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A Digital Learning Platform for Generation Z:
Passport to IFRS®

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IFRS® Standard 1 First-time Adoption of International Financial Reporting Standards

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IFRS® Standard 1 First-time Adoption of International Financial Reporting Standards

Scope and Key Definitions

IFRS ® Standard 1 First-time Adoption of International Financial Reporting Standards was issued in 2003 with an effective date of January 1, 2004. Entities should apply this Standard when they adopt the International Financial Reporting Standards for the first time confirming clearly, explicitly and unreservedly that its financial statements fully comply with the IFRS standards.

The objective of IFRS 1 is to set out the requirements and exemptions from the requirements, for an entity's opening statement of the financial position which it prepares for the first date it starts accounting under the IFRS Standards. Additionally, IFRS 1 requires entities to explain how the transition from the previously applied national accounting standards to IFRS Standards impacted the entity's financial reporting information.

IFRS 1 ensures that the financial information stated in accordance with the IFRS Standards:

- is transparent and comparative;
- provides a suitable starting point for accounting and is in accordance with IFRS Standards;
- and its adoption can be generated at a cost that does not exceed the benefits.

An entity applies this IFRS 1 Standard when preparing its first financial statements in accordance with the IFRS Standards. In addition, if an entity prepares its intermediate financial reports according to IAS® Standard 34 Interim Financial Reporting, this Standard is also applied to all those interim periods that will cover the first annual financial reporting according to IFRS Standards.

This Standard defines in what cases the entity is treated as the first-time adopter of IFRS Standards:

a) the entity's most recent financial reports have been prepared:
   - according to the national standards;
   - according to the IFRS Standards, but without confirmation that they comply with the IFRS Standards;
   - according to the national standards and partly complying with the IFRS Standards;
   - according to the national standards with some reconciliations to the IFRS Standards.
b) the entity prepared the most recent financial reports according to the IFRS Standards, but only for its internal use without making them available for other users;
c) the entity prepared only the consolidated financial reports according to the IFRS Standards, but did not prepare the complete set of statement, accruing requirements of IAS Standard 1 Presentation of Financial Statements;
d) the entity has not prepared any financial statements at all.

There may be situations when an entity claims to prepare financial statements according the IFRS Standards and makes an explicit and unreserved statement confirming this fact. However, later, for some reason, further statements do not comply with the IFRS Standards. When the entity returns to the preparation of financial reports according to the IFRS Standards, it is not considered to be the first-time adopter and then IFRS 1 is not applicable.

In cases an entity already reports in accordance with the IFRS Standards and implements changes in its accounting policies, then it performs these changes in accordance with the requirements of IAS® Standard 8 Accounting Policies, Changes in Accounting Estimates and Errors and other IFRS Standards related to these changes.

Key Definitions (IFRS 1.Appendix A):

Date of transition to IFRS Standards – refers to the first day of the earliest period for which the entity presents the full comparative information under the IFRS Standards in its first IFRS Standard financial reports.

First IFRS financial statements – refer to the first annual financial reporting, for which the entity confirms that they have been prepared in accordance with the IFRS Standards.

First IFRS reporting period – is the first reporting period, for which the entity prepares the financial reports in accordance with IFRS Standards.

First-time adopter – refers to an entity that presents its first financial reports in accordance with the IFRS Standards.

Fundamental Issues: Recognition

When adopting the IFRS Standards for the first time, the entity starts with the preparation of the opening statement of financial position for the first day of the period, during which it will switch from the national reporting to the IFRS reporting. Therefore, it is very important to identify the date of the opening statement of financial position. The easiest way is to start from the decision with how many periods the entity plans to compare its first financial report made in accordance with IFRS Standards. Therefore, the first day of the earliest reporting period for comparing is the day for the opening statement of financial position. An example describing setting out of the comparative period is given below (see Fig. 1)

Situation:

Entity A used to prepare its financial reporting in accordance with the national accounting standards. Its reporting period coincides with the calendar year. It decides starting the application of the IFRS Standards to its financial reporting starting year 20X9.

