses from the inception of the plan until the date of transition to IFRSs into
    - a recognised portion and
    - an unrecognised portion.

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

3. Employee benefits (applicable to defined benefit plan)

- However, a first-time adopter may elect to
  - recognise all cumulative actuarial gains and losses at the date of transition to IFRSs
    - even if it uses the corridor approach for later actuarial gains and losses.
    - In other words, dividing into recognised and unrecognised portions are exempted at the date of transition to IFRSs.
- If a first-time adopter uses this election,
  - it shall apply it to all defined benefit plans.

2. Recognition and Measurement

Example

- Trident has a separately administered defined benefit pension scheme.
- Contributions are charged to the income statement and the regular pension costs are attributed using the projected unit method.
- Variations in pension costs as a result of actuarial valuations are amortised over the average remaining service lives of employees.
- No actuarial gains and losses had been recognised in the financial statements.
- Based on the information above, draft a memo. setting out the specific accounting implications of IFRS 1 for the Trident Group at the date of transition to IFRS.

Modified from ACCA

2. Recognition and Measurement

Example

- IAS 19 *Employee Benefits* adopts a "corridor" approach which can leave some actuarial gains and losses unrecognised.
- The company currently has not recognised any actuarial gains and losses.
- The company has two choices in order to comply with IFRS at the transition date:
  a) Retrospectively apply IAS 19 from the inception of the scheme to the date of transition, applying the "corridor" approach at each year end, or
  b) Recognising all cumulative gains or losses at the date of transition to IFRSs and writing them off against retained earnings.

     It can use the "corridor approach" under this alternative after the date of transition.
- The latter approach would be less onerous to the company but it must be applied to all plans.

2. Recognition and Measurement

Example

- BerryBerry Limited would have its first IFRSs financial statements for the year ended 31 December 2007.
- It has a defined benefit plan for its employees, in which an actuarial loss at the date of transition to IFRSs has been accumulated to $ 5 million.
- It would adopt the "corridor approach" under IAS 19 to account for its actuarial gains or losses for its defined benefit plan.
- The actuary of BerryBerry Limited estimated that 40% of the cumulative actuarial losses at the date of transition to IFRSs was beyond BerryBerry's "corridor".
- Please comment and calculate the implication on applying and not applying IFRS 1.

2. Recognition and Measurement

Example

- BerryBerry has two choices in order to comply with IFRS 17 at the transition date:
  a) Retrospectively apply IAS 19 from the inception of the scheme to the date of transition, applying the "corridor" approach at each year end, or
  b) Recognising all cumulative gains or losses at the date of transition to IFRSs and writing them off against retained earnings.
  It can use the "corridor approach" under this alternative after the date of transition.
- By using (a) above, BerryBerry is required to
  – split the cumulative actuarial losses into 2 portions, 60% and 40% and
  – recognise 40% of such losses ($ 2 million) in its retained earnings
- By using (b) above, BerryBerry can
  – recognise all such losses, i.e. $ 5 million, its retained earnings at the date of transition to IFRSs (as exempted from IFRS 1.20),
  – can still use the "corridor approach" under IAS 19 after the date of transition.

2. Recognition and Measurement

Case

2005 Annual Report

HSBC

- HSBC
  - has elected to apply the employee benefits exemption and
  - has, therefore, recognised in equity at 1 January 2004 all cumulative actuarial gains and losses on post-employment benefit plans.
- Recognising certain actuarial gains and losses under the alternative 'corridor approach' would have
  - reduced liabilities and
  - increased retained earnings

  at 1 January 2004.
- HSBC has not elected to adopt a corridor approach going forward under IAS 19 'Employee Benefits'.

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

4. Cumulative translation differences

- IAS 21 *The Effects of Changes in Foreign Exchange Rates*, requires an entity:
  a) to classify some translation differences as a separate component of equity; and
  b) on disposal of a foreign operation, to transfer the cumulative translation difference for that foreign operation (including, if applicable, gains and losses on related hedges) to the income statement as part of the gain or loss on disposal.

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

4. Cumulative translation differences

- A first-time adopter need not comply with IAS 21
  - for cumulative translation differences (to classify some translation differences as a separate component of equity) that existed at the date of transition to IFRSs.
- If a first-time adopter uses this exemption:
  a) the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to IFRSs; and
  b) the gain or loss on a subsequent disposal of any foreign operation
     - shall exclude translation differences that arose before the date of transition to IFRSs and
     - shall include later translation differences.

2. Recognition and Measurement

Example

- NAA has used
  - to recognise all the exchange gains and losses on the translation of the financial statements of foreign operations in the income statements, and
  - to calculate the gains or losses on disposal of foreign operations by comparing the sales proceeds and the carrying amounts of the foreign operations at the date of disposal in its consolidated financial statements.
- In order to adopt IFRSs, NAA considers whether the above practice should be amended.

2. Recognition and Measurement

Example

- Under IAS 21 *The Effects of Changes in Foreign Exchange Rates,* NAA is required
  - to classify the translation differences as a separate component of the equity and
  - to reclassify the corresponding differences to the income statement when the foreign operation is disposed of.
- By using the exemption under IFRS 1, NAA can elect
  - not to comply with such requirements,
  - deem the cumulative translation differences for all foreign operations to be zero at the date of transition to IFRSs,
  - exclude translation differences that arose before the date of transition to IFRSs from the gain or loss on a subsequent disposal of any foreign operation, and
  - only include later translation differences in the gain or loss on a subsequent disposal of any foreign operation.

2. Recognition and Measurement

Case

ESPRIT

Esprit Holdings Limited

- Its annual report of 2004 stated that:
  - With effect from this financial year, the Company decided to prepare its consolidated financial statements in accordance with International Financial Reporting Standards (instead of HK GAAP) and convert the comparative financial information for the year ended June 30, 2003 to be in accordance with IFRS.
- One of the exemption it elected:
  - The Group has adopted the option available in IFRS 1 to deem the translation reserve as at July 1, 2002 to be zero.
  - Under HKGAAP, this reserve was a debit of HK$100,664,000 as at July 1, 2002.

2. Recognition and Measurement

Case

2005 Annual Report

- In accordance with IFRS 1, HSBC has set the cumulative exchange differences for all foreign operations to zero at the date of transition to IFRSs.
- On disposal of a foreign operation, exchange differences relating thereto and previously recognised in reserves are recognised in the income statement ……
- The alternative, a retrospective application of IAS 21 'The Effect of Changes in Foreign Exchange Rates', would have resulted in a re-allocation between
  - retained earnings and
  - other reserves at 1 January 2004

  but would have had no impact on total equity.

2. Recognition and Measurement

Example

- Trident's Group policy is to amortise goodwill but some goodwill had been totally written off against retained earnings on the acquisition of certain subsidiaries.
- On the disposal or closure of the business to which the goodwill related, goodwill previously eliminated against retained earnings is charged to the income statement.
- The gains and losses on the translation of the financial statements of overseas subsidiaries have been charged to retained earnings for many years and not recycled to the income statement on the disposal of subsidiaries.
- Based on the information above, draft a memo. setting out the specific accounting implications of IFRS1 for the Trident Group at the date of transition to IFRS.

