

# ASSURANCE AND ACCOUNTING

## IFRS 1

### Introduction and Background to IFRS 1

Generally, on first time adoption of International Financial Reporting Standards ('IFRSs') an entity is required to fully retrospectively apply all IFRS standards. For many entities adopting IFRSs for the first time, having previously prepared financial statements in accordance with Canadian GAAP ('Canadian first time adopters'), to go back and restate all Canadian GAAP prepared accounting records since inception of the entity into IFRS compliant accounting records would be an enormous task. Fortunately, the standard setters recognized this major impediment to adopting IFRSs, not just for Canadian first time adopters', but for all entities that adopt IFRSs, and developed an accounting standard, *IFRS 1 - First Time Adoption of Financial Reporting Standards* ('IFRS 1'), to provide relief to first time adopters.

The objective of IFRS 1 is to ensure that an entity's first IFRS financial statements, and the interim financial reports for part of the period they cover, contain high quality information that:

- Is transparent for users and comparable over all periods presented;
- Provides a consistent starting point for accounting in accordance with IFRS; and
- Can be generated at a cost that does not exceed the benefits to users.

IFRS 1 provides some relief from the full retrospective application in the form of mandatory and optional exemptions. These are discussed in detail later on. Generally, they allow an entity to elect not to apply full retrospective application for certain standards and interpretations. These exemptions are in areas where the International Accounting Standards Board ('IASB') believes that the cost of complying with the requirements is likely to exceed the benefits to users of the financial statements.

Along with this retrospective accounting issue there are other unique financial reporting issues that a first time adopter faces. For example, normally when an IFRS standard is adopted, an entity is required to follow the transitional provisions included within each individual standard. These provisions were developed to apply to entities that already use IFRS, so some of these provisions may not provide sufficient guidance to first time adopters' on what is required to adopt the standard. Therefore, generally IFRS 1 prohibits first time adopters from following these transitional provisions. First time adopters' must follow the provisions and requirements set out in IFRS 1. This may or may not require an entity to apply the transitional provisions of an individual standard, but generally this is not the case.

Another issue faced by first time adopters', is the amount of information they need to disclose in their first IFRS financial statements for users to fully understand changes that have been made from previous GAAP financial statements. IFRS 1 attempts to resolve this issue by prescribing what specific reconciliation disclosures are required, whether to follow an individual IFRS disclosure requirements and / or if other specific disclosures are required.



This document focuses on some of the issues that will impact a Canadian entity adopting IFRS for the first time. These issues include the key concepts and requirements of IFRS 1, when it is applied, what exemptions are available, the related implications for Canadian entities, (for all of the examples referring to dates, assume that the entity has a standard calendar year-end date and is not early adopting IFRS).

### When is IFRS 1 Applied?

An entity's first IFRS financial statements are the first annual financial statements in which the entity adopts IFRS, by an explicit and unreserved statement in those financial statements of compliance with IFRSs. The mandatory change over date in Canada is January 1, 2011. Therefore, Canadian entities with a calendar year-end the first annual IFRS financial statements will be December 31, 2011. However, for many Canadian entities that adopt IFRS the first IFRS published financial information will be the first interim report, for the three months ended March 31, 2011.

Note that recent amendments to IFRS 1 clarify that *IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors* does not apply to the changes in accounting policies that occur when an entity adopts IFRS or to changes in those policies until after it presents its first IFRS financial statements.

In addition where an entity changes accounting policies or its use of any IFRS 1 exemptions, during a period covered by its first IFRS financial statements (i.e. the entity has applied an accounting policy or IFRS 1 exemption in a previous interim financial statement), the entity is required to explain how those changes impacted its reported financial position, financial performance and cash flows in each such interim financial report. This amendment also requires reconciliations to be updated for the change in accounting policy or application of an exemption.

### Key Dates and the Need for Comparatives

The first annual IFRS reporting date of December 31, 2011 can be misleading. To truly understand when an entity has to be ready for the adoption of IFRSs, we need to look at IFRS 1. IFRS 1 defines the following dates:

- The date of transition to IFRS – “the beginning of the earliest period for which an entity presents full comparative

information under IFRS in its first IFRS financial statements.” So for a Canadian first time adopter with a calendar year-end their date of transition to IFRS will be January 1, 2010.

- The first IFRS reporting period – “the latest reporting period covered by an entity's first IFRS financial statements.” For an enterprise with a calendar year-end, the first IFRS reporting date is December 31, 2011.

Ideally, an entity with a calendar year-end would have been prepared for the adoption of IFRSs by the transition date of January 1, 2010. Since IFRS 1 also requires the comparative statements to be restated to comply with IFRSs, entities need to be ready by the date of transition. There are many recognition, measurement and disclosure differences between IFRSs and Canadian GAAP, so the most efficient way to build the 2010 comparative statements is to maintain a set of Canadian GAAP and a set of IFRS statements in 2010.

- retrospective application;
- Apply the mandatory exemptions from Retrospective application; and
- Make extensive disclosures to explain the transition to IFRSs.

If you require further guidance on first time adoption of IFRS, IFRS 1 or any other IFRSs information or reference sources, please contact your local BDO office or visit [www.bdo.ca/ifrs](http://www.bdo.ca/ifrs).

### What is the Opening IFRS Statement of Financial Position?

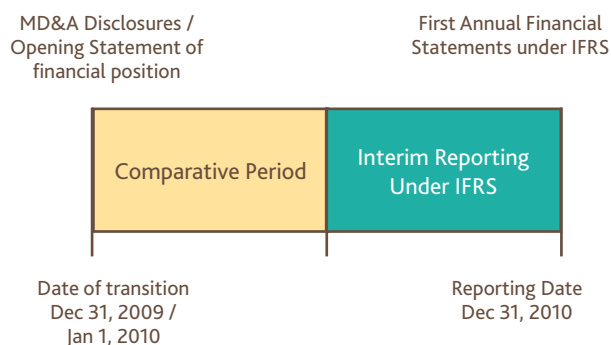
An entity is required to prepare and present an opening IFRS statement of financial position at the date of transition to IFRSs. This opening statement of financial position is the starting point for the entity's accounting under IFRS.

In particular, IFRS 1 requires an entity to do the following in the opening IFRS statement of financial position as a starting point for its accounting under IFRSs:

- Recognize all assets and liabilities whose recognition is required by IFRS;
- Not recognize items as assets or liabilities if IFRS does not permit such recognition;
- Reclassify items that it recognized 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 IFRS; and
- Apply IFRS in measuring all recognized assets and liabilities.