Period of comparative information:

It makes the decision to present one-year comparative information. In this case, the date of the transition is 1st January 20X8.

Preparation of opening the financial statement:

The opening statement of the financial position should be prepared as of the 1st January 20X8.

Preparation of financial statements for the reporting year:

20x9 financial statements are prepared in accordance with the IFRS. Thus, financial reporting for year 20X9 would be comparative to the financial reporting for year 20X8.

Figure 1. Example of comparative financial information

The first-time adopter is obliged to apply the same accounting policies when preparing the opening statement of financial position and all other periods presented in the first IFRS Standards financial reporting. However, there may be some exemptions which are listed in the IFRS Standard.

The first-time adopter is also obliged to comply with all the IFRS Standards that are valid at the reporting day. Such an entity is also eligible for an early application of new IFRS Standards, but it is not obligatory.

With certain exceptions indicated by IFRS 1, an entity should do the following when preparing its opening statement of financial position:

a) recognize all assets and liabilities for which the recognition is required in accordance with the IFRS Standards;
b) do not recognize as assets or liabilities of items, if such recognition is not permitted by the IFRS Standards;
c) make the reclassification for those items of assets, liability or equity, which are differently treated, if comparing the previously used national accounting standards to the IFRS Standards;
d) measure all recognized items of assets and liabilities as it is regulated under the IFRS Standards.

Summarizing the rules listed, if there is no exception established in this IFRS Standard, the opening statement of the financial position should be prepared as if the entity has always worked under the requirements of the IFRS Standards.

All adjustments listed must be recognized as retained earnings in the opening statement of the financial position. The general rule is the retrospective application of the accounting in accordance with IFRS

Standards in the opening statement of the financial position. However, some exceptions may be applied, and they will be discussed in the section below.

Fundamental Issues: Measurement

There may be cases, when the application of IFRS Standards retrospectively may be too resource-intensive, and, therefore, it does not fulfill the objective of the IFRS Standard 1 in regards to the costs being lower than the benefit. Therefore, in such cases, the first-time adopter may be allowed to use one or more exceptions from the measurement and restatement principles applicable for the opening statement of the financial position. There are two types of exceptions:

a) the mandatory one, which forbids the retrospective application of some regulations set in other IFRS Standards;
b) the optional one, from some requirements of other IFRS Standards.

Table 1 lists the mandatory and optional exemptions. If in case of mandatory exemptions an entity must apply them all, then in case of optional exemptions, such entities may apply one or more exemptions or do not apply any optional exemption. Exemptions applied by the entity must be explained in the financial reports.

Table 1. The list of mandatory and optional exemptions for the first-time adoption of IFRS Standards

Mandatory exemptions	**Optional exemptions**
Estimates	Business combinations
Derecognition of financial assets and financial liabilities	Share-based transactions
Hedge accounting	Deemed cost
Consolidation and non- controlling interests	Leases
Government loans	Cumulative translation differences
Classification and measurement of financial assets	Investment in subsidiaries, associates and joint ventures
Impairment of financial assets	Assets and liabilities of subsidiaries, associates, and joint ventures
Embedded derivatives	Compound financial instruments
Insurance contracts	Designation of previously recognized financial instruments measured at fair value through profit or loss
	Fair value measurement of financial assets or financial liabilities at initial recognition
	Decommissioning liabilities included in the cost of property, plant and equipment
	Financial assets or intangible assets accounted for in accordance with the IFRIC 12 ® Service Concession Arrangements
	Borrowing costs
	Extinguishing financial liabilities with equity instruments
	Severe hyperinflation

	Joint arrangements
	Stripping costs in the production phase of a surface mine
	Designation of contracts to buy or sell a non-financial item measured at fair value through profit or loss
	Revenue
	Foreign currency transactions and advance consideration

All **estimates** of an entity on the opening statement of financial position should be the same, including the ones made in accordance with the previous national standards and the IFRS Standards, unless it is clear that those estimates were made in error. Some examples are presented in Figure 2.