Modified from ACCA

2. Recognition and Measurement

Example

- Goodwill cannot be recycled to the income statement on the disposal of a subsidiary whose goodwill had been written off equity in the year of acquisition.
- Goodwill recognised in the opening IFRS balance sheet (1 Jan. 2004) will be the carrying amount under the GAAP used by Trident as amended for any wrongly classified intangible asset and any contingent consideration. Goodwill should also be impairment tested using IAS 36 *Impairment of Assets* at the date of transition to IFRS.
- IAS 21 *The Effects of Changes in Foreign Exchange Rates* requires that some translation differences are classed as a separate component of equity on the disposal of the operation, the cumulative translation difference for that operation should be recognised in profit or loss when the gain or loss on disposal is recognised.
- However, Trident can elect under IFRS1 not to comply with these requirements, and set the cumulative translation differences for all operations to zero as at 1 Jan. 2004 and recognise any differences in accumulated profits/losses at that date.
- The directors will need to look at the nature of the records of the company in order to see if the necessary detail to comply with IAS 21 is available.

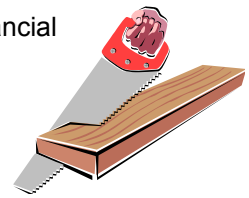
2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

5. Compound financial instruments

- IAS 32 requires an entity to split a compound financial instrument at inception into separate
  a) liability and
  b) equity components.



- If the liability component is no longer outstanding, <u>retrospective application of IAS 32</u> involves separating 2 portions of equity.
  a) The first portion is in <u>retained earnings</u> and represents the cumulative interest accreted on the liability component.
  b) The other portion represents <u>the original equity component</u>.

2. Recognition and Measurement

Example

c. Exemptions from Other IFRSs

Optional – entities can choose

5. Compound financial instruments

- On 1.1. 2003, NAA issued a zero convertible bond of $1,000 at par for 1 year.
  - A professional valuer estimated that the effective interest rate for a bond without such convertible right was 10% and the value of such bond amounted to $909.
  - NAA recognised the full amount received as a current non-interesting bearing loan.
- On 31.12.2003, NAA repaid the bond in full.
- In 2005, NAA decided to adopt IFRSs in full and to provide 1-year full comparative information.
- Advise NAA the implication of the above bond on its financial statements for the year ended 31.12.2005.

2. Recognition and Measurement

Example

c. Exemptions from Other IFRSs

Optional – entities can choose

5. Compound financial instruments

- Under IAS 32, NAA is required in the year ended 31.12.2003
  - to split the zero convertible bond into:
    - Liability $ 909
    - Equity 91
  - to recognise an interest expense of $91 in the income statement
- In substance, the retained earnings of 2004 to 2005 would be reduced by $91 and a separate equity account would be increased by $91.
- However, under IFRS 1 ……

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

5. Compound financial instruments

- Under IFRS 1,
  - a first-time adopter need not separate these 2 portions
    - if the liability component is no longer outstanding at the date of transition to IFRSs.

- Following the previous example, NAA is not required to spilt the liability (or retained earnings) portion and the equity portion
  - as the bond is no longer outstanding on 1.1.2004.

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

6. Assets and Liabilities of subsidiaries, associates and JV

Later for subsidiary

- If a subsidiary becomes a first-time adopter later than its parent, the subsidiary shall, in its (subsidiary's) financial statements (or separate financial statements), measure its assets and liabilities at either:
  a) the carrying amounts that would be included in the parent's consolidated financial statements, based on the parent's date of transition to IFRSs; or
  b) the carrying amounts required by the rest of IFRS 1, based on the subsidiary's date of transition to IFRSs.
- A similar election is available to an associate or joint venture.

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

6. Assets and Liabilities of subsidiaries, associates and JV

Later for parent

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

Consolidation Financial Statements

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

6. Assets and Liabilities of subsidiaries, associates and JV

Earlier or later

- If a parent becomes a first-time adopter for its separate financial statements earlier or later than for its consolidated financial statements
  - it shall measure its assets and liabilities at the same amounts in both financial statements, except for consolidation adjustments.

Consolidation Financial Statements ← **Same amount** → Separate Financial Statements

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

7. Designation of previously recognised financial instruments

- IAS 39 *Financial Instruments: Recognition and Measurement* permits a financial asset to be designated on initial recognition as
  - available for sale or
  - a financial instrument (provided it meets certain criteria) to be designated as a financial asset or financial liability at fair value through profit or loss.
- Despite this requirement exceptions apply in the following circumstances,
  - any entity is permitted to make an available-for-sale designation at the date of transition to IFRSs.
- Such exemption for financial instruments to be designated as financial asset or financial liability at fair value through profit or loss should still comply with the fair value option amendment.

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

8. Share-based payment transactions

- A first-time adopter is encouraged, but not required, to apply IFRS 2 to equity instruments that were granted
  - That were granted on or before 7 November 2002, or
  - That were granted after 7 November 2002 that vested before the later of
    - a) the date of transition to IFRSs and
    - b) 1 January 2005.

- If a first-time adopter elects to apply IFRS 2 to such equity instruments, it may do so only if
  - the entity has disclosed publicly the fair value of those equity instruments, determined at the measurement date, as defined in IFRS 2.

Only allowed if fair value disclosed before

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

8. Share-based payment transactions

- A first-time adopter is encouraged, but not required, to apply IFRS 2 to liabilities arising from share-based payment transactions
  - That were settled before the date of transition to IFRSs
  - That were settled before 1 Jan. 2005
- For liabilities to which IFRS 2 is applied,
  - a first-time adopter is not required to restate comparative information to extent that the information relates to a period or date that is earlier than 7 Nov. 2002.

2. Recognition and Measurement

Case

2005 Annual Report

HSBC

- HSBC has elected to undertake full retrospective application of IFRS 2 'Share-based Payment'.
- The alternative, excluding share options issued before 7 November 2002 as permitted by IFRS 1,
  - would have slightly reduced administrative expenses and increased net income in 2004.
- There would have been no impact on retained earnings or total equity.

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

9. Insurance contracts

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

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

12. Fair value measurement of financial assets or financial liabilities

- Notwithstanding the requirements in IFRS 1, an entity may apply the requirements in
  - the last sentence of IAS 39 paragraph AG76, and
  - paragraph AG76A,

  in either of the following ways:

  a) prospectively to transactions entered into after 25 October 2002; or

  b) prospectively to transactions entered into after 1 January 2004.

Last sentence of IAS 39.AG76
IAS 39.AG76G

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

12. Fair value measurement of financial assets or financial liabilities

Last sentence of IAS 39.AG 76:

- The best evidence of the fair value of a financial instrument at initial recognition is the transaction price (i.e. the fair value of the consideration given or received)
  - unless the fair value of that instrument is
    - evidenced by comparison with other observable current market transactions in the same instrument (without modification or repackaging) or
    - based on a valuation technique whose variables include only data from observable markets.

Last sentence of IAS 39.AG76 IAS 39.AG76G

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

12. Fair value measurement of financial assets or financial liabilities

IAS 39.AG76A:

- The subsequent measurement of the financial asset or financial liability and the subsequent recognition of gains and losses shall be consistent with the requirements of IAS 39.
  - The application of paragraph AG76 may result in no gain or loss being recognised on the initial recognition of a financial asset or financial liability.
  - In such a case, IAS 39 requires that a gain or loss shall be recognised after initial recognition only to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price.

Last sentence of IAS 39.AG76 IAS 39.AG76G

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

13. Service concession arrangements

- A first-time adopter may apply the transitional provisions in IFRIC Interpretation 12 *Service Concession Arrangements*.

What is a service concession arrangement?

2. Recognition and Measurement

c. Exemptions from Other IFRSs

Optional – entities can choose

13. Service concession arrangements

- IFRIC 12 gives guidance on the accounting by operators for public-to-private service concession arrangements
- It applies to public-to-private service concession arrangements if:
  a) the grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price; and
  b) the grantor controls–through ownership, beneficial entitlement or otherwise–any significant residual interest in the infrastructure at the end of the term of the arrangement.
- Such an arrangement is also described as
  – a “build-operate-transfer”,
  – a “rehabilitate-operate-transfer” or
  – a “public-to-private” service concession arrangement.