### Apply IFRSs in measuring all recognized assets and liabilities

In preparing the opening IFRS statement of financial position, an entity does not follow the standards that are in place at January 1, 2010, but rather the standards that will be in place at December 31, 2011. This may create a challenge for some entities. While first time adopters are now dealing with a stable platform (i.e. No new standards or interpretations are proposed with a mandatory effective date prior to December 31, 2011) new standards or interpretations may be issued with an option for early adoption.



An entity needs to understand any changes proposed by a new standard or interpretation and the impact early adoption may have on its first IFRS annual reporting date.

### What to Disclose in the First Annual IFRS Financial Statements?

The first annual IFRS financial statements should be presented in accordance with the presentation and disclosure requirements of *IAS 1 – Presentation of Financial Statements (IAS 1)* and other relevant standards and interpretations. IFRS 1 does not provide an entity with relief from these presentation and disclosure requirements. To comply with IAS 1 and IFRS 1, an entity's first annual IFRS financial statements need to include at least three statements of financial position (as at January 1, 2010, December 31, 2010 and December 31, 2011), two statements of comprehensive income, two statements of cash flows and two statements of changes in equity (for the periods ended December 31, 2010 and December 31, 2011) and related notes, including comparative information. Any historical summaries for periods before the first period for which they present full comparative IFRS information do not have to comply with the recognition and measurement requirements of IFRS. The entity should prominently disclose that the information is not prepared in accordance with IFRS, and include a narrative explanation of any major differences from IFRS. No quantitative disclosure is required for these differences.

IFRS 1 prescribes the detailed disclosures required to explain to users how the transition from previous GAAP to IFRS affected the entity's reported financial position, financial performance and cash flows. Any adjustments that arise are from events and transactions before the date of transition to IFRSs. Except for any reclassifications from intangible assets to goodwill, the entity should recognize any adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to IFRSs (e.g. January 1, 2010).

A number of reconciliations between Canadian GAAP and IFRSs are required in the first IFRS financial statements to illustrate to users the adjustments made. These include a reconciliation of:

- The entity's equity reported under previous GAAP to its equity under IFRS at the date of transition to IFRSs. For a Canadian entity with a calendar year-end and adopting IFRS on January 1, 2011 this reconciliation would be as at January 1, 2010;
- The entity's equity at the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP. For a Canadian entity with a calendar year-end and adopting IFRS on January 1, 2011 this reconciliation would be as at December 31, 2010; and
- The total comprehensive income reported under previous GAAP for the latest period in the entity's most recent annual financial statements to its total comprehensive income under IFRS for the same period. If an entity did not report a comprehensive income total under previous GAAP, profit and loss from previous GAAP should be used. For a Canadian entity with a calendar year-end and adopting IFRS on January 1, 2011 this reconciliation would be for the year-ended December 31, 2010.

The reconciliations above need to provide sufficient detail to enable the user to understand the material adjustments to the statement of financial position and income statement. An entity would also have to explain the material adjustments to the cash flow statement. An important disclosure requirement in relation to the reconciliations is that any corrections of errors made under previous GAAP identified during the conversion process should be separately distinguished from adjustments arising from changes in accounting policies. Note that *IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors* does not apply to the changes in accounting policies that occur when an entity adopts IFRS or to changes in those policies until after it presents its first IFRS financial statements.

In addition, if the entity recognized or reversed any impairment losses for the first time in preparing its opening IFRS statement of financial position, the disclosures that *IAS 36 - Impairment of Assets* would have required if the entity had recognized those impairment losses or reversals in the period beginning with the date of transition to IFRS are required.

What are the Exceptions from Full Retrospective Application?

IFRS 1 provides detailed guidance to first time adopters of IFRSs with respect to applying individual standards. As mentioned above, generally an entity is required to apply IFRSs retrospectively. However, IFRS 1 establishes two categories of exceptions to this principle, namely IFRS 1:

- Prohibits retrospective application of IFRS in some areas, particularly where retrospective application would require judgements by management about past conditions after the outcome of a particular transaction is already known; and
- Grants limited optional exemptions from these requirements in specified areas where the cost of complying with them would be likely to exceed the benefits to users of financial statements.

### What are the Optional Exemptions to Retrospective Application?

As mentioned above, IFRS 1 provides specific optional exemptions that an entity may elect to use when first adopting IFRSs. An entity may take advantage of all, some or none of these exemptions but as the exemptions are specific an entity cannot apply any of these exemptions to other items. Along with being specific the exemptions do not impact on the ongoing accounting policy choices that an entity can make under IFRS. For example, if an entity elects to use fair value as deemed cost for property, plant and equipment it will not impact the *IAS 16 - Property, Plant and Equipment* accounting policy decision (i.e. adopting either the cost or revaluation measurement methods).

The optional exemptions available to a first time adopting entity are in the following areas:

- Business combinations;
- Share-based payment transactions;
- Insurance contracts;

- Deemed cost;
- Leases;
- Employee benefits;
- Cumulative translation differences;
- Investments in subsidiaries, jointly controlled entities and associates;
- Assets and liabilities of subsidiaries, associates and joint ventures;
- Compound financial instruments;
- Designation of previously recognized financial instruments;
- 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 an intangible assets accounted for in accordance with IFRIC 12 Service Concession Arrangements;
- Borrowing costs;
- Transfers of assets from customers;
- Extinguishing financial liabilities with equity instruments; and
- Use of Deemed Cost after Severe Hyperinflation (Proposed amendment to IFRS 1);

It is important for a Canadian entity to carefully review and make informed selections in relation to the exemptions. The level of work that is required in the conversion process for a specific area, such as business combinations, will be heavily influenced by the decision to elect to use or not use the optional exemptions that are available.

### Business Combinations

For many Canadian entities that have completed acquisitions since inception electing to apply this exemption will save a lot of time, costs and resources. Under this exemption a first time adopter may account for transactions prior to the date of transition that meet *IFRS 3 - Business Combinations as revised in 2008 (IFRS 3)* definition of a business combination, in three ways:

- Retrospectively restate all business combinations since inception in accordance with IFRS 3;
- Elect to retrospectively restate all business combinations after a particular date in accordance with IFRS 3 and also apply *IAS 27 - Consolidated and Separate Financial Statements (revised 2008)* (IAS 27) from that same date; or
- Elect not to retrospectively restate any business combinations (i.e. prospective application of IFRS 3).

This exemption is also available for past acquisitions of investments in associates and interests in joint ventures and is very relevant for

Canadian entities. A new business combinations standard has been adopted in Canada, which is substantially converged with IFRS 3. The new Canadian standard is not effective until the changeover date of January 1, 2011. However, early adoption is permitted, and the standard does not require retrospective application. Due to IFRS 3 and the new Canadian standard being converged, entities that enter into business combinations in 2010 may find it beneficial to early adopt the Canadian standard. By early adopting the standard an entity will not need to restate the business combination accounting under Canadian GAAP to be IFRS 3 compliant.