Figure 2. Examples of the opening statement of the financial position

Situation Entity X prepares its first financial reporting in accordance with the IFRS Standards for the year 20x5. Its date of the opening is 1 January 20x4. Entity X did not need to make allowance a for bad debts arising from sales in October 20x3 in the financial reporting for year 20x3. In April 20x4, it was clear that the customer will not be able to cover its debt for the amount of CU5,000.

Solution 1. When preparing financial reporting for 20x3, the entity was not aware that the customer would not be able to cover its debt. Therefore, it did not have to make allowance on the bad debt. Therefore, in the opening of 1 January 20x4, entity X is also not making these allowance.

Solution 2. When preparing the financial reporting for 20x3, the entity had to make an additional check whether that the customer would be able to cover its debt. Then it would collect the evidence of possible insolvency and make. Therefore, in the opening statement of financial position of 1 January 20x4, entity X is making of CU5,000 as it is clear evidence of an error on estimates.

If the first-time adopter has subsidiaries, then it must consolidate its subsidiaries, and the requirements of IFRS® Standard 10 Consolidated Financial Statements must be applied prospectively, unless there are exceptions for the past business combinations. These exceptions are applied to:

- the total comprehensive income;
- accounting for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and
- accounting for a loss of control over a subsidiary, and the related requirements.

The requirements for the government loans classification are as follows:

- Government loans received before the switch to the IFRS Standards should be measured at the value booked under previously applied national accounting standards. Entity shall not recognize the corresponding benefit of the government loan at a below-market rate of interest as a government grant;
- loans received after the opening statement of financial position may be measured using an effective interest rate calculated at the date of transition;

- an entity must apply IAS Standard 20 Accounting for Government Grants and Disclosure of Government Assistance to government loans received after the date of the transition.

The entity must assess whether the financial assets meet the requirements of IFRS® Standard 9 Financial Instruments for **classification and measurement of financial assets**. It is important to note that the evaluation must be made on the basis of terms and conditions that existed at the day of opening statement of financial position according to IFRS Standards.

The first-time adopter must perform the **impairment of financial assets** and present the impaired value of financial assets in the opening statement of financial position. The impairment must be based only on verifiable data and supported by evidence information at the day of the change to IFRS Standards reporting.

When evaluating the necessity to separate **embedded derivatives** from the main contract and book them as derivatives in the accounts, the entity must evaluate whether the requirements of IFRS 9 are applicable in that particular situation.

The transition provisions must be recognized for **insurance contracts.** The first-time adopter must follow the requirements of IFRS® Standard 17 Insurance Contracts.

According to IFRS 1, the first-time adopter may choose to apply one or more optional exceptions from the full retrospective application. If an entity decides to apply one of these exceptions, it uses an accounting method specified in this standard and does not use the methods it has previously employed.

A first-time adopter may choose not to restate a past **business combination** that has taken place before the date of transition to IFRS Standards. This exception is granted as an entity may not have enough reliable information to perform the restating of the past business combination. This exception can also be possibly applied to the past acquisitions of investments in associates and of interests in joint ventures.

IFRS 1 describes the limitations required in accordance with the IFRS Standards Share-based Payment to certain **share-based payment** awards, but only to the ones granted during the previous periods. For all awards granted after the date of shift to the IFRS Standards the entity must apply the IFRS® Standard 2 Share-based Payment in full.

The possibility to use fair value or revaluation as **deemed cost** is granted **only** for property, plant and equipment, as well as the investment property including the right of use the assets, and for intangible assets that may be revalued in terms of IAS® Standard 38 Intangible Assets.

