Draft Implementation Guidance

# ED 1 FIRST-TIME APPLICATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

*Comments to be received by 31 October 2002*

This draft Implementation Guidance accompanies the proposed International Financial Reporting Standard (IFRS) set out in ED 1 *First-time Application of International Financial Reporting Standards* (see separate booklet).

Comments on the draft IFRS and its accompanying documents should be submitted in writing so as to be received by **31 October 2002**.

All replies will be put on the public record unless confidentiality is requested by the commentator. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@iasb.org.uk** or addressed to:

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# INTERNATIONAL FINANCIAL REPORTING STANDARD IFRS X First-time Application of International Financial Reporting Standards

# [Draft] Implementation Guidance

*This [draft] guidance is not part of the [draft] IFRS. It explains how the requirements of the [draft] IFRS interact with the requirements of some other IFRSs.*

## IAS 10 Events After the Balance Sheet Date

IG1 Except as described in paragraph IG2, an entity applies IAS 10 in determining whether:

(a) its opening IFRS balance sheet reflects an event that occurred after the date of transition to IFRSs; and

(b) comparative balance sheet amounts in its first IFRS financial statements reflect an event that occurred after the end of that comparative period.

IG2 Paragraphs 25-27 of the [draft] IFRS require some modifications to the principles in IAS 10 when a first-time adopter determines whether changes in estimates are adjusting or non-adjusting events at the date of transition to IFRSs (or, when applicable, the end of the comparative period). Cases 1 and 2 below illustrate those modifications. In case 3 below, paragraphs 25-27 of the [draft] IFRS do not require modifications to the principles in IAS 10.

(a) Case 1—Previous GAAP required estimates of similar items for the date of transition to IFRSs, using an accounting policy that is consistent with IFRSs. In this case, the estimates under IFRSs need to be consistent with estimates made for that date under previous GAAP, unless there is objective evidence that those estimates were in error (see IAS 8 *Accounting Policies, Changes in Estimates and Errors)*.[1] The entity reports later revisions to those estimates as events of the period in which it makes the revisions, rather than as adjusting events resulting from the receipt of further evidence about conditions that existed at the date of transition to IFRSs.

[1] The IASB proposes to replace the concept of fundamental errors in IAS 8 with a concept of material errors (see Exposure Draft *Improvements to International Accounting Standards*, published in May 2002).

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(b) Case 2—Previous GAAP required estimates of similar items for the date of transition to IFRSs, but the entity made those estimates using accounting policies that are not consistent with its accounting policies under IFRSs. In this case, the estimates under IFRSs need to be consistent with the estimates required under previous GAAP for that date (unless there is objective evidence that those estimates were in error), after adjusting for the difference in accounting policies. The opening IFRS balance sheet reflects those adjustments for the difference in accounting policies. As in case 1, the entity reports later revisions to those estimates as events of the period in which it makes the revisions.

For example, previous GAAP may have required an entity to recognise and measure provisions on a basis consistent with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, except that the previous GAAP measurement is on an undiscounted basis. In this example, the entity uses the estimates under previous GAAP as inputs in making the discounted measurement required by IAS 37.

(c) Case 3—Previous GAAP did not require estimates of similar items for the date of transition to IFRSs. Estimates under IFRSs for that date do not reflect conditions that arose after that date. In particular, estimates of market prices, interest rates or foreign exchange rates at the date of transition to IFRSs reflect market conditions at that date. This distinction parallels the distinction in IAS 10 *Events After the Balance Sheet Date* between adjusting events after the balance sheet date and non-adjusting events after the balance sheet date.


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**Example**

**BACKGROUND**

Entity J's first IFRS financial statements have a reporting date of 31 December 2005 and include comparative information for one year. In its previous GAAP financial statements for 31 December 2003 and 2004, entity J:

(a) made estimates of accrued expenses and provisions at those dates;

(b) accounted on a cash basis for a defined benefit pension plan; and

(c) did not recognise a provision for a court case arising from events that occurred in September 2004. When the court case was concluded on 30 June 2005, entity J was required to pay 1,000 and paid this on 10 July 2005.