For many Canadian publicly accountable entities, retrospective application of IFRS 3 for past business combinations may be difficult, or even impossible, given the historical information currently available. Therefore, some Canadian entities will only be able to elect to prospectively account for the past business combinations. The remaining entities need to consider whether they have the necessary information to apply IFRS 3 at the date of a business combination, or all subsequent business combinations, with sufficient reliability.

An entity that elects not to fully retrospectively adopt IFRS 3, but rather elects to restate all business combinations after a particular date, is also required to apply IAS 36 and IAS 38 – Intangible Assets (IAS 38) from that date, regardless of whether there is any indication of impairment<sup>1</sup>. For example, if a Canadian entity with a calendar year-end elects to restate a business combination that occurred on June 30, 2007, it shall restate all business combinations between June 30, 2007 and the date of transition to IFRSs (January 1, 2010) and it shall also apply IAS 36 and IAS 38 from June 30, 2007.

### Consequences of Not Applying Business Combinations Retroactively

In accordance with IFRS 1 the entity is required to recognize all assets acquired and liabilities assumed except for:

- Some financial assets and liabilities derecognized under Canadian GAAP; and
- Assets, including goodwill, and liabilities not recognized by the acquirer under Canadian GAAP and also would not qualify for recognition under IFRSs.

If a first time adopter derecognized non-derivative financial assets or non-derivative financial liabilities under Canadian GAAP as a result of a business combination, the entity should not recognize those assets / liabilities under IFRSs (unless they qualify for recognition as a result of a later transaction or event).

If an asset acquired, or liability assumed, in a past business combination was not recognized under Canadian GAAP, it does not have a deemed cost of zero in the opening IFRS statement of financial position. Instead, the acquirer recognizes and measures the asset or liability in its consolidated statement of financial position on the basis that IFRSs would require in the statement of

<sup>1</sup> This requirement is amended to be in accordance with IAS 27 – Consolidated and Separate Financial Statements (revised 2008). The revised standard is applicable for annual periods beginning on or after July 1, 2009. Earlier adoption is permitted.

financial position of the acquiree. For example, if under Canadian GAAP the acquirer had not, capitalized finance leases (capital leases under Canadian GAAP) acquired in a past business combination, the entity should capitalize those leases in its consolidated financial statements, as *IAS 17 - Leases* would require the acquiree to do in its IFRS statement of financial position. Conversely, if an asset or liability was included in goodwill under Canadian GAAP accounting but would have been recognized separately if IFRS 3 was applied at the time of the business combination, that asset or liability remains in goodwill unless IFRSs would require its recognition in the financial statements of the acquiree.

An entity's opening statement of financial position must also exclude any previously recognized items that do not meet IFRSs recognition criteria. For example, a first time adopter may have, in a past business combination recognized as an intangible asset an item that does not qualify for recognition under IAS 38. Where this is the case, the entity should reclassify the intangible items to goodwill. All other changes (i.e. not intangible asset related) with respect to acquired or assumed items are recognized in retained earnings. Therefore, in the previous example the entity should reclassify that intangible item under Canadian GAAP (and any related future tax and minority interest) as part of goodwill.

Other significant consequences of not applying IFRS 3 retrospectively are:

- i. The entity would retain the Canadian GAAP classifications, such as legal acquirer or legal acquiree, uniting of interests;
- ii. The carrying amount of goodwill recognized under Canadian GAAP is not adjusted, except for specific circumstances as set out above or resolution of contingent purchase consideration before the date of transition; and
- iii. There is no requirement to remeasure some assets and liabilities original values at the time of the business combination to fair value after initial recognition.

In addition to ii) above, for a Canadian entity, the Canadian GAAP purchase allocation of items will be used as the IFRS 'deemed acquisition cost'. This is an important concept as this deemed cost is the basis for measurement of those assets and liabilities. The deemed cost is the basis for cost based depreciation or amortization from the date of the business combination, rather than the date of transition to IFRSs.

Relating to point iii) above, some standards require an entity to remeasure to fair value some assets and liabilities after initial recognition. Where a first time adopting entity elects not to apply IFRS 3 retrospectively, the item should be remeasured to fair value at the date of transition, with any differences being recognized as a change in retained earnings. The change is not reflected in goodwill.

Another issue that may arise is in relation to consolidation of subsidiaries. It is possible that a first-time IFRS adopter may not have consolidated an entity that the parent is required to consolidate under IFRSs. This is because the requirements to consolidate under IFRSs are based on control and this control test is different from Canadian GAAP consolidation requirements. Therefore, due to differences in

approach the parent may not have regarded the entity as a subsidiary or consolidated the entity under Canadian GAAP, whereas the entity is a subsidiary under IFRSs. Under Canadian GAAP no consolidation was performed, but under IFRSs consolidation is required. Therefore, the entity is required to recognize the subsidiary's assets and / or liabilities at the level IFRSs would require in the subsidiary's separate statement of financial position. In this case, goodwill is to be determined for this entity at the date of transition. The deemed cost of goodwill in this instance is the difference between i) the parents interest in the subsidiary's equity, as adjusted under IFRSs at the date of transition, and ii) the parents cost of the investment in the subsidiary at the acquisition date.

### Share-based Payment Transactions

*IFRS 2 - Share Based Payments (IFRS 2)* applies to situations where an entity grants shares or share options to employees or to other parties providing goods and services and requires these payments to be recognized as an expense in the entity's financial statements.

Generally, a first time adopter should apply IFRS 2 retrospectively. However, while a first time adopter is encouraged to retrospectively apply IFRS 2, an entity may elect not to retrospectively apply IFRS 2 to equity instruments (equity settled transactions) granted on or before November 7, 2002.

Similarly, while IFRS 1 encourages a first time adopter to apply IFRS 2 to equity instruments that were granted after November 7, 2002 and that vested before the later of i) the date of transition and ii) January 1, 2005 (for Canadian entities the later date will be the date of transition, January 1, 2010), an entity may elect not to retrospectively apply IFRS 2 to these equity instruments. However, an entity can only retrospectively apply IFRS 2, if it had previously disclosed publicly the fair value of those equity instruments, determined at the measurement date. This may be an issue for Canadian entities as the requirements under IFRSs and Canadian GAAP in relation to options with graded vesting are different. Therefore, retrospective application of IFRS 2 may not be possible and those entities may be forced to make this election.

To summarize, if an entity elects to use this exemption and the entity's date of transition to IFRSs is January 1, 2010, the entity applies IFRS 2 to shares, share options or other equity instruments that were granted after November 7, 2002 and had not yet vested at January 1, 2010.

If a first time adopter elects to apply the exemption, it is nevertheless required to disclose information that enables users of the financial statements to understand the nature and extent of share based payment arrangements that existed during the reporting and comparative period.