Today's Agenda

Simple and Comprehensive

Real Cases and Examples

Introduction

1. Objective and Scope
2. Recognition and Measurement
   a. Opening IFRS Balance Sheet
   b. Accounting Policies
   c. Exemption from Other IFRSs
   d. Exceptions to Retrospective Application
3. Presentation and Disclosure
   a. Comparative Information
   b. Explanation of Transition to IFRSs

Final Remarks

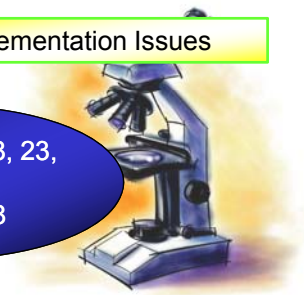
Today's Agenda

Introduction

1. Objective and Scope
2. Recognition and Measurement
   a. Opening IFRS Balance Sheet
   b. Accounting Policies
   c. Exemption from Other IFRSs

Implementation Issues

IAS 12, 17, 18, 23, 36,
37 and 38



Implementation – IAS 12

- An entity applies IAS 12 *Income Taxes* to temporary differences between
  - the carrying amount of the assets and liabilities in its opening IFRS balance sheet and
  - their tax bases.
- Under IAS 12, the measurement of current and deferred tax reflects tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.
- An entity accounts for the effect of changes in tax rates and tax laws when those changes are enacted or substantively enacted.

Implementation – IAS 17 Leases

- 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 17.13).

Finance Lease

- A finance lease
  - is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset.
  - Title may or may not eventually be transferred.

Operating Lease

- An operating lease
  - is a lease other than a finance lease

- The inception of the lease is the earlier of
  - the date of the lease agreement and
  - the date of commitment by the parties to the principal provisions of the lease.

Implementation – IAS 17 Leases

- 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 in accordance with 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.

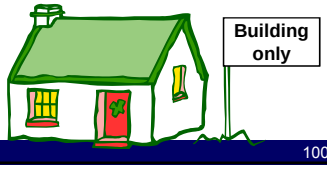
Implementation – IAS 17 Leases

Lease of land

Lease of land and buildings

- Lease of land and of buildings are classified as operating or finance leases
  - in the same way as leases of other assets
  - but ……

Critical change and problematic area



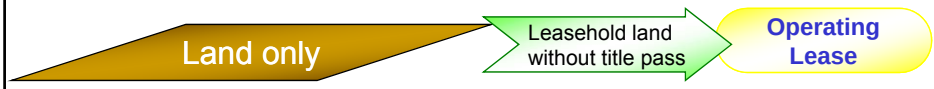
Building only

Land only

Implementation – IAS 17 Leases

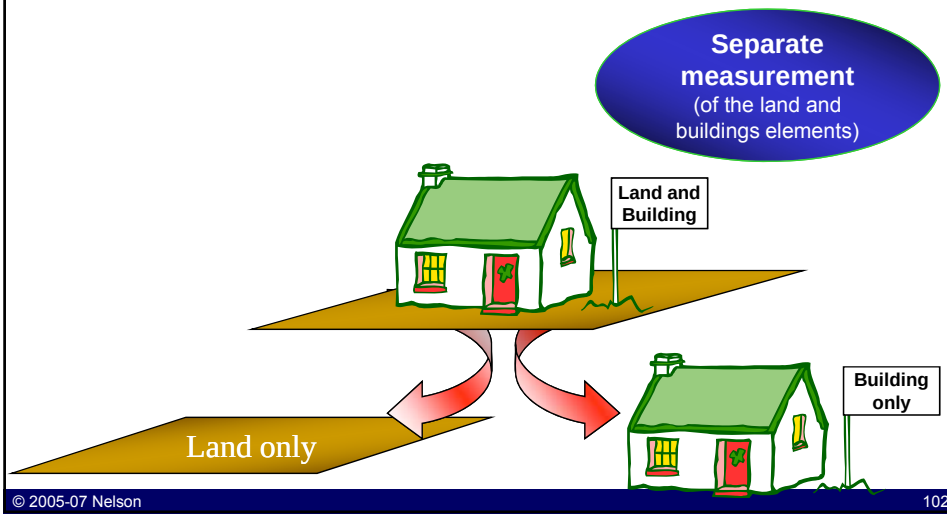
Lease of land

- Lease of land is classified in the same way as leases of other assets
- However, as land normally has an indefinite economic life
- If title of leasehold land is not expected to pass to the lessee
  - ⇒ Lessee normally does not receive substantially all of the risks and rewards incidental to the ownership
  - ⇒ In which case the lease of land will be an **operating lease**
    - payment acquiring such leasehold represents **prepaid lease payments**
    - amortised over the lease term in accordance with the pattern of benefits provided



Implementation – IAS 17 Leases

Lease of land ⇨ **Lease of land and buildings**



Implementation – IAS 17 Leases

Lease of land and buildings

If a lease contains land and buildings elements

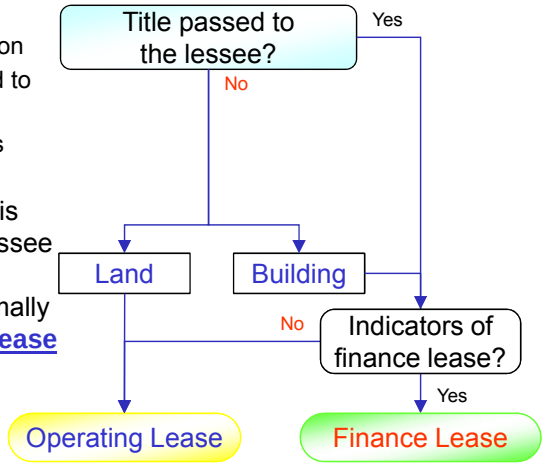
- 2 elements are considered separately for lease classification

If **title** of both elements is expected to pass to the lessee

- Both elements are classified as **finance lease**

If **title** of land or both elements is NOT expected to pass to the lessee

- The land element alone (as having indefinite life) is normally classified as an **operating lease**
- The building element is considered separately

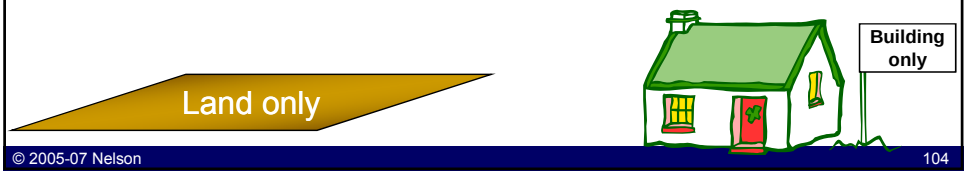


Implementation – IAS 17 Leases

Lease of land and buildings

- To classify and account for a lease of land and buildings
  - the minimum lease payments (including any lump-sum upfront payments) are allocated between
    - the land and
    - the buildings elements
  - in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the lease at the inception of the lease