In preparing its first IFRS financial statements, entity J concludes that its estimates under previous GAAP of accrued expenses and provisions at 31 December 2003 and 2004 were made on a basis consistent with its accounting policies under IFRSs. Although some of the accruals and provisions turned out to be overestimates and others to be underestimates, entity J concludes that its estimates were reasonable and, therefore, no error had occurred. As a result, accounting for those over- and underestimates involves the routine adjustment of estimates under IAS 8.

**APPLICATION OF REQUIREMENTS**

In preparing its opening IFRS balance sheet at 1 January 2004 and in its comparative balance sheet at 31 December 2004, entity J:

(a) does not adjust the previous estimates for accrued expenses and provisions; and

(b) makes estimates (in the form of actuarial assumptions) necessary to account for the pension plan under IAS 19 *Employee Benefits*. Entity J's actuarial assumptions at 1 January 2004 and 31 December 2004 do not reflect conditions that arose after those dates.

*continued* …





For example, entity J's:

(i) discount rates at 1 January 2004 and 31 December 2004 for the pension plan and for provisions reflect market conditions at those dates; and

(ii) actuarial assumptions at 1 January 2004 and 31 December 2004 about future employee turnover rates do not reflect conditions that arose after those dates—such as a significant increase in estimated employee turnover rates as a result of a curtailment of the pension plan in 2005.

The treatment of the court case at 31 December 2004 depends on the reason why entity J did not recognise a provision under previous GAAP at that date.

ASSUMPTION 1 – Previous GAAP was consistent with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Entity J concluded that the recognition criteria were not met. In this case, entity J's assumptions under IFRSs are consistent with its assumptions under previous GAAP. Therefore, entity J does not recognise a provision at 31 December 2004.

ASSUMPTION 2 – Previous GAAP was not consistent with IAS 37. Therefore, entity J develops estimates under IAS 37. Under IAS 37, an entity determines whether an obligation exists at the balance sheet date by taking account of all available evidence, including any additional evidence provided by events after the balance sheet date. Similarly, under IAS 10 *Events After the Balance Sheet Date*, the resolution of a court case after the balance sheet date is an adjusting event after the balance sheet date if it confirms that the entity had a present obligation at that date. In this instance, the resolution of the court case confirms that entity J had a liability in September 2004 (when the events occurred that gave rise to the court case). Therefore, entity J recognises a provision at 31 December 2004. Entity J measures that provision by discounting the 1,000 paid on 10 July 2005 to its present value, using a discount rate that complies with IAS 37 and reflects market conditions at 31 December 2004.

## IAS 16 Property, Plant and Equipment

IG3 An entity that adopts the benchmark treatment in IAS 16 measures its property, plant and equipment at the date of transition to IFRSs at depreciated cost, less accumulated impairment losses, if any. In some cases, this may involve undue cost or effort for one or more items of property, plant and equipment. For example, if an entity did not maintain a register of property, plant and equipment, reconstructing reliable cost-based measurements for all or some items may involve undue cost or effort. If so, an entity measures those items at the date of transition to IFRSs at their fair value and uses that fair value as their deemed cost at that date, unless paragraph 17 or 19 applies (paragraph 16 of the [draft] IFRS). Subsequent depreciation is based on that deemed cost.

IG4 If an entity's depreciation methods and rates under previous GAAP are acceptable under IFRSs, the entity does not restate accumulated depreciation in its opening IFRS balance sheet. Instead, the entity accounts for any change in estimated useful life or depreciation pattern prospectively from the period when it makes that change in estimate (paragraph 25 of the [draft] IFRS and paragraph 52 of IAS 16). However, in some cases, an entity's depreciation methods and rates under previous GAAP result in amounts that differ materially from those that would be acceptable under IFRSs (for example, if they were adopted solely for tax purposes and were not a reasonable estimate of the asset's useful life). If so, the entity adjusts accumulated depreciation in its opening IFRS balance sheet retrospectively so that it complies with IFRSs.