In addition to the exemptions relating to equity instruments, an entity is encouraged but not required to retrospectively apply IFRS 2 to liabilities arising from share based payment transactions (cash settled transactions) that were settled before the date of transition or prior to January 1, 2005. An entity can elect not to retrospectively apply IFRS 2 to share based payments of this type that were not settled before the date of transition or prior

to January 1, 2005. The treatment of these types of liabilities is significantly different under IFRSs than that required under current Canadian GAAP. These differences may result in many Canadian entities having to elect to use the exemptions available.

### Insurance Contracts

In contrast to the IFRS 1 general principle of not allowing an IFRS first time adopter to apply a specific standards transitional provisions, an entity issuing insurance contracts (insurer) may elect on first time adoption to apply the transitional provisions of *IFRS 4 – Insurance Contracts (IFRS 4)*. These provisions allow an insurer to apply IFRS 4 prospectively for reporting periods beginning on or after January 1, 2005. However, generally IFRS 4 restricts changes in accounting policies for insurance contracts. Therefore, this effectively means that Canadian entities will continue to account for insurance contracts as they have under Canadian GAAP.

### Deemed Cost

With respect to property, plant and equipment a first time adopting entity may make three elections on transition to IFRSs. These elections relate to:

- i. Deemed cost;
- ii. Changes in existing decommissioning, restoration and similar liabilities included in the cost of property, plant and equipment (see exemption section below); and
- iii. Borrowing costs (see Borrowing Costs exemption section below).

A first-time adopter may elect to use one of the following as deemed cost of an item of property, plant and equipment:

- i. Fair value at the date of transition;
- ii. A revaluation under previous GAAP that is broadly comparable to fair value or cost or depreciated costs under IFRSs, adjusted to reflect, for example, changes in a general or specific price index; or
- iii. A previous GAAP event-driven fair value measurement (e.g. Initial Public Offering).

A first-time adopter may have established a deemed cost in accordance with 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

- (a) If the measurement date is at or before the date of transition to IFRSs, the entity may use such event-driven fair value measurements as deemed cost for IFRSs at the date of that measurement.
- (b) If the measurement date is after the date of transition to IFRSs, but during the period covered by the first IFRS financial statements, the event-driven fair value measurements may be used as deemed cost when the event occurs. The resulting adjustments are recognized directly in retained earnings (or if appropriate, another category of equity) at the measurement date.

An entity may want to use one of these elections for reasons such as:

- i. Differences between the costs recorded under Canadian GAAP and what would be recorded as cost in accordance with IFRS. To determine this may take up a lot of resources that could be used elsewhere in the conversion process;
- ii. Difficulty retrospectively applying IFRS component accounting as historical information may no longer be available; or
- iii. The entity simply wants to use the exemption.

In relation to the exemption, fair value at the date of transition is usually the items appraised market value at that same date. This value should be the highest possible price that could be obtained by the entity for the item, without reference to the items current use in the entity. Furthermore, no deduction should be made in determining market value for any estimated disposal costs.

If an entity is unable to determine the market value, due to i) the specialized nature of the property, plant and equipment and / or ii) the item is rarely sold, the entity will need to estimate the market value based on an income or depreciated replacement cost approach.

The ability to use previous revaluations as deemed cost may result in Canadian entities that applied push down accounting in the past, although the concept of push down accounting doesn't exist under IFRSs, to use those push down accounting values as deemed cost.

If a revaluation under previous GAAP did not satisfy ii) above, an entity measures the revalued assets in its opening statement of financial position on one of the following bases:

- i. Cost less any accumulated depreciation and any accumulated impairment losses under the cost model in *IAS 16 – Property, Plant and Equipment (IAS 16)*;
- ii. Deemed cost, being the fair value at the date of transition to IFRSs; or
- iii. Revalued amount, (if adopting the revaluation model in IAS 16).

An entity may also use the above fair value or a revalued amount as deemed cost for items of Investment Property, if the entity elects to use the cost model in *IAS 40 – Investment Property, and / or IAS 38 – Intangible Assets*, provided the recognition and revaluation criteria in IAS 38 are satisfied, and fair value can be determined by reference to an active market.

If the entity elects to use deemed cost, depreciation is based on that deemed cost and starts from the date from which the entity established the fair value measurement or revaluation. Further, where the entity's depreciation methods and rates under previous Canadian GAAP are acceptable under IFRSs, any change in estimated useful life or depreciation are accounted for prospectively from the date the change is made. Where this is not the case and the differences result in a material effect on the financial statements, the entity must make a retrospective adjustment so that accumulated depreciation in its opening IFRS statement of financial position complies with IFRSs.

Electing to use fair value as deemed cost may have implications on other areas of the financial statements for an entity. For example,

where the fair value amount exceeds or increases the carrying value of property, plant and equipment, the subsequent future depreciation expense is likely to be greater than what it would have been without the fair value adjustment. As the fair value amount is higher, it is also more likely that impairment losses may need to be recognized in future periods.

### Cost or Revaluation Measurement Method

Another important consideration when adopting IFRS is that an entity must make an accounting policy choice whether to use the revaluation or cost method of accounting for each class of property, plant and equipment. For more information on the accounting policy choice see Issue 3 of our *IFRS – Canadian GAAP Differences Series – Property, Plant and Equipment*.

If an entity chooses the revaluation method for some or all classes of property, plant and equipment, the cumulative revaluation surplus should be presented 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, the entity's first IFRS financial statements for each line item must include disclosures of the aggregate of the fair values and the aggregate adjustment to the previous Canadian GAAP carrying amounts.

### Use of Deemed Cost for Oil and Gas Assets

An exemption is available for first-time adopters that were required under previous GAAP to account for exploration and development costs of oil and gas properties in the development or production phases, in cost centres that include all properties in a large geographical area. Where the first-time adopter has used such accounting they may elect to measure oil and gas assets at the date of transition to IFRSs on the following basis:

- i. Exploration and evaluation assets at the amount determined under the entity's previous GAAP; and
- ii. Assets in the development or production phases at the amount determined for the cost centre under the entity's previous GAAP. The entity allocates this amount to the cost centre's underlying assets pro rata using reserve volumes or reserve values as of that date.

In addition, the entity is required to test exploration and evaluation assets and assets in the development and production phases for impairment at the date of transition to IFRSs. The impairment testing is required to follow *IFRS 6 Exploration for and Evaluation of Mineral Resources (IFRS 6)* for entities in the E&E phase or *IAS 36 (Impairment of Assets)* with any impairment being recorded against the above amount.

Specific disclosures are required to be made when using this exemption namely the fact the entity has used the exemption for its oil and gas assets, and the basis on which carrying amounts determined under previous GAAP were allocated.