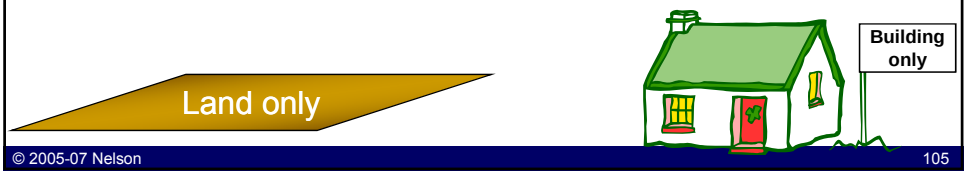
Relative Fair Value



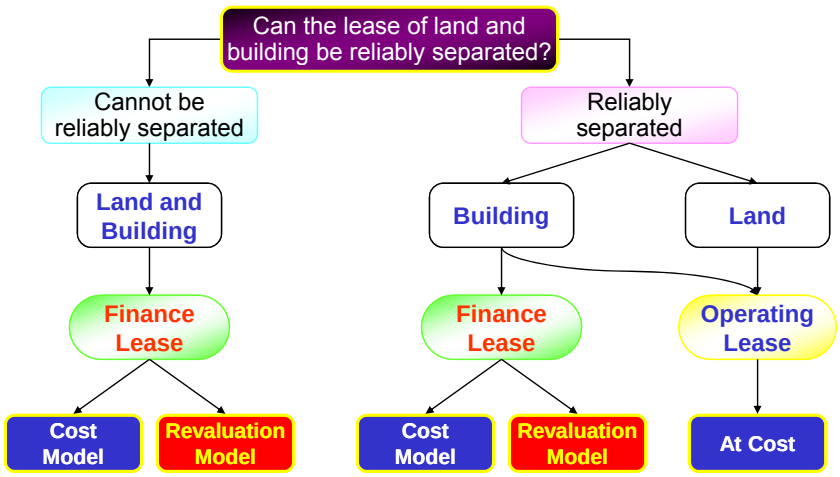
Implementation – IAS 17 Leases

Lease of land and buildings

- If the lease payments cannot be allocated reliably between the 2 elements
  - the entire lease is classified as a **finance lease**
  - unless it is clear that both elements are operating leases, in which case the entire lease is classified as an **operating lease**
- For a lease of land and building if the land is immaterial
  - The lease may be treated as a single unit and classified as finance or operating leases



Implementation – IAS 17 Leases



Implementation – IAS 18 Revenue

- 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.

Implementation – IAS 23

- 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),
    - Benchmark treatment cannot be chosen for period beginning on or after 1 Jan. 2009.

Allowed Alternative – Capitalisation

Benchmark – Expenses

- The entity applies that policy consistently
  - in its opening IFRS balance sheet and
  - in all periods presented in its first IFRS financial statements.
- However, if the entity established a deemed cost for an asset,
  - the entity does not capitalise borrowing costs incurred before the date of the measurement that established the deemed cost.

Implementation – IAS 23

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

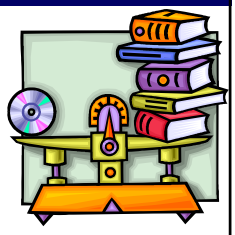
Allowed Alternative – Capitalisation

- 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 of IAS 23 that meet the criteria for capitalisation.
- However, if a first-time adopter adopts the IAS 23 allowed alternative treatment, IFRS 1 requires retrospective application of the treatment, even for periods before the effective date of IAS 23.
  - Since transitional provisions of IAS 23 do not apply to first-time adopter's transition to IFRSs (IFRS 1.9).

Implementation – IAS 36 and IAS 37

- An entity applies IAS 36 in:
  a) determining whether any impairment loss exists at the date of transition to IFRSs; and
  b) measuring any impairment loss that exists at that date, and reversing any impairment loss that no longer exists at that date.
    - An entity's first 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 (IFRS 1.39c).

Implementation – IAS 36 and IAS 37



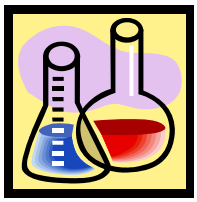
- The estimates used to determine whether an entity recognises an impairment loss or provision (and to measure any such impairment loss or provision) at the date of transition to IFRSs are consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies),
  - unless there is objective evidence that those estimates were in error (IFRS 1.31 and 32).
- The entity reports the impact of any later revisions to those estimates as an event of the period in which it makes the revisions.

Implementation – IAS 36 and IAS 37

- The transitional provisions in IAS 36 and IAS 37 do not apply to an entity's opening IFRS balance sheet (IFRS 1.9).
- 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.

Implementation – IAS 38

- 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 at the date of transition to IFRSs; and
  b) includes all intangible assets that meet the recognition criteria in IAS 38 at that date, except for
     - intangible assets acquired in a business combination that were not recognised in the acquirer's consolidated balance sheet under previous GAAP and also would not qualify for recognition under IAS 38 in the separate balance sheet of the acquiree (see IFRS 1.B2f).



Implementation – IAS 38

- The criteria in IAS 38 require an entity to recognise an intangible asset if, and only if:
  a) it is probable that the future economic benefits that are attributable to the asset will flow to the entity; and
  b) the cost of the asset can be measured reliably.

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

Implementation – IAS 38

- Under IAS 38.65 and 71, an entity capitalises the costs of creating internally generated intangible assets prospectively from the date when the recognition criteria are met.
- IAS 38 does not permit an entity to use hindsight to conclude retrospectively that these recognition criteria are met.
- Therefore, even if an entity concludes retrospectively that a future inflow of economic benefits from an internally generated intangible asset is probable and the entity is able to reconstruct the costs reliably,
  - IAS 38 prohibits it from capitalising the costs incurred before the date when the entity both:
    a) concludes, based on an assessment made and documented at the date of that conclusion, that it is probable that future economic benefits from the asset will flow to the entity; and
    b) has a reliable system for accumulating the costs of internally generated intangible assets when, or shortly after, they are incurred.

Implementation – IAS 38

- If an **internally generated intangible asset** qualifies for recognition at the date of transition to IFRSs,
  - an entity recognises the asset in its opening IFRS balance sheet even if it had recognised the related expenditure as an expense under previous GAAP.
- If the asset does not qualify for recognition under IAS 38 until a later date,
  - its cost is the sum of the expenditure incurred from that later date.

Implementation – IAS 38

- The recognition criteria in IAS 38 also apply to an **intangible asset acquired separately**
  - In many cases, contemporaneous documentation prepared to support the decision to acquire the asset will contain an assessment of the future economic benefits.
  - Furthermore, as explained in IAS 38.26, the cost of a separately acquired intangible asset can usually be measured reliably.

Implementation – IAS 38

- A first-time adopter may elect to use the fair value of an intangible asset at the date of an event (such as a privatisation or initial public offering) as its deemed cost at the date of that event (IFRS 1.19), provided that the intangible asset qualifies for recognition under IAS 38 (IFRS 1.10).
- In addition, if, and only if, an intangible asset meets both (1) the recognition criteria in IAS 38 (including reliable measurement of original cost) and (2) the criteria in IAS 38 for revaluation (including the existence of an active market),
  - a first-time adopter may elect to use one of the following amounts as its deemed cost (IFRS 1.18):
    a) fair value at the date of transition to IFRSs (IFRS 1.16), in which case the entity gives the disclosures required by IFRS 1.44; or
    b) a revaluation under previous GAAP that meets the criteria in IFRS 1.17.

Implementation – IAS 38

- 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 (IFRS 1.31 and IAS 38.104).

Implementation – IAS 38

Common in Macao?

- However, in some cases, an entity's amortisation methods and rates under previous GAAP may differ from those that would be acceptable under IFRSs (for example, if they were adopted solely for tax purposes and do not reflect a reasonable estimate of the asset's useful life).
- If those differences have a material effect on the financial statements,
  - the entity adjusts the accumulated amortisation in its opening IFRS balance sheet **retrospectively** so that it complies with IFRSs (IFRS 1.31).