A first-time adopter does not need to comply with all the requirements for the **cumulative translation differences** that existed on the date of the transition to the IFRS Standards. Under this exception, the accumulated translation differences for all foreign operations at the date of the shifting period are zero. Any gain or loss on further sale does not include translation differences that arose before the transition date and any later differences.

A first-time adopter may use the deemed cost to measure an **investment in a subsidiary, joint venture or associate** in the financial reporting. For this measurement, either fair value or the amount at that date of previously used national accounting standards on the day of the opening statement of the financial position is used.

In cases when a **subsidiary** adopts the IFRS Standards later than its parent for measuring its **assets and liabilities** in financial reporting, a subsidiary may choose to report the value either at the date of transition of its parent, or the date of its own transition. The same exception is also used for the associates and joint ventures.

There is no obligation to separate the **compound financial instruments** into equity and liability components, as required by IAS® Standard 32 Financial Instruments: Presentation, if the liability component is no longer outstanding at the date of transition to the IFRS Standards.

An entity may designate the previously recognized **financial instruments** at fair value through profit or loss basing this specification on the terms and conditions that existed on the day of the preparation of the opening statement of financial position under the IFRS Standard 9 Financial Instruments requirements.

In cases where an entity **measures the financial assets or financial liabilities at fair value on the initial recognition,** it may apply the requirements of IFRS Standard 9 Financial Instruments prospectively to the transitions on the same day or after the day of transition to the IFRS Standards.

A first-time adopter shall estimate the **decommissioning liabilities** on the date of the opening balance. Then, the estimate of what would have been the amount included in the cost of the asset booked for the first time. Finally, the accumulated depreciation based on that amount should be calculated as well.

For the accounting of **financial assets or intangible assets,** the regulations of IFRIC® 12 Service Concession Arrangements are used.

The transitional provisions set out in IAS® Standard 23 *Borrowing Costs* to the **borrowing costs** may be applied by choosing one of the dates: either from the day of the opening balance or from the earlier date.

For accounting of the **extinguishing financial liabilities with equity instruments,** the entity may apply the transitional provisions based on requirements of IFRIC® 19 Interpretations Extinguishing Financial Liabilities with Equity Instruments.

If an entity operates in the economy with **severe hyperinflation,** then it must identify whether the currency is affected by the hyperinflation, and then apply the requirement set in this standard for measuring the currency.

A first-time adopter may apply the transitional provisions for **joint arrangements** in IFRS® Standard 11 Joint Arrangements on the day of the opening statement of the financial position and test impairment on investments.

Stripping costs in the production phase of a surface mine reflects how mining entities are recording the costs incurred when removing mine waste materials for gaining access to the mineral ore deposits during the production phase of the mine. For this purpose, regulations set in IFRIC® 20 Interpretations Stripping Costs in the Production Phase of a Surface Mine shall be applied.

A first-time adopter may choose to **designate the contracts to buy or sell a non-financial items** that have already been concluded on the day of the opening statement of financial position The designation should be at fair value through profit or loss following two conditions: first, the contracts meet the requirements of paragraph 2.5 of IFRS Standard 9 Financial Instruments, and second, this exception is used for all contracts of the same type.

The transition provisions for **revenue** from customers at the beginning of the first financial reporting period may be applied in accordance with the IFRS Standards.

In summary, IFRS 1 allows quite a wide range of optional exceptions, because of which, the shift from the national accounting standards to the IFRS Standards is more fluent and less time- and cost-consuming.

Fundamental Issues: Derecognition and Procedures

To sum up, an entity passes through five procedures when adopting IFRS for the first time. These procedures are presented in Figure 3.