Also, where the entity uses this exemption, an entity is prohibited from using the decommissioning, restoration and similar liabilities exemption above. The entity:

- i. Measures decommissioning, restoration and similar liabilities as at the date of transition to IFRSs in accordance with *IAS 37 (Provisions, Contingent Liabilities and Contingent Assets)*; and
- ii. Recognize directly in retained earnings any difference between that amount and the carrying amount of those liabilities at the date of transition to IFRSs determined under the entity's previous GAAP.

This exemption is applicable for annual periods beginning on or after January 1, 2010, with early adoption permitted.

### Rate regulated

Under previous GAAP some entities hold items of property, plant and equipment or intangible assets that are used, or were previously used, in operations subject to rate regulation. For the purpose of IFRS 1 operations are subject to rate regulation if they provide goods or services to customers at prices (ie rates) established by an authorised body empowered to establish rates that bind the customers and that are designed to recover the specific costs the entity incurs in providing the regulated goods or services and to earn a specified return. The specified return could be a minimum or range and need not be a fixed or guaranteed return.

The carrying amount of such items of property, plant and equipment or intangible assets might include amounts that were determined under previous GAAP but may not qualify for capitalization in accordance with IFRSs. If this is the case, a first-time adopter may elect to use the previous GAAP carrying amount of such an item at the date of transition to IFRSs as deemed cost. This exemption is available on an item by item basis.

At the date of transition to IFRSs, an entity shall test for impairment in accordance with *IAS 36* each item for which this exemption is used.

This exemption is a recent amendment to IFRS. The amendment is to be applied for annual periods beginning on or after January, 1 2011. Earlier application is permitted.

Entities that adopted IFRSs in periods before the effective date of IFRS 1 or applied IFRS 1 in a previous period are permitted to apply the amendment retrospectively in the first annual period after the amendment is effective.

### Leases

At the date of transition to IFRSs, a lessee or lessor classifies leases as operating leases or finance leases as determined under IFRSs, rather than the operating and capital lease categorization under Canadian GAAP, on the basis of circumstances existing at the date of inception of the lease.

IFRS 1 allows a first time adopter of IFRSs to apply the transitional provisions of *IFRIC 4 - Determining whether an Arrangement contains a Lease (IFRIC 4)*. IFRIC 4 is an interpretation that takes a substance over form approach to identifying whether a transaction or arrangement contains a lease. IFRIC 4 looks at whether a transaction or a series of related transactions, that may not take the form of a legal lease, but convey a right to use an asset in return for a payment or series of payments is a lease. The interpretation is

similar to *EIC 150 – Determining Whether an Arrangement Contains a Lease (EIC 150)*. Due to this, even if a Canadian entity elects to use the exemption the entity would at the date of transition have to assess arrangements that they have already assessed under EIC 150.

Many observers believe that this, reassessing items that have already been assessed under identical requirements of an entities previous GAAP, is an ineffective use of resources during the conversion process, as such IFRS 1 was recently amended to exempt the first-time adopter from needing to reassess that exact same determination when it adopts IFRSs. This amendment is applicable for annual periods beginning on or after January 1, 2010, with early adoption permitted. One of the key criteria for an entity to have made the same determination of whether the arrangement contained a lease in accordance with previous GAAP, is that the determination would have to have given the same outcome as that resulting from applying *IAS 17* and *IFRIC 4*. This very strict criteria is likely to restrict Canadian first time adopters from using this additional exemption.

### Employee Benefits

Under *IAS 19 – Employee Benefits*, an entity may elect to use a 'corridor' approach that leaves some actuarial gains and losses unrecognized. This is similar to the approach in current Canadian GAAP Section 3461 – Employee Future Benefits. Therefore, the exemption may not have as substantive an impact as those already mentioned.

Retrospective application of the corridor approach would require an entity to split the cumulative actuarial gains and losses from the inception of the plan until the date of transition to IFRSs into recognized and unrecognized portions. However, under IFRS 1 a first-time adopter may elect to recognize all cumulative actuarial gains and losses at the date of transition to IFRSs. If a first-time adopter uses this election, they apply the election to all defined benefit plans. However, this election can be used even if the entity uses the corridor approach for subsequent actuarial gains and losses. This allows some Canadian entities currently using the corridor approach to elect to use this exemption. For example, an entity may have unrecognized actuarial losses. By using the exemption the entity will recognize these cumulative actuarial losses, in the form of a charge to retained earnings at the date of transition and will thereby potentially reduce the future pension expense or amortization. Only actuarial losses arising subsequent to the date of transition will be amortized and recognized in the income statement.

IFRS 1 also provides an optional exemption with respect to *IAS 19* disclosures. Amongst the prescribed disclosures of *IAS 19*, an entity is required to disclose for the current and four previous annual periods the present value of the defined benefit obligation, the fair value of the plan assets and the surplus or deficit in the plan; and experience adjustments arising on the plan liabilities expressed either as (i) an amount or (ii) a percentage of the plan liabilities at the statement of financial position date and the plan assets expressed either as (i) an amount or (ii) a percentage of

the plan assets at the statement of financial position date. The IFRS 1 exemption allows a first time adopter to disclose these amounts as the amounts are determined for each accounting period prospectively from the date of transition to IFRSs.

### Cumulative Translation Differences

Under *IAS 21 – The Effects of Changes in Foreign Exchange Rates*, translations of foreign operations are performed using the current rate method. This is the same method as Canadian GAAP uses to translate self-sustaining operations. This method results in exchange differences being recognized in other comprehensive income and accumulated as a separate component of equity. Only on disposal of the related foreign operation are the accumulated translation differences recognized in the income statement, as part of the gain or loss on disposal of the subsidiary.

The exemption in IFRS 1 allows a first time adopter to elect not to calculate this translation difference retrospectively. Where this election is made the cumulative translation balance for all foreign operations is set to zero, at the date of transition. The gain or loss on subsequent disposal of a foreign operation will therefore only include foreign exchange differences arising subsequent to the date of transition.

This election could be beneficial to entities that want to 'tidy' up the cumulative translation balance by setting it to zero. In addition it will allow entities to avoid any adjustments to the balance which would be required as a result of the IFRSs transition adjustments of foreign operations.

### Assets and Liabilities of Subsidiaries, Associates and Joint Ventures

This is an important exemption for many Canadian entities with foreign parents that have either already adopted IFRSs or will not be adopting IFRSs at the same date as the Canadian entity. For example, when a Canadian subsidiary adopts IFRS in Canada it may have a different date of transition to that of the parent entity. For example, if the parent is a European company that entity's date of transition may have been January 1, 2004, while the Canadian entities date of transition may be January 1, 2010. Therefore, potential differences between the parent and subsidiary accounting records could exist, especially where the measurement is dependent on the date of transition to IFRSs, or in relation to IFRS 1 elections. This goes against one of the objectives of using IFRSs - to ease the financial reporting burden for groups with operations in multiple jurisdictions.