Similar to Property, Plant and Equipment

Implementation – IAS 39

Recognition Issues

- An entity recognises and measures all financial assets and financial liabilities in its opening IFRS balance sheet in accordance with IAS 39,
  - except for derecognition, hedge accounting, and exemption from restating comparative information (if conditions met)
- An entity recognises all financial assets and financial liabilities (including all derivatives) that qualify for recognition under IAS 39 and have not yet qualified for derecognition under IAS 39
  - except some specified cases
- 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.

Implementation – IAS 39

Embedded Derivatives

- When IAS 39 requires an entity to separate an embedded derivative from a host contract,
  - the initial carrying amounts of the components at the date when the instrument first satisfies the recognition criteria in IAS 39 reflect circumstances at that date (IAS 39.11).
- If the entity cannot determine the initial carrying amounts of the embedded derivative and host contract reliably,
  - it treats the entire combined contract as a financial instrument held for trading (IAS 39.12).
  - This results in fair value measurement (except when the entity cannot determine a reliable fair value, see IAS 39.46c), with changes in fair value recognised in profit or loss.

Implementation – IAS 39

Measurement Issues

- In preparing its opening IFRS balance sheet, an entity applies the criteria in IAS 39 to identify
  - those financial assets and financial liabilities that are measured at **fair value**
  - those that are measured at **amortised cost**.

FA at FV through P/L	**at Fair Value through P/L**
AFS financial assets	**at Fair Value through equity** **at Cost (only conditions met)**
HTM investments	**at Amortised Cost**
Loans and receivables	**at Amortised Cost**

Financial Assets

Implementation – IAS 39

FA at FV through P/L

A financial asset that meets either of the following 2 conditions to be classified as **fair value through P/L**

a) It is classified as **held for trading**, if it is:

i) acquired or incurred principally for the purpose of selling or repurchasing it in the near term;

ii) part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or

iii) a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

b) Upon **initial recognition** it is **designated** by the entity as at fair value through profit or loss (only if the entity meets any one of three conditions in IAS 39)

Implementation – IAS 39

Available-for-sale financial assets

- Those non-derivative financial assets that are designated as available for sale, or
- Those not classified into other categories
- Implies
  - ⇒ Except for those held for trading, all the remaining financial assets can be designated as AFS financial assets
  - ⇒ Loans and receivables and HTM investments can also be initially designated as AFS financial assets

AFS financial assets

Implementation – IAS 39

Held to maturity investments

- Non-derivative financial assets with fixed or determinable payments and fixed maturity
- That the entity has the positive intention and ability to hold to maturity, other than
  - those initially designated as FA at FV through P/L
  - those designated as AFS financial assets
  - those that meet the definition of loans and receivables

HTM investments

- An entity shall not classify any financial assets as held to maturity
  - if the entity has,
    - during the current financial year or
    - during the two preceding financial years,
    - sold or reclassified more than an insignificant amount of held-to-maturity investments before maturity (more than insignificant in relation to the total amount of held-to-maturity investments)

Implementation – IAS 39

Held to maturity investments

- Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than
  - those the entity intends to sell immediately or in the near term (which shall be classified as held for trading)
  - those initially designated as FA at FV through P/L
  - those initially designated as AFS financial assets
  - those for which the holder may not recover substantially all of its the initial investment, other than because of credit deterioration, which shall be classified as AFS financial assets

Loans and receivables

Implementation – IAS 39

Measurement Issues

- Be careful for:
  a) to comply with IAS 39.51, classification of financial assets as held-to-maturity investments relies on a designation made by the entity in applying IAS 39 reflecting the entity's intention and ability at the date of transition to IFRSs.
     - It follows that sales or transfers of held-to-maturity investments before the date of transition to IFRSs do not trigger the 'tainting' rules in IAS 39.9.
  b) to comply with IAS 39.9, the category of loans and receivables refers to the circumstances when the financial asset first satisfied the recognition criteria in IAS 39.

HTM investments

Loans and receivables

Implementation – IAS 39

Measurement Issues

- 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 that date (IFRS 1.B2e).

HTM investments

Loans and receivables

Implementation – IAS 39

Measurement – Impairment

- 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 (IFRS 1.31).
- 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.

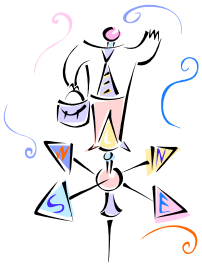
HTM investments

Loans and receivables

Implementation – IAS 39

Transition adjustments

- An entity shall treat an adjustment to the carrying amount of a financial asset or financial liability
  - as a transition adjustment to be recognised in the opening balance of retained earnings at the date of transition to IFRSs
  - only to the extent that it results from adopting IAS 39.
- IAS 8 (as revised in 2003) applies to adjustments resulting from changes in estimates.
  - If an entity is unable to determine whether a particular portion of the adjustment is a transition adjustment or a change in estimate, it treats that portion as a change in accounting estimate under IAS 8, with appropriate disclosures (IAS 8.32 – 40).



Today's Agenda

Introduction

1. Objective and Scope
2. Recognition and Measurement
   a. Opening IFRS Balance Sheet
   b. Accounting Policies
   c. Exemption from Other IFRSs
   d. Exceptions to Retrospective Application

2. Recognition and Measurement

d. Exceptions to Retrospective Application of IFRSs

2. Recognition and Measurement

d. Exceptions to Retrospective Application of IFRSs

No Choice! Mandatory!

IFRS 1 prohibits retrospective application of some aspects of other IFRSs relating to:

1. Derecognition of financial assets and financial liabilities
2. Hedge accounting
3. Estimates, and
4. Assets classified as held for sale and discontinued operations

2. Recognition and Measurement

d. Exceptions to Retrospective Application of IFRSs

1. Derecognition of financial assets and financial liabilities

- A first-time adopter shall
  - apply the derecognition requirements in IAS 39 prospectively from the effective date of IAS 39.

Apply Derecognition Prospectively

- In other words, if a first-time adopter derecognised financial assets or financial liabilities under its previous GAAP in a financial year beginning before 1 January 2004,
  - it shall not recognise those assets and liabilities under IFRSs (unless they qualify for recognition as a result of a later transaction or event).

2. Recognition and Measurement

d. Exceptions to Retrospective Application of IFRSs

1. Derecognition of financial assets and financial liabilities

Allow Retrospective Application on condition

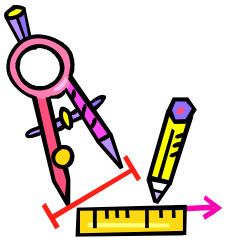
- Notwithstanding the above requirements, an entity may apply the derecognition requirements in IAS 39 retrospectively from a date of the entity's choosing,
  - provided that the information needed to apply IAS 39 to financial assets and financial liabilities derecognised as a result of past transactions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

2. Recognition and Measurement

d. Exceptions to Retrospective Application of IFRSs

2. Hedge accounting

- An entity shall not reflect in its opening IFRS balance sheet a hedging relationship of a type that does not qualify for hedge accounting under IAS 39.
- However, if an entity designated a net position as a hedged item under previous GAAP,
  - it may designate an individual item within that net position as a hedged item under IFRSs
    - provided that it does so no later than the date of transition to IFRSs.

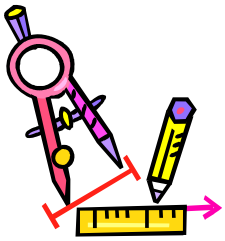


2. Recognition and Measurement

d. Exceptions to Retrospective Application of IFRSs

2. Hedge accounting

- If, before the date of transition to IFRSs, an entity had designated a transaction as a hedge but the hedge does not meet the conditions for hedge accounting in IAS 39,
  - the entity shall apply IAS 39.91 and IAS 39.101 to discontinue hedge accounting.
- Transactions entered into before the date of transition to IFRSs
  - shall not be retrospectively designated as hedges.



