International Financial Reporting Standards (IFRS) are fast becoming the global accounting and financial reporting language. More than 100 countries all over the world have already adopted IFRS and many more including India and Canada have committed to make the transition by 2011.

An Insight into IFRS 1 – First Time Adoption of IFRS

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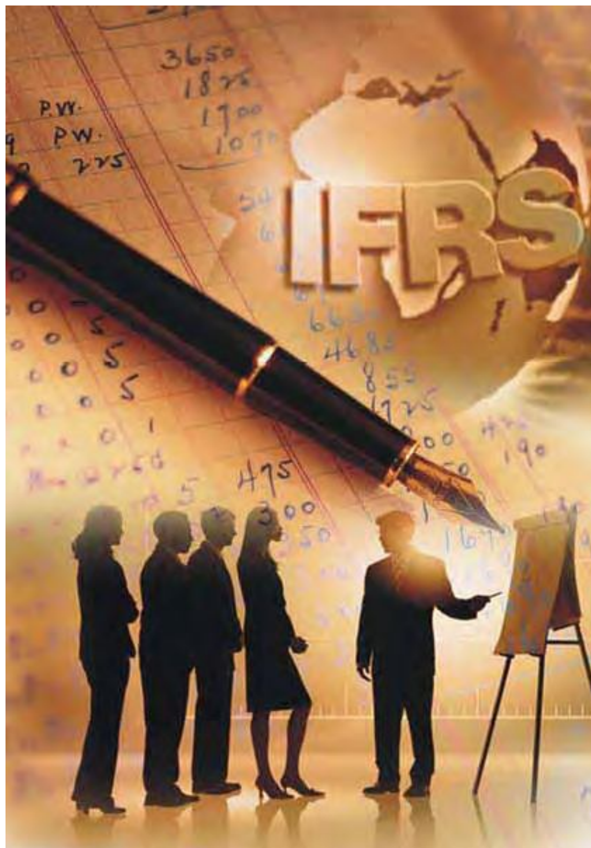

Convergence with IFRS

As announced by the Institute of Chartered Accountants of India (ICAI), Indian Accounting practices are set to converge with IFRS by 1.4.2011. Convergence with IFRS refers to achieving harmony of national accounting practices with IFRS. It may be important to note that convergence with IFRS does not mean adoption of IFRS *in toto*, but adoption of IFRS provisions. Hence, when the Indian standards will be converged to IFRS, the compliance with Indian Accounting Standards would automatically ensure compliance with IFRS. The Accounting Standards Board is however free to eliminate any optional treatments provided in IFRS or provide for any additional disclosure requirements in the road to convergence.

Benefits of Convergence with IFRS

1) Improved access to international capital markets
2) Access to low-cost foreign funds.
3) Easier Comparability with global peers
4) Elimination of multiple reporting costs
5) Opportunities for professionals

First Time Adoption of IFRS

IFRS would be applicable to all the listed entities and public-interest entities at first and is proposed to be applicable to other entities as well in due course of time in India. International Accounting Standards Board (IASB) has come up with IFRS 1 *First Time Adoption of IFRS* to set out rules for the entities adopting IFRS for the first time. The purpose of IFRS 1 is to provide for a roadmap of transition from using local GAAP in the preparation of financial statements to using IFRS.

Before proceeding with the provisions and requirements of IFRS 1, following important terms need to be understood:

1) **IFRS —** It stands for International Financial Reporting Standards and includes Standards & Interpretations adopted by International

Accounting Standards Board (IASB) including International Accounting Standards (IAS) and Interpretations developed by International Financial Reporting Interpretation Committee (IFRIC).

2) **Reporting Date —** It is the date up to which the set of IFRS Financial statements is being prepared. For example, for entities presenting financial statements for the year ending 31.3.2012, the reporting date would be 31.3.2012.
3) **Transition Date —** It is the beginning of the earliest period for which comparative information is required to be presented in the Financial Statements. For example, for entities presenting financial statements for the year ending 31.3.2012, the transition date would be 1.4.2010, as in India, comparative information of one year is to be presented.
4) **First-Time Adopter -** It refers to the entity which presents its first IFRS Financial Statements.
5) **First IFRS Financial Statements —** These are the first annual statements in which an entity adopts IFRS through an explicit and unreserved statement of compliance with IFRS.
6) **Local GAAP -** It refers to the Generally Accepted Accounting Principles followed in the country which in Indian context, point towards Accounting Standards & Accounting Standard Interpretations read along with Guidance Note on different accounting aspects issued by the Institute of Chartered Accountants of India (ICAI).