Therefore, IFRS 1 provides an optional exemption for a subsidiary that is a first-time adopter later than its parent entity. This optional exemption is also available for an Associate or Joint Venture that becomes a first time adopter later than an entity that has significant influence or joint control over it.

In this scenario (i.e. subsidiary adopting IFRSs later than its parent) IFRS 1 allows a subsidiary to measure its assets and liabilities at either:

- i. The carrying amounts included in the parent's consolidated financial statements, based on the parent's date of transition to

IFRSs, if no adjustments were made for consolidation procedures and for the effects of the business combination in which the parent acquired the subsidiary; or

- ii. The carrying amounts required by IFRS 1, based on the subsidiary's date of transition to IFRSs.

If the entity elects to use option i) above, the subsidiary and parent will avoid recognizing different amounts (other than for consolidation adjustments) in their financial statements.

IFRS 1 also provides guidance in situations where:

- i. A parent is a first-time adopter later than its subsidiary; or
- ii. A parent becomes a first-time adopter for its separate financial statements earlier or later than for its consolidated financial statements.

In relation to the first scenario, where the entity becomes a first-time adopter later than its subsidiary (or associate or joint venture), the parent in its consolidated financial statements should measure the assets and liabilities of the subsidiary (or associate or joint venture) at the same carrying amounts as in the 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.

In relation to the second scenario, where a parent becomes a first-time adopter for its separate financial statements earlier or later than for its consolidated financial statements, the parent entity should measure its assets and liabilities at the same amounts in both financial statements, except for consolidation adjustments.

### Compound Financial Instruments

On first time adoption of IFRS an entity is required to retrospectively apply *IAS 32 - Financial Instruments Disclosure and Presentation (IAS 32)*. Where a compound instrument is issued, IAS 32 requires the instrument be split into its two component parts (debt and equity). This classification of the components is based on the conditions that existed at the date the instrument first met the recognition requirements of IAS 32. Therefore, to comply with applying IAS 32 retrospectively the carrying amounts would need to be determined on the basis of circumstances existing when the instrument was issued, not on circumstances at the date of transition.

However, under IFRS 1, if the liability component of the instrument has either been settled or converted prior to the date of transition, an entity can elect not to split the amount recognized into the debt and equity components. The reason for this exemption is that retrospective adjustment would only result in an analysis of the amounts in shareholders' funds into two separate components. Therefore, this exemption allows an entity to avoid the reallocation of equity components. An entity must remember that this exemption only covers situations where the liability component is no longer outstanding. If the liability is still outstanding this difference will have to be adjusted for on transition to IFRS.

This exemption may not seem that relevant to entities reporting in accordance with Canadian GAAP as they are currently required to make a split into debt and equity. However, when comparing Canadian GAAP and IFRS a difference exists in relation to how the split between debt and equity is allocated. Broadly, under Canadian GAAP there are two methods of allocating the proceeds either i) the relative fair value method, the fair value of each component is determined and allocate the proceeds on a prorata basis, or ii) the residual method where an entity determines the fair value of the component, which is easier to determine and allocates the residual proceeds to the other component. Under IFRSs the liability component is always calculated first and the equity component is allocated the residual amount. This difference in allocation may impact whether or not an entity will elect to use the exemption.

### Designation of Previously Recognized Financial Instruments

This exemption relates to the classification of financial instruments at the date of transition to IFRS. Classification of financial instruments is an issue that Canadian entities have encountered with the recent adoption of *Section 3855 - Financial Instruments – Recognition and Measurement of the CICA Handbook (Section 3855)*. While similar Section 3855 and IAS 39 - Financial Instruments: Recognition and Measurement (IAS 39) do have some differences, especially with respect to designating financial instruments at fair value through profit and loss, or what is termed as held for trading under Section 3855.

Due to the differences this exemption may still be applicable to Canadian entities that have adopted Section 3855.

The IFRS 1 exemption permits a first time adopter at the date of transition to make an available for sale designation, or to designate any financial asset or financial liability as at fair value through profit and loss provided the asset or liability meets the IAS 39 classification criteria. One illustration of this exemption may be for a Canadian entity to elect to use the exemption to previous Canadian GAAP designated held for trading financial instrument as available for sale at the date of transition.

### Fair Value Measurement of Financial Assets or Financial Liabilities at Initial Recognition

This is an exemption included in IFRS 1 that is not currently applicable for Canadian entities as it requires prospective application from January 1, 2004. The exemption allows an entity to elect to apply the last sentence of IAS 39 paragraph AG76, and paragraph AG76A prospectively.

The last sentence of IAS 39 paragraph AG76 sets out that the best evidence of the fair value of a financial instrument at initial recognition is:

- The transaction price (ie 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 (ie without modification or repackaging); or

- Based on a valuation technique whose variables include only data from observable markets.

Application of this paragraph and AG76 may result in no gain or loss, or gains and losses due to the transaction price not equalling the fair value amount of a financial asset or liability, being recognized on the initial recognition of a financial asset or financial liability. In such a case, IAS 39 requires that a gain or loss be recognized 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.

However, the IASB has recently issued an exposure draft that proposes an amendment to IFRS 1 to remove the fixed dates for first time adopters. As a result this exemption will be applicable from the date of transition to IFRS (i.e. an entity is required to apply IAS 39.AG76 and AG76A prospectively from the date of transition, which for a Canadian first time adopter with a calendar year-end their date of transition to IFRS will be January 1, 2010).

### Decommissioning Liabilities Included in the Cost of Property, Plant and Equipment

Under *IFRIC 1 – Changes in Existing Decommissioning, Restoration and Similar Liabilities*, any changes in the estimated value of an existing decommissioning, restoration or similar liability, which under Canadian GAAP are typically referred to as Asset Retirement Obligations (ARO), shall be added to, or deducted from, the cost of the asset to which it relates. Without an exemption, this change would require an entity to retrospectively recalculate the decommissioning liability and the related impact on the cost of the related asset and accumulated depreciation.

For a first time adopter, retrospective application of these requirements would require an entity to construct historical records of all such adjustments that would have been made in the past, which in many cases would be impractical. Therefore, IFRS 1 provides an optional exemption for an entity, excluding oil and gas related entities in the development or production phases (see use of deemed cost for oil and gas assets below) to elect not to comply with these requirements, for such liabilities incurred before the date of transition to IFRSs. If using this exemption an IFRS first time adopter is required to:

- Measure the liability (or ARO) at the date of transition to IFRSs in accordance with *IAS 37 - Provisions, Contingent Liabilities and Contingent Assets (IAS 37)*;
- Estimate the amount that would have been included in the cost of the related asset when the liability first arose, by discounting the liability to that date using the best estimate of the historical risk adjusted discount rates that would have applied for that liability over the intervening period; and
- Calculate the accumulated depreciation on that amount as at the date of transition to IFRS, on the basis of the current estimate of the useful life of the asset, using the depreciation policy adopted by the entity under IFRS.