2. Recognition and Measurement

Example

- Trident has several financial instruments in issue. It has preference share capital which was originally redeemable on 1 January 2001.
- However if the preference shareholders so wish the capital can be converted into ordinary shares of Trident at any time up to 31 December 2007 at which time the preference shares will be converted compulsorily.
- Additionally Trident enters into foreign exchange contracts to hedge existing monetary assets and liabilities, and hedges against the effects of changes in exchange rates in the net investment in overseas subsidiaries. Hedge accounting is currently not used by Trident.
- Based on the information above, draft a memo. setting out the specific accounting implications of IFRS1 for the Trident Group at the date of transition to IFRS.

Modified from ACCA

2. Recognition and Measurement

Example

- Under IFRSs compound financial instruments such as the redeemable convertible preference capital, should be split into separate liability and equity components.
- However, as the liability component is no longer outstanding on these preference shares, IFRS 1 allows the first time adopter not to separate these two elements and treat it as 100% equity.
- Further the treatment of hedge accounting under IFRS 1 is quite complex. Basically IFRS 1 requires prospective application of IAS 39 in relation to hedging. If the hedging relationship does not qualify under IAS 39 for hedge accounting then it should not be accounted for in the opening IFRS balance sheet.
- Additionally a first time adopter is not permitted to recognise financial assets and liabilities that had been derecognised under previous GAAP prior to the initial effective date of IAS 39.

2. Recognition and Measurement

d. Exceptions to Retrospective Application of IFRSs

3. Estimates

- 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.
- An entity may receive information after the date of transition to IFRSs about estimates that it had made under previous GAAP.
  - Under the above paragraph, an entity shall treat the receipt of that information in the same way as non-adjusting events after the balance sheet date under IAS 10 *Events After the Balance Sheet Date*.

2. Recognition and Measurement

Example

- Entity A's first IFRS financial statements have a reporting date of 31 Dec. 2007 and include comparative information for one year.
- In its previous GAAP financial statements for 31 Dec. 2005 and 2006, Entity A:
  a) made estimates of accrued expenses and provisions at those dates;
  b) accounted on a cash basis for a defined benefit pension plan; and
  c) did not recognise a provision for a court case arising from events that occurred in Sep. 2006. When the court case was concluded on 30 June 2007, Entity A was required to pay $1,000 and paid this on 10 Jul. 2007.
- In preparing its first IFRS financial statements, Entity A concludes that its estimates under previous GAAP of accrued expenses and provisions at 31 Dec. 2005 and 2006 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 A concludes that its estimates were reasonable and that, therefore, no error had occurred.
- As a result, accounting for those over- and under-estimates involves the routine adjustment of estimates under IAS 8.

2. Recognition and Measurement

Example

- In preparing its opening IFRS balance sheet at 1 Jan. 2006 and in its comparative balance sheet at 31 Dec. 2006, entity A:
  a) does not adjust the previous estimates for accrued expenses and provisions; and
  b) makes estimates (in the form of actuarial assumptions) necessary to account for the pension plan under IAS 19 *Employee Benefits*.
- The treatment of the court case at 31 Dec. 2006 depends on the reason why Entity A did not recognise a provision under previous GAAP at that date.
  - Assumption 1 – Previous GAAP was consistent with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*:
    - Entity A concluded that the recognition criteria were not met. In this case, Entity A's assumptions under IFRSs are consistent with its assumptions under previous GAAP.
    - Thus, Entity A does not recognise a provision at 31 Dec. 2006.

2. Recognition and Measurement

Example

- Assumption 2 – Previous GAAP was not consistent with IAS 37:
  - Therefore, Entity A 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 A had a liability in Sep. 2006 (when the events occurred that gave rise to the court case).
  - Therefore, Entity A recognises a provision at 31 Dec. 2006.
  - Entity A measures that provision by discounting the $1,000 paid on 10 Jul. 2007 to its present value, using a discount rate that complies with IAS 37 and reflects market conditions at 31 Dec. 2006.

2. Recognition and Measurement

d. Exceptions to Retrospective Application of IFRSs

4. Assets classified as held for sale and discontinued operations

- IFRS 5 requires that it shall be applied prospectively to
  - non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and
  - operations that meet the criteria to be classified as discontinued after the effective date of IFRS.
- IFRS 5 permits an entity to apply the above requirements for any date before the effective date of IFRS,
  - provided the valuations and other information needed to apply the IFRS were obtained at the time those criteria were originally met.

2. Recognition and Measurement

d. Exceptions to Retrospective Application of IFRSs

4. Assets classified as held for sale and discontinued operations

- An entity with a date of transition to IFRSs
  - before 1 January 2005,
    - shall apply the transitional provisions of IFRS 5
  - on or after 1 January 2005,
    - shall apply IFRS 5 retrospectively.

2. Recognition and Measurement

- In accordance with IFRS 5, an entity shall classify a non-current asset (or disposal group) as held for sale if
  - its carrying amount will be recovered principally
    - through a sale transaction
    - rather than through continuing use

Classification → For this to be the case

- the asset (or disposal group) must be **available for immediate sale**
- its sale must be **highly probable**

Measurement

Presentation

Available for Immediate Sale

Highly Probable

Today's Agenda

Introduction

1. Objective and Scope
2. Recognition and Measurement

3. Presentation and Disclosure
   a. Comparative Information
   b. Explanation of Transition to IFRSs

3. Presentation and Disclosure

a. Comparative information

b. Explanation of transition to IFRSs

- IFRS 1 does not provide exemptions from the presentation and disclosure requirements in other IFRSs

3. Presentation and Disclosure

a. Comparative information

- To comply with IAS 1, an entity's first IFRS financial statements shall include <u>at least one year of comparative information</u> under IFRSs
- The areas to be addressed:
  1. Exemption from the requirement to restate comparative information for IAS 39 and IFRS 4
  2. Exemption from the requirement to present comparative information for IFRS 6
  3. Exemption from the requirement to provide comparative disclosures for IFRS 7
  4. Historical summaries

3. Presentation and Disclosure

a. Comparative information

⇒ 1. Exemption from the requirement to restate comparative information for *IAS 32, IAS 39 and IFRS 4*

- In its first IFRS financial statements, an entity that adopts IFRSs before 1 Jan. 2006 shall present at least one year of comparative information
  - but this comparative information need not comply with IAS 32, IAS 39 or IFRS 4
- An entity that chooses to present comparative information that does not comply with IAS 32, IAS 39 or IFRS 4 in its first year of transition shall fulfill certain conditions

3. Presentation and Disclosure

Case

2005 Annual Report

HSBC

- In preparing these consolidated financial statements, HSBC has elected to take advantage of certain transitional provisions within IFRS 1 *'First-time Adoption of International Financial Reporting Standards'* ('IFRS 1') which offer exemption from
  - presenting comparative information or
  - applying IFRSs retrospectively.
- The most significant of these provisions is the exemption from presenting comparative information in accordance with IFRSs in the following areas:
  - IAS 32 *'Financial Instruments: Presentation'* ('IAS 32');
  - IAS 39 *'Financial Instruments: Recognition and Measurement'* ('IAS 39'); and
  - IFRS 4 *'Insurance Contracts'* ('IFRS 4').