Applicability of IFRS 1

IFRS 1 applies to the preparation of an entity's first financial statements that are being prepared in accordance with IFRS. Entities are also required to apply it in any Interim Financial Report for the periods covered in its first IFRS financial statements. IFRS 1 requires a first-time adopter to prepare and present an opening IFRS balance sheet as at its transition date. This opening IFRS balance sheet must be in accordance with the IFRS in effect as of the entity's first IFRS reporting date. The opening balance sheet forms the starting point for subsequent reporting under IFRS.

Therefore, IFRS 1 would apply in the following situations:

1. If the entity presented its last annual financial statements under local GAAP that were not consistent with IFRS in all respects.
2. If the entity presented its last annual financial statements under local GAAP that were in conformity with IFRS in all respects, but the financial statements did not contain an explicit and unreserved statement of compliance with IFRS.
3. If the entity presented its last annual financial statements under local GAAP that contained an explicit statement of compliance with some, but not all, IFRS.
4. If the entity prepared its last annual financial statements under IFRS for internal use only, without making them available to the shareholders or any other external users of the financial statements.
5. If the entity prepared a reporting package under IFRS for consolidation purposes without preparing a complete set of financial statements as defined in IAS 1 *Presentation of Financial Statements*.

It has further been clarified that IFRS 1 would not apply in the following situations:

1. If the entity previously presented statements under local GAAP in addition to statements that contained an explicit and unreserved statement of compliance with IFRS.
2. If the entity presented its last annual financial statements that contained an explicit and unreserved statement of compliance with IFRS, even if the auditors qualified their audit report on those financial statements.

Subject to some mandatory exceptions and optional exemptions, it calls for a retrospective application of the IFRS requirements, as if the concerned entity had always followed the IFRS.

Which Version of IFRS Needs to be Applied?

An entity has to reinstate the statement of financial position (referred to as 'Balance Sheet' in the local GAAP) as on the transition date by

retrospectively applying all the effective IFRS subject to the mandatory exceptions and optional exemptions. It has specifically been clarified under IFRS 1 that an entity should apply all the IFRS effective as on the reporting date.

Adjustment of Reserves

IFRS 1 requires that an entity should recognize the differences in the local GAAP and IFRS in the retained earnings in its opening statement of financial position as on the transition date, or another category of equity, if appropriate. The differences relate to events that occurred before the date of transition to IFRS and should not, therefore, affect profit or loss or other comprehensive income for the reporting period. The amount is not to be treated as a prior period item as well. For example, the liability for proposed dividend might be required to be derecognized in IFRS and the difference will be adjusted in the retained earnings. It has also been specified that a first-time adopter might be required to recognise the differences in another category of equity depending on the specific IFRS requirements that apply to the related item in the Statement of Financial Position. For example, where a first-time adopter chooses to adopt revaluation method in IAS 16 *Property, Plant and Equipment* while adopting IFRS, it should present the cumulative revaluation surplus as a separate component of equity under the 'Revaluation Reserves'.

Steps Involved

1) **Recognition —** It refers to recognising all the assets and liabilities as required by IFRS. This might result in recognition of any item not previously recognised. For example, an entity might be required to recognize prevent value of the decommissioning liabilities in the cost of plant, property or equipment as laid down in IAS 16 Property, Plant and Equipment.
   *(*It may however be clearly understood that an optional exemption has been granted in this regard for retrospective application under IFRS 1).*
2) **Derecognition —** It refers to derecognizing all the assets and liabilities that do not meet IFRS recognition criteria but have been earlier recognised under local GAAP. For example, proposed dividend is required to be adjusted in the financial statements as per AS-4 Contingencies and Events Occurring after the Balance Sheet if it relates to the reporting period and is proposed before the finalization of financial statements in accordance with the statutory requirements laid out in Schedule VI to the Companies Act, 1956. However, while preparing the statement of Financial Statement as on the transition date, the entity might be required to derecognize the liability of proposed dividend as IFRS provide for recognition of the liability for proposed dividend as and when it is declared.

3) **Reclassification —** It refers to the reclassification of items recognised under local GAAP into classification required by IFRS. For example, redeemable preference shares are required to be shown as a liability under IFRS instead of equity as under Indian GAAP.
4) **Measurement —** It refers to the measurement of recognised assets & liabilities by applying IFRS.