The effects of any changes from previous GAAP, as a result of this, are recognized in the opening IFRS statement of financial position in net assets and retaining earnings.

Although entities have been accounting for ARO's under Canadian GAAP, there is a difference between Canadian GAAP and IFRSs with respect to the obligations that are included. Canadian GAAP is based on legal obligations whereas IFRSs also include constructive obligations. There are also differences in the measurement of AROs. Therefore, on adopting IFRSs an entity may exist as to when and how changes in estimates are accounted for.

The effect of electing to use this exemption is that an entity does not have to attempt to determine when and how the changes in estimates arose. Instead, the entity will recalculate the liability as at the date of transition and then adjust this amount for a historical risk discount rate, to estimate the amount when the liability arose. This balance is then added to the cost of the asset and accumulated depreciation adjusted accordingly.

### Financial Assets or Intangible Assets Accounted for in Accordance with IFRIC 12 - Service Concession Arrangements

Like the insurance contracts exemption above, IFRS 1 allows a first-time adopter to elect to apply the transitional provisions in IFRIC 12. The IFRIC 12 transitional provisions provide special relief when retrospective application is impracticable. Guidance on what is deemed to be impracticable is provided in IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors.

If retrospective application at the date of transition is impracticable, then an operator should:

- Reclassify assets recognized previously under the service concession arrangement as intangible and / or financial assets at the date of transition, without remeasurement from the previous recognized carrying amount of the assets; and
- Test the financial and intangible assets recognized for impairment at the date of transition, or if this is impracticable, at the start of the current period.

### Borrowing Costs

Again, similar to the insurance contracts and IFRIC 12 service concession exemptions above, a first-time adopter may elect to apply the transitional provisions of *IAS 23 - Borrowing Cost (revised 2007) (IAS 23)*. The IAS 23 transitional provisions allow an entity to choose the date to apply capitalization of borrowing costs relating to all qualifying assets. This date is either:

- The later of January 1, 2009 or the date of transition to IFRSs; or
- An earlier date.

Where an entity does not elect to use deemed cost for property, plant and equipment and elects to apply capitalization of borrowing costs from a date prior to the date of transition to IFRSs, the capitalization of borrowing costs in the cost of property, plant and equipment should be in accordance with IAS 23. This may require a change in the actual cost of the property, plant and equipment from that recorded previously under Canadian GAAP.

### Transfers of Assets from Customers

*IFRIC 18 - Transfers of Assets from Customers (IFRIC 18)* sets out the requirements for how an item of property, plant and equipment transferred to an entity should be initially recognized, how any difference between fair value and any cash should be recognized and how the entity should account for any cash also transferred.

A first-time adopter is permitted to apply the transitional provisions IFRIC 18. Therefore, an entity may apply the requirements of IFRIC 18 from the later of July 1, 2009 or the date of transition to IFRSs. In addition, a first-time adopter may designate any date before the date of transition to IFRSs and apply IFRIC 18 to all transfers of assets from customers received on or after that date.

### Extinguishing Financial Liabilities with Equity Instruments

*IFRIC 19 - Extinguishing Financial Liabilities with Equity Instruments (IFRIC 19)* sets out the accounting requirements for when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability. IFRIC 19 does not address the accounting by the creditor.

IFRIC 19 prescribes that the:

- Issuance of an entity's equity instruments to a creditor to extinguish all or part of a financial liability is consideration paid;
- Equity instruments issued should be measured at their fair value, unless fair value cannot be reliably measured; and
- Difference between the carrying amount of the financial liability (or part of a financial liability) extinguished, and the consideration paid, is recognized in profit or loss however, where a financial liability is only partially extinguished the entity is required to determine whether any of the consideration paid relates to a modification of the terms of the remaining part of the liability and allocate accordingly.

A first-time adopter may apply the transitional provisions in IFRIC 19. Therefore, the exemption is applicable for annual periods beginning on or after July 1, 2010 (Earlier application is permitted with disclosure of early adoption required).

An entity applies a change in accounting policy in accordance with IAS 8 from the beginning of the earliest comparative period presented. For Canadian first time adopters this will be from the date of transition, which for a Canadian first time adopter with a calendar year-end will be January 1, 2010.

### Use of Deemed Cost after Severe Hyperinflation (Proposed amendment to IFRS 1)

The IASB has recently issued an exposure draft that proposes an amendment to IFRS 1 to add an exemption that an entity can apply at the date of transition to IFRSs after being subject to severe hyperinflation. This exemption would allow an entity to measure assets and liabilities at fair value and use that fair value as

the deemed cost of those assets and liabilities in the opening IFRS statement of financial position.

The amendment to IFRS 1 is proposed in response to the situation in Zimbabwe, where severe hyper-inflation previously existed due to a lack of a reliable general price index to all entities with transactions and balances in the local currency. However subsequently a new currency (or a new functional currency) was issued which provides a reliable general price index to all entities.

If Canadian entities have interests in Zimbabwe they will need to consider this amendment and its implications in detail.

### What are the Mandatory Exemptions to Retrospective Application?

IFRS 1 prescribes three mandatory exemptions in Appendix B - Exceptions to the Retrospective Application of other IFRSs and one for Estimates in the main body of the standard. These exceptions prohibit an entity from applying standards retrospectively. In these situations IFRS 1 requires an entity to make a prospective application of the relevant standard. The mandatory exemptions are:

- i. Derecognition of financial assets and financial liabilities;
- ii. Hedge accounting;
- iii. Non-controlling interests; and
- iv. Estimates.

### Derecognition of Financial Assets and Financial Liabilities

Financial assets and financial liabilities are required to be recognized and measured in the opening IFRS statement of financial position in accordance with IAS 39. Currently IFRS 1 includes an exemption such that if the entity has achieved derecognition of the financial assets and / or financial liabilities under Canadian GAAP before January 1, 2004, these are not required to be recognized again in the opening IFRS statement of financial position. For example, if an entity entered into a securitization agreement on December 30, 2003 and determined that the derecognition criteria of *AcG-12 - Transfers of Receivables* (i.e. can be treated as a sale) was achieved, the entity does not have to consider whether or not the derecognition criteria of IAS 39 is met at the date of transition to IFRSs. The entity will continue to leave this off the statement of financial position. However, if the same entity entered into a securitization transaction on January 2, 2004, under the current IFRS 1, the entity would have to consider the recognition and measurement requirements of IAS 39, if the assets derecognized still exist at the date of transition.