3. Presentation and Disclosure

a. Comparative information

⇒ 2. Exemption from the requirement to provide comparative information for *IFRS 6*

- An entity that adopts IFRSs before 1 Jan. 2006 and chooses to adopt IFRS 6 *Exploration for and Evaluation of Mineral Resources* before 1 January 2006
  - need not present the disclosures required by IFRS 6 for comparative periods in its first IFRS financial statements.

3. Presentation and Disclosure

a. Comparative information

⇒ 3. Exemption from the requirement to provide comparative disclosures for *IFRS 7*

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

3. Presentation and Disclosure

Case

2005 Annual Report

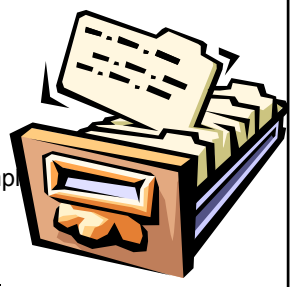
HSBC

- In addition, HSBC has elected not to present comparative information for disclosures required under IFRS 7 *'Financial Instruments: Disclosure'* (IFRS 7) as permitted for entities applying the standard for annual periods beginning before 1 January 2006.
- The notes affected by the transition provisions within IFRS 1 that do not contain comparative information are:
  - net income from financial instruments designated at fair value;
  - net earned insurance premiums;
  - net insurance claims incurred and movement in policyholders' liabilities;
  - net operating income;
  - analysis of financial assets and liabilities by measurement basis;
  - financial assets designated at fair value;
  - hedging instruments within the derivatives note;
  - securitisation and other structured transactions;
  - financial liabilities designated at fair value and liabilities under insurance contracts issued.

3. Presentation and Disclosure

a. Comparative information

⇒4. Historical summaries

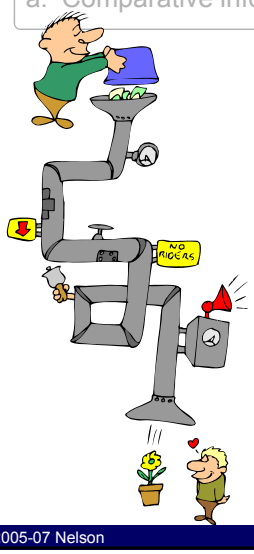


- Some entities present historical summaries of selected data for periods before the date of transition
  - IFRS 1 does not require such summaries to comp with the recognition and measurement requirements of IFRSs
- Some entities present comparative information under previous GAAP as well as the comparative information required by IAS 1, an entity shall
  - have proper label and
  - disclose the nature of the main adjustments that would make it comply with IFRSs (need not quantify those adjustments)

3. Presentation and Disclosure

a. Comparative information

b. Explanation of transition to IFRSs



- An entity shall explain how the transition from previous GAAP to IFRSs affected its reported financial position, financial performance and cash flows
- The areas to be covered:
  1. Reconciliations
  2. Designation of financial assets or financial liabilities
  3. Use of fair value as deemed cost
  4. Interim financial reports

3. Presentation and Disclosure

1. Reconciliations

b. Explanation of transition to IFRSs

- The first IFRS financial statements shall include:
  a. Reconciliations of:
     - its equity reported under previous GAAP to
     - its equity under IFRSs, for both:
       - the date of transition to IFRSs and
       - the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP

Reconciliation of Equity

  b. 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

Reconciliation of Profit or Loss

3. Presentation and Disclosure

Example

1. Reconciliations

b. Explanation of transition to IFRSs

- If Entity NAA adopts IFRSs in full for the year ending 31 December 2007 and provide one year comparative.
- Please suggest the date or period of reconciliation required under IFRS 1.

1 Jan. 2006 and 31 Dec. 2006 → Reconciliation of Equity

The year ended 31 Dec. 2006 → Reconciliation of Profit or Loss

3. Presentation and Disclosure

Case

2005 Annual Report

HSBC

Reconciliation of previously reported shareholders' funds under UK GAAP to total shareholders' equity under IFRSs at 31 December 2004 and 1 January 2004

	At 31 December 2004 US$m	At 1 January 2004 US$m
Shareholders' funds as previously reported under UK GAAP	86,623	74,473
Goodwill	1,869	(22)
	88,492	74,451
Retirement benefits	(4,470)	(3,529)
Dividends	2,996	2,627
Leases	(503)	(402)
Share-based payments	198	211
Software capitalisation	551	518
Property	(1,607)	–
Land held under operating leases	(495)	(755)
Other	42	245
Tax	318	382
Total shareholders' equity under IFRSs	85,522	73,748

3. Presentation and Disclosure

Case

2005 Annual Report

HSBC

Reconciliation of previously reported profit attributable to shareholders under UK GAAP to profit attributable to shareholders under IFRSs for the year ended 31 December 2004

	Year ended 31 December 2004 US$m
Profit before tax under UK GAAP	17,608
Goodwill amortisation	1,818
	19,426
Other goodwill adjustments	(102)
Retirement benefits	(170)
Leases	(90)
Share-based payments	(152)
Software capitalisation	25
Property	106
Tax on associates	(48)
Other	(52)
Profit before tax under IFRSs	18,943
Tax – UK GAAP	(4,507)
Tax – IFRSs adjustments	(178)
Minority interests – UK GAAP	(1,261)
Minority interests – IFRSs adjustments	(79)
Profit attributable to shareholders under IFRSs	12,918

3. Presentation and Disclosure

Case

Extract of Reconciliations (2004 Annual Report)

ESPRIT

35 RECONCILIATION OF EQUITY AND PROFIT FROM HKGAAP TO IFRS *continued*

(b) Reconciliation of equity as at June 30, 2003 *continued*

	NOTES	HKGAAP HK$'000	Effect of conversion to IFRS HK$'000	IFRS HK$'000
Financed by:				
Share capital		118,869	–	118,869
Share premium		1,270,243	–	1,270,243
Contributed surplus		6,602	–	6,602
Translation reserve	(i),(vi)	31,141	122,967	154,108
Retained profits		2,810,872	(168,708)	2,642,164
Shareholders' funds		4,237,727	(45,741)	4,191,986
Obligations under finance leases – due after one year		336	–	336
Long-term bank loan		776,411	–	776,411
Deferred tax liabilities	(v)	4,256	314,057	318,313
		781,003	314,057	1,095,060
		5,018,730	268,316	5,287,046

3. Presentation and Disclosure

Case

ESPRIT

Extract of Reconciliations (2004 Annual Report)

35 RECONCILIATION OF EQUITY AND PROFIT FROM HKGAAP TO IFRS *continued*

(c) Reconciliation of profit for the year ended June 30, 2003

	NOTES	HKGAAP HK$'000	Effect of conversion to IFRS HK$'000	IFRS HK$'000
Turnover		12,381,458	–	12,381,458
Cost of goods sold		(6,198,869)	–	(6,198,869)
Gross profit		6,182,589	–	6,182,589
Staff costs		(1,603,630)	–	(1,603,630)
Depreciation and amortization	(i),(ii),(iii)	(378,884)	106,314	(272,570)
Other operating costs	(i),(v)	(2,479,118)	(2,900)	(2,482,018)
Operating profit		1,720,957	103,414	1,824,371
Interest income		41,584	–	41,584
Finance costs		(32,463)	–	(32,463)
Share of results of associates	(iv)	61,024	(15,561)	45,463
Profit before taxation		1,791,102	87,853	1,878,955
Taxation				
– Company and subsidiaries	(vi)	(592,208)	2,082	(590,126)
– Associates	(iv)	(13,324)	13,324	–
		(605,532)	15,406	(590,126)
Profit attributable to shareholders		1,185,570	103,259	1,288,829

3. Presentation and Disclosure

1. Reconciliations

b. Explanation of transition to IFRSs

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

3. Presentation and Disclosure

2. Designation of financial assets or financial liabilities

b. Explanation of transition to IFRSs

- An entity is permitted to designate
  - a previously recognised financial asset or financial liability as a financial asset or financial liability at fair value through profit or loss or
  - a financial asset as available for sale in accordance with IFRS 1.25A.
- The entity shall disclose
  - the fair value of financial assets or financial liabilities designated into each category at the date of designation and
  - their classification and carrying amount in the previous financial statements.