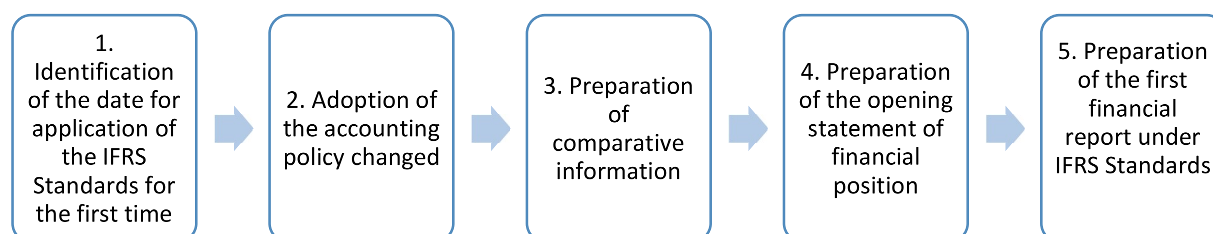

Figure 3. Procedures for the first-time adoption of IFRS

As noted in the previous section, the change of the accounting policy in an entity and initiation of the application of the IFRS Standards and the elements of accounting thereof (except the ones that fall into the exceptions) are adjusted retrospectively. However, derecognition of certain accounting elements may be applied in some cases.

or For the **derecognition of the financial assets and financial liabilities** on the date of the opening statement of the financial position the prospective approach to the transactions on or after the date of the opening statement of the financial position in accordance with the IFRS standards should be applied. The retrospective approach is allowed only in cases, when the information required to do so was obtained at the time of the initial accounting for the transaction. Derecognition scheme is illustrated in Figure 4.

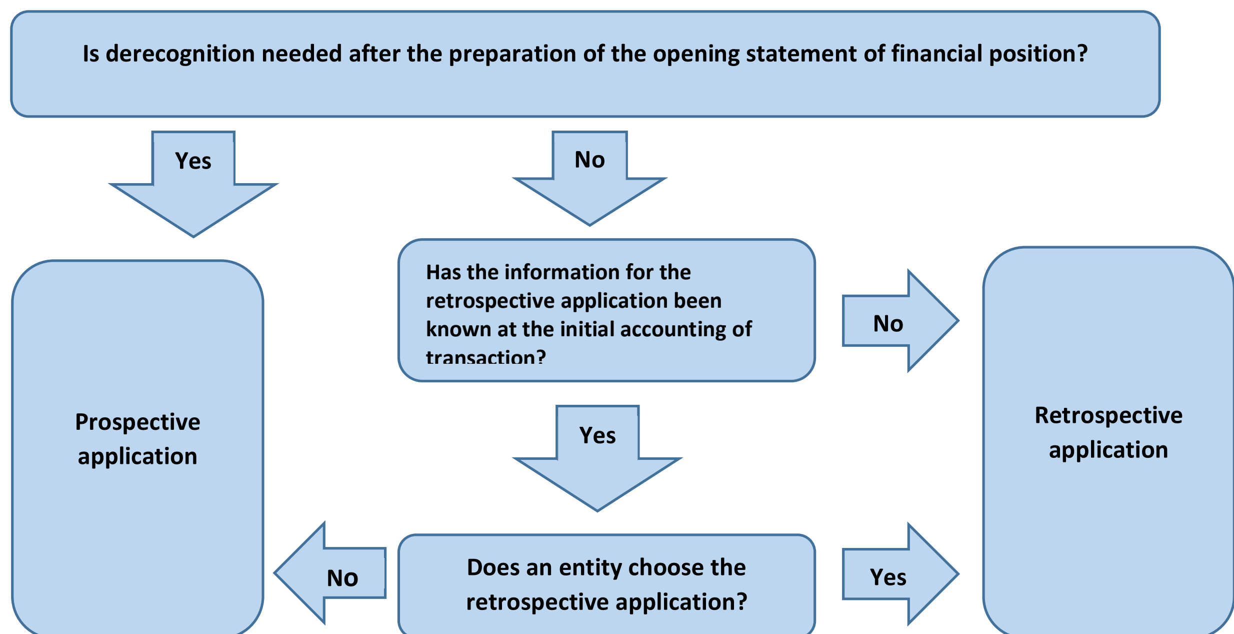

Figure 4. Derecognition

If **hedging** relationships are not qualified as such in accordance with the IFRS Standards, then they are not declared when changing from the national accounting standards to the IFRS Standards. However, in cases when transactions were made before the date of change to the IFRS Standards, then the retrospective approach should not be applied on those transactions.