IFRS 1 also allows a first time adopter to elect to retrospectively apply the derecognition requirements in IAS 39 from an earlier date than January 1, 2004, provided the information required to do so was obtained at the time of initially accounting for the transaction.

The IASB has recently issued an Exposure Draft that proposes an amendment to IFRS 1 to remove the fixed dates for first time adopters. As a result this mandatory exemption will be applicable from the date of transition to IFRS (i.e. an entity is required to apply IAS 39 prospectively from the date of transition, which for a Canadian first time adopter with a calendar year-end their date of transition to IFRS will be January 1, 2010). If a first-time adopter derecognized non-derivative financial assets or non-derivative financial liabilities in accordance with Canadian GAAP as a result of a transaction that occurred before the date of transition to IFRSs, it shall not recognize those assets and liabilities in accordance with IFRSs (unless they qualify for recognition as a result of a later transaction or event).

### Hedge Accounting

A first time adopter is required to apply IAS 39, at the date of transition to IFRSs. Therefore, an entity is required to:

- i. Measure all derivatives at fair value; and
- ii. Eliminate all deferred losses and gains arising on derivatives that were reported under previous GAAP as if they were assets or liabilities.

As a result, the opening IFRS statement of financial position of a first time adopter should not include a hedging relationship of a type that would not qualify for hedge accounting under IAS 39.

Hedge accounting in accordance with IAS 39 is similar to hedge accounting under Canadian GAAP (i.e. Section 3865). However, certain differences exist between the two standards which may result in some Canadian hedges not being accounted for as hedges under IFRSs. For example, Canadian GAAP allows the use of a short cut method, whereas this is not permitted in IFRSs. In these cases, where a previously designated hedge item under Canadian GAAP does not meet the full detailed criteria for hedge accounting under IAS 39, the entity would have to discontinue using hedge accounting on adoption of IFRSs.

Designation of a hedging relationship cannot be made retrospectively, therefore, if an item was not designated on or before the date of transition to IFRS as a hedge then that item cannot be designated as a hedge under IFRSs. 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 the designation is done no later than the date of transition to IFRS.

### Non Controlling Interests

A first-time adopter is required to apply the following requirements of IAS 27 prospectively from the date of transition to IFRSs:

- i. Attribute total comprehensive income to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance;
- ii. Account for changes in the parent's ownership interest in a subsidiary that do not result in a loss of control; and

- iii. Account for a loss of control over a subsidiary, and the related requirements of IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

However, if the first-time adopter elects to apply IFRS 3 retrospectively to past business combinations, the entity must also apply IAS 27 in the same manner.

### Estimates

When restating the opening IFRS statement of financial position an entity may have information available that was not available at the time an accounting estimate was originally made. This exemption is to prevent an entity from adjusting previously made accounting estimates for the benefit of hindsight. IFRS 1 requires that all accounting estimates at the date of transition to IFRS should be made consistently with the accounting estimate made under previous GAAP, unless:

- i. There is a difference in accounting policies; or
- ii. There is objective evidence that they were in error.

Where an entity is required to make an accounting estimate on transition to IFRSs that was not required under previous GAAP, those estimates should reflect conditions that existed at the date of transition. For example, estimates of market based prices should reflect the market conditions at the date of transition and not reflect events that occurred after that date.

To help illustrate this issue, take an entity that prepared its December 2009 financial statements in accordance with Canadian GAAP. Those financial statements included a provision for asset impairment due to market conditions. Suppose that in 2011, the market circumstances changed such that the impairment amount would be different taking into consideration the new additional information. When preparing the opening IFRS statement of financial position at January 1, 2010 the provision would not reflect the new information which became available in 2011.

### Short term exemptions from IFRSs

Exemption from the requirement to restate comparative information for *IFRS 9 – Financial Instruments*

In its first IFRS financial statements, an entity that (a) adopts IFRSs for annual periods beginning before January 1, 2012 and (b) applies IFRS 9 is normally required to present at least one year of comparative information. However, this comparative information need not comply with IFRS 9 or IFRS 7 - Financial Instruments: Disclosures, to the extent that the disclosures required by IFRS 7 relate to assets within the scope of IFRS 9.

The application of this short term exemption may be limited in Canada as some regulators prohibit early adoption of IFRS 9.

### Disclosures about Financial Instruments (Amendments to IFRS 7)

First-time adopters of IFRSs to the extent that the entity's first IFRS reporting period starts earlier than January 1, 2010, are exempt from

providing the additional disclosures introduced in March 2009 by Improving Disclosures about Financial Instruments (Amendments to IFRS 7).

Therefore 2009 and 2010 first-time adopters' benefit from the same transition provisions that Amendments to IFRS 7 provides to current IFRS preparers. The additional disclosure requirements included in Amendments to IFRS 7 were part of the IASB's response to the financial crisis; they require enhanced disclosures about fair value measurements and liquidity risk.

The amendment is effective on July 1, 2010, with earlier application permitted.

### Disclosures about Financial Instruments

In October 2010 the IASB issued *Disclosures—Transfers of Financial Assets (Amendments to IFRS 7)*. The amendments to IFRS 7 amended disclosures to help users of financial statements evaluate the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position particularly those that involve securitization of financial assets.

The amendment to IFRS 7 also required a short-term exemption in IFRS 1 to avoid the potential use of hindsight and to ensure that first-time adopters are not disadvantaged as compared with current IFRS preparers. Therefore a first-time adopters may use the transition provisions that are included in *Disclosures—Transfers of Financial Assets (Amendments to IFRS 7)*.

The amendment is applicable for annual periods beginning on or after July 1, 2011. Earlier application is permitted.

### Conclusion

In summary, the basic approach to IFRS 1 for an entity is to:

- Identify the first IFRS annual financial statements (e.g. December 31, 2011);
- Prepare an opening IFRS statement of financial position at the date of transition to IFRS (e.g. January 1, 2010);
- Identify the standards that are effective for the entity's first IFRS annual financial statements (e.g. December 31, 2011);
- Select accounting policies based on those standards;
- Apply those policies fully retrospectively in preparing the opening IFRS statement of financial position (for example, January 1, 2010);
- Consider whether to apply any optional exemptions from retrospective application;
- Apply the mandatory exemptions from retrospective application; and
- Make extensive disclosures to explain the transition to IFRSs.

If you require further guidance on first time adoption of IFRS, IFRS 1 or any other IFRSs information or reference sources, please contact your local BDO office or visit [www.bdo.ca/ifrs](http://www.bdo.ca/ifrs).

The information in this publication is current as of October 26<sup>th</sup>, 2010.

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