3. Presentation and Disclosure

3. Use of fair value as deemed cost

b. Explanation of transition to IFRSs

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

3. Presentation and Disclosure

4. Interim financial reports

b. Explanation of transition to IFRSs

- If an entity presents an interim financial report under IAS 34 for part of the period covered by its first IFRS financial statements, the entity shall have the following disclosure:
  a) Each such interim financial report shall, if there is comparative information, 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) additionally, the reconciliations described before or a cross-reference to another published document that includes these reconciliations.

3. Presentation and Disclosure

Example

- Trident is planning to prepare its first financial statements under IFRSs as at 31 Dec. 2005. It has 2 foreign subsidiaries, Spar and Mask.
- Spar, incorporated in HK, is 80% owned by Trident and prepared its first IFRS financial statements at 31 Dec. 2003 in order to comply with local legislation.
- Trident acquired a 70% holding in Mask in 1999. Mask was consolidated from that date using purchase accounting practices that are similar but not the same as those used by IFRS.
- However, the local rules relating to the financial statements of Mask as regards, for example, the concept of substance over form, are totally different to IFRS.
- Mask had adopted the IFRS relating to investment properties in its own financial statements for the year ended 31 Dec. 2003 because this standard had been incorporated into the local legislation.
- Draft a memo. setting out
  - whether the measurement criteria in IFRS1 would be applied to the opening balances of Mask and Spar in the first IFRS group financial statements.
  - the specific accounting implications of IFRS1 for the Trident Group at the date of transition to IFRS.

Modified from ACCA

3. Presentation and Disclosure

Example

- An immediate question arises as to whether partial adoption of IFRS, as in the case of the subsidiary Mask, would constitute prior adoption of IFRS.
- However, because Mask only utilised IAS 40 in its financial statements there would not have been an explicit and unreserved statement of compliance with IFRS and, therefore, Mask will be treated as a 'first-time adopter' and the assets and liabilities measured using IFRS 1.
- Trident has become a first time adopter later than its subsidiary Spar. Spar has already applied the IFRS in force at 31 December 2003, and these balances will be included in the opening balance sheet of Trident at 1 January 2004 (after the normal consolidated adjustments).
- Thus there will be no need to adjust retrospectively the financial statements of Spar for the IFRS effective at 31 December 2005, and no need to apply IFRS1 to the opening balances of Spar at 1 January 2004.

3. Presentation and Disclosure

Example

- A first time adopter can keep the original previous GAAP accounting and not apply IFRS 3 retrospectively to past business combinations.
- If a first-time adopter restates any business combinations to comply with IFRS 3, then all later business combinations shall be restated.
- If IFRS 3 is not applied retrospectively, there are certain consequences, for example:
  - a) all the assets and liabilities not recognised under previous GAAP that should be recognised under IFRS should be shown in the opening IFRS balance sheet. Thus in the case of Mask, as there is no local concept of 'substance over form', assets or liabilities not shown in the GAAP accounts may appear under IFRS.
  - b) the carrying amounts of the assets and liabilities under local GAAP will be the same under IFRS in the opening balance sheet and shall be their deemed cost under IFRS. If however IFRS requires a fair value measurement, the assets and liabilities should be shown on that basis, with the adjustment going to opening reserves.
  - c) Any assets and liabilities recognised under local GAAP but not recognised under IFRS should be excluded from the opening IFRS balance sheet.
  - d) Past business combinations cannot be reclassified. Therefore purchase accounting must be used. Generally, the principles in (a) above should be applied.

Today's Agenda

Introduction

1. Objective and Scope
2. Recognition and Measurement
   a. Opening IFRS Balance Sheet
   b. Accounting Policies
   c. Exemption from Other IFRSs
   d. Exceptions to Retrospective Application
3. Presentation and Disclosure
   a. Comparative Information
   b. Explanation of Transition to IFRSs

Final Remarks

Implementation – IAS 39

Transition adjustments

- An entity may, under its previous GAAP, have measured investments at fair value and recognised the revaluation gain directly in equity.
  - If an investment is classified as at fair value through profit or loss,
    - The pre-IAS 39 revaluation gain that had been recognised in equity is reclassified into retained earnings on initial application of IAS 39.
  - If, on initial application of IAS 39, an investment is classified as available for sale,
    - Then the pre-IAS 39 revaluation gain is recognised in a separate component of equity.
    - Subsequently, the entity recognises gains and losses on the available-for-sale financial asset in that separate component of equity until the investment is impaired, sold, collected or otherwise disposed of.
    - On subsequent derecognition or impairment of the available-for-sale financial asset, the entity transfers to profit or loss the cumulative gain or loss remaining in equity (IAS 39.55b).

Final Remarks – Top Ten Errors

- In 2006, PwC found ten most common errors from hot reviews of recent IFRS annual reports:
  1. Incomplete or poorly worded accounting policies
  2. Incorrect presentation of the Statement of Recognised Income and Expenses
  3. Poor application IAS 32 and 39
  4. Parent entity financial statement incomplete
  5. Incomplete impairment disclosures
  6. Accounting in the parent entity for share-based payments in the subsidiary
  7. Mortality not disclosed as a key IAS 19 assumption
  8. New standards not disclosed as not yet applied
  9. First time adoption errors
  10. Related party disclosures incomplete

Top Ten Errors – IAS 32/39

- Treasury shares need to be deducted from retained earnings and not shown as a separate reserve.
- The narrative required by IAS 32 around hedging and specifically hedge ineffectiveness has been poor - this is particularly the case where the company is using economic hedging. The term 'hedge' should not be used for economic hedging; it should only be used for IAS 39 hedge accounting.
- Financial guarantees are in the scope of IAS39 and should be recognised at fair value on initial recognition
- Finance costs policy should not be to charge costs as incurred, but recognise using the effective interest method
- Hedge (in)effectiveness and P&L geography should be disclosed in the segmental information
- Description and disclosure of 'traditional' off-balance sheet items, for example, guarantees and acceptances which may now be on-balance sheet or where related income may be recognised in a different manner, for example, loan commitments are missing.

Top Ten Errors – Impairment

- The company should make the following disclosures for each cash generating unit (or group of units) that has goodwill or indefinite lived intangibles even if no impairment is required:
  - carrying amount of goodwill allocated to the unit
  - the carrying amount of intangible assets with indefinite useful lives
  - the basis on which recoverable amount has been determined
  - description of key assumptions used
  - description of management's approach (IAS 36.134 and 135)

Top Ten Errors – 1st Time Adoption

- It should be clear which exemptions on first-time adoption have been taken
- Disclosures have to be given in comparatives if the IFRS 1 exemption not to restate comparatives for IAS 32/IAS 39 is used
- Where IAS 32/IAS 39 are not applied in the comparative period, some entities incorrectly describe this as being "prospective application"
- 2004 comparatives which have not been adjusted for IAS 32/IAS 39 (and IFRS 4) should be annotated as such in primary statements and relevant notes (IFRS 1.36A)

First Time Adoption of IFRSs

(IFRS 1) 27 October 2007

Full set of slides in PDF can be found in
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(IFRS 1) 27 October 2007

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