Disclosures

IFRS 1 requires that in respect to presenting comparative information, the first financial reporting in accordance with the IFRS Standards would consist of at least:

- three statements of the financial position (at the end of the current period and the two comparative periods);
- two statements of profit or loss and other comprehensive income, separate statements of profit or loss (if presented), changes in equity, cash flows (covering the current period and the comparative period);
- related notes, including comparative information for all the statements presented.

IFRS 1 Standard does not provide any exceptions for presenting and disclosing requirements listed in other IFRS Standards. However, it describes some points of attention when preparing the financial reporting for the first time in accordance with the IFRS Standards in regards to the presentation of comparative information:

1. **Non-IFRS comparative information and historical summaries.**

If an entity includes historical data for earlier periods not reported under IFRS Standards, then it does not need to follow the IFRS Standards for these summaries. However, an entity must clearly label this information as prepared not in accordance with IFRS Standards, as well as provide additional disclosure on the retreatments that would make the information comply with IFRS Standards.

2. **Explanation of transition to IFRS Standards.**

An entity must describe how the transition from the national accounting standards to the IFRS Standards has changed its financial reporting. This explanation is very important for the financial information users as it shows how the transition influenced the financial result of the entity.

2.1. For the explanatory reasons, some reconciliations must take place:

- equity reconciliation;
- comprehensive income reconciliation;
- information disclosures required by IAS® Standard 36 Impairment of Assets for any impairment adjustments resulting from the first time in preparing its IFRS opening statement of the financial position.

2.2. If an entity is preparing a statement of cash flow, it should explain any material misstatements to it.

2.3. Errors observed in the previous reporting periods under the national accounting standards should be clearly excluded from reconciliations. This way, the users of financial information will clearly see which amounts have accumulated due to the errors discovered and which exist due to the transition.

2.4. If the accounting policy of an entity changes due to the adoption of the IFRS Standards or if it has changed before the first IFRS Standards financial reporting has been presented, then the IAS 8 Standard requirements are not applied. However, if the changes in the accounting policies appear during the transition period or an entity is using the exemptions, then it must report those changes.

2.5. An entity may designate the financial assets and financial liabilities at fair value by booking the differences in profit or loss account and disclose this information in its financial reporting.

2.6. In cases when an entity chooses to use fair value as the deemed cost of property, plant and equipment, investment property, intangible assets or the right-of-use assets for the opening statement of financial position in accordance with the IFRS Standards, then it must disclose those fair values and amounts of adjustments which arose due to this decision.

This standard also provides additional explanations on specific cases of the use of fair value as deemed cost for the opening statement of financial position preparation, i.e. on the investments in subsidiaries, joint ventures and associates, on oil and gas assets or after severe hyperinflation.

2.7. In cases when an entity is preparing intermediate financial reports, additional requirements to those described in the IAS® Standard 34 Interim Financial Reporting are applied, including reconciliation between the previously used national accounting standards and IFRS Standards. The main purpose is to supply the users of financial information with comparative information.

Examples

Entity X is the first-time adopter of IFRS Standards. It has decided to switch its accounting to comply with the IFRS Standards starting year 20x5 with the comparative information for one year. Therefore, the date of transition and the date of the opening statement of the financial position is 1 January 20x4.

Entity X applied some changes in the accounting policies, so they would comply with the requirements of the IFRS Standards. Under the previous accounting policy, the land was measured applying the cost model. Under the IAS Standard 16 Property, Plant and Equipment, entity X apply the revaluation model. The effect of the revaluation of land increases in the value of land and in equity by CU3,000.