Mandatory Exceptions to the Retrospective Application of IFRS

IFRS 1 specifies four specific exceptions in which the general principle of retrospective application of IFRS is to be ignored and these are to be applied prospectively from the time of adoption of IFRS by the entity by following the provisions contained in their respective standards. These exceptions are:

1. Accounting Estimates **(IAS 8)**
2. Derecognition of Financial Instruments **(IAS 39)**
3. Hedge Accounting **(IAS 39)**
4. Non-Controlling Interests **(IAS 27)**

Optional Exemptions for Retrospective Application of IFRS

Recognising the costs involved to extract the information required to retrospective apply all the applicable IFRS and implications involved in applying the same, the International Accounting Standards Board (IASB) has provided for some optional exemptions for the retrospective application of the related IFRS. Thus, it grants an option to the entity to decide whether it wants to retrospectively apply IFRS in the given situations

by undertaking cost-benefit analysis. These optional exemptions are:

1. Business Combinations **(IFRS 3)**
2. Share-based Payments **(IFRS 2)**
3. Insurance Contracts **(IFRS 4)**
4. Deemed Cost **(IAS 16, IAS 38, IAS 40)**
5. Leases **(IAS 17)**
6. Employee Benefits **(IAS 19)**
7. Cumulative Translation Differences **(IAS 21, IAS 27)**
8. Investments in Subsidiaries, Associates & Joint Ventures **(IAS 27)**
9. Assets & Liabilities of Subsidiaries, Associates & Joint Ventures **(IAS 27)**
10. Compound Financial Instruments **(IAS 32)**
11. Fait Value Measurement of Financial Instruments **(IAS 39)**
12. Decommissioning Liabilities included in cost of Property, Plant and Equipment **(IAS 16, IFRIC 1)**
13. Service Concession Arrangements **(IFRIC 12)**
14. Borrowing Costs **(IAS 23)**
15. Transfer of Assets from Customers **(IFRIC 18)**

Presentation & Disclosure Requirements

To comply with IAS 1 *Presentation of Financial Statements,* an entity's first IFRS financial statements shall include at least three statements of financial position, two statements of comprehensive income, two separate income statements (if presented), two statements of cash flows and two statements of changes in equity and related notes, including comparative information.

IFRS 1 also allows that if an entity chooses to include historical summaries of selected data for periods before the first period for which they present full comparative information under IFRS, or comparative information under local GAAP that is in addition to the required comparatives under IFRS, these summaries and additional comparatives do not need to comply with IFRS. For example, most of the Indian companies usually present a 5-year comparative data in their annual reports for the information and reference of their stakeholders. However, where financial statements contain these types of historical summaries or additional comparative information under previous GAAP, the entity is required to:

- label the previous GAAP information prominently as not being prepared under IFRS, and
- disclose the nature of the main adjustments that would make it comply with IFRS. The entity is not required to quantify those adjustments.

It also needs to be understood that this IFRS does not provide exemptions from the presentation and disclosure requirements in other IFRS subject to the exception provided for the historical summaries and voluntary additional comparatives. Rather, it calls for some additional disclosures and reconciliations. IFRS 1 calls for specific disclosures which enable the users of the financial statements of the effect of the transition to IFRS from local GAAP in the financial position, financial performance and cash flows as reported in the first IFRS Financial Statements. This includes:

1. Reconciliations of equity reported under previous GAAP to equity under IFRS both (a) at the date of the opening IFRS balance sheet and (b) the end of the last annual period reported under the previous GAAP. For an entity presenting its first IFRS financial statements as on 31.3.2012, the reconciliations to be presented would be as of 1.4.2010 and 31.3.2012.
2. Reconciliations of total comprehensive income for the last annual period reported under the local GAAP to total comprehensive income under IFRS for the same period. For an entity presenting its first IFRS financial statements as on 31.3.2012, the reconciliation to be presented would be for the period 1.4.2010 to 31.3.2011.
3. Explanation of material adjustments that were made, in adopting IFRS for the first time, to the balance sheet, income statement and cash flow statement as in local GAAP in order to ensure compliance with IFRS.
4. Separate disclosures must be made if any material error has been detected in previous GAAP financial statements in the course of transition to IFRS.
5. Separate disclosure in respect of recognition or reversal of any impairment loss by the entity in preparing its opening IFRS balance sheet as on the transition date.
6. Appropriate disclosures are required if the entity opts apply to any of the optional recognition and measurement exemptions permitted under IFRS 1, e.g. *if it has elected* to apply IFRS 3 *Business Combinations retrospectively.*