Entity X developed its own trademark during 20x3 and 20x4. Under the previous accounting policy, the costs of development were expensed. Under the IFRS Standards, these costs are capitalized as intangible assets and depreciated. The total development expenses during 20x3 were CU2,000 and CU3,000 during 20x4. The effect of this change is an increase in the equity by CU2,000 at the opening balance on 1 January 20x4 and by CU5,000 on 31 December 20x4.

In May 20x4, Entity X purchased buildings for the value of CU150,000. The period for straight line depreciation is 50 years. Under the previous accounting policy, the buildings were measured applying the cost model. Therefore, depreciation calculated for June – December in 20x4 was CU1,750 and the value of buildings on 31 December 20x4 was CU148,250. Under IFRS Standard, the entity applies the revaluation model. As the market value of the building at the acquisition was CU204,000, the changes in the comparative balance are registered both as the increasing value of the buildings by CU54,000, and as the increase in the calculated depreciation by CU630.

Inventories under the previous accounting policy were measured at their acquisition cost of CU 5,000 on 31 December 20x4. Under the IAS Standard 2 Inventories, the entity measures inventories at the lower of their cost and net realisable value. The entity has reliable information that the net realisable value of inventories at the opening balance date was smaller due to the situation in the market by CU1,000. The effect of change is the reduction in equity by CU1,000. During 20x4, the market situation has changed, the inventory was not moving throughout the entire 20x4, but its net realisable value increased by CU500.

The changes in the accounting policy and the value of items are listed below:

	20x4, CU	**Prior accounting policy**	**New accounting policy**
Land	10,000	Cost model	Revaluation model
Intangible assets	0	Expensing	Capitalization
Buildings	148,250	Cost model	Revaluation model
Inventory	5,000	Acquisition cost	Net realisable value

The effect of the change in the accounting policies due to the transition to the IFRS Standards is illustrated below:

	Before the adoption of IFRS 31 December, 20x4, CU	Adjustments for the opening statement of the financial position, CU	Comparative information on the date of transition 1 January 20x4, CU	Adjustments for the comparative period, CU	Comparative information 31 December 20x4, CU
Land	10,000	3,000	13,000		13,000
Intangible assets	0	2,000	2,000	3,000	5,000
Buildings	148,250	-	-	53,370	201,960
Inventory	5,000	-1,000	4,000	500	4,500

The statement of the financial position before and after reconciliations due to transition to IFRS Standard is illustrated below:

ASSETS	In accordance with the previous accounting policy 31 December 20x4	Effect of transition to IFRS	According IFRS Standards 31 December 20x4
NON-CURRENT ASSETS	**158,250**	**61,370**	**219,620**
Intangible assets	**0**	**5,000**	**5,000**
Tangible assets	**158,250**	**56,370**	**214,620**
Land	10,000	3,000	13,000
Buildings	148,250	53,370	201,620
Other tangible assets	0		0
FINANCIAL ASSETS	**0**		**0**
OTHER NON-CURRENT ASSETS	**0**		**0**
CURRENT ASSETS	**116,500**	500	116,000
Inventories	5,000	-500	4,500
Other receivables	72,000		72,000
Other current assets	0		0
Cash and cash equivalents	39,500		39,500
TOTAL ASSETS:	**274,750**	60,870	335,620
EQUITY AND LIABILITIES			
EQUITY	**115,350**	60,870	176,220
Share capital	2,900		2,900
Revaluation reserve	0	56,370	56,370
Other reserves	290		290
Retained earnings (losses)	**112,160**	4,500	116,660
Profit (loss) of the reporting year	52,000	500	52,500
Profit (loss) of the previous year	60,160	4,000	64,160

GRANTS AND SUBSIDIES			
AMOUNTS PAYABLE AND LIABILITIES	**159,400**	**0**	**159,400**
Non-current amount payable and liabilities	151,400	0	151,400
Current amount payable and liabilities	8,000	0	8,000
TOTAL EQUITY AND LIABILITIES:	**274,750**	60,870	335,620