IG5 In some cases, an asset is made up of components that have different useful lives or provide benefits to the entity in different patterns. Under IAS 16, the entity accounts for these components as separate assets (see IAS 16, paragraphs 12 and 27, and SIC-23 *Property, Plant and Equipment – Major Inspection or Overhaul Costs*).

IG6 If an entity adopts the allowed alternative treatment in IAS 16 for some or all classes of property, plant and equipment, the entity measures those classes at fair value in its opening IFRS balance sheet. If it can determine, without undue cost and effort, the amounts that would have been included in the opening IFRS balance sheet under the benchmark treatment, the entity presents the cumulative revaluation surplus as a separate component of equity. If determining these amounts would involve undue cost or effort, the entity treats the fair value at the date of transition to IFRSs as deemed cost (paragraph 16 of the [draft] IFRS) and gives the disclosures required by paragraph 35 of the [draft] IFRS.

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IG7 Using its previous GAAP, an entity may have revalued items of property, plant and equipment, by applying, for example, a general or specific price index to a cost that is broadly comparable to cost determined under IFRSs, or have revalued the items to an amount that is broadly comparable to fair value determined under IFRSs. Paragraph 17 of the [draft] IFRS permits an entity to treat such revalued amounts as deemed cost under IFRSs—even if the entity could establish an IFRS-compliant measurement based on original cost without undue cost or effort. Paragraph 17 applies only to property, plant and equipment (and investment property, if an entity elects to use the cost model in IAS 40 *Investment Property*).

IG8 If an entity carried out revaluations under previous GAAP that did not satisfy the criteria in the previous paragraph, the entity measures the revalued assets in its opening balance sheet on one of the following bases:

(a) cost less any accumulated depreciation and any accumulated impairment losses under the IAS 16 benchmark treatment;

(b) deemed cost, being the fair value at the date of transition to IFRSs, if determining the measurement in (a) would involve undue cost or effort (paragraph 16 of the [draft] IFRS); or

(c) revalued amount, if the entity adopts the IAS 16 allowed alternative treatment as its accounting policy under IFRSs for all assets in the same class.

IG9 In some cases, an entity may have established a deemed cost under previous GAAP for an item of property, plant and equipment (or other assets and liabilities) by measuring it at fair value at one particular date because of an event such as a privatisation or initial public offering. Such event-driven measurements establish a deemed cost for subsequent accounting under IFRSs (paragraph 19 of the [draft] IFRS).

IG10 In some cases, the construction or commissioning of an asset results in an obligation for an entity to dismantle or remove the asset and restore the site on which the asset stands. An entity applies IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* in recognising and measuring any resulting provision. The entity applies IAS 16 in determining the resulting amount included in the cost of the asset, before depreciation and impairment losses. Items such as depreciation and, when applicable, impairment losses cause differences between the carrying amount of the provision and the amount included in the carrying amount of the asset.


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## IAS 17 Leases

IG11 At the date of transition to IFRSs, a lessee or lessor classifies leases as operating leases or finance leases on the basis of circumstances existing at the inception of the lease (IAS 17, paragraph 10). In some cases, the lessee and the lessor may agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification under IAS 17 had the changed terms been in effect at the inception of the lease. If so, the revised agreement is considered as a new agreement over its term. However, changes in estimates (for example, changes in estimates of the economic life or of the residual value of the leased property) or changes in circumstances (for example, default by the lessee) do not give rise to a new classification of a lease.

IG12 When IAS 17 was revised in 1997, the net cash investment method for recognising finance income of lessors was eliminated. IAS 17 permits finance lessors to eliminate this method prospectively. However, the transitional provisions in IAS 17 do not apply to an entity's opening IFRS balance sheet. Therefore, the [draft] IFRS requires a finance lessor to measure finance lease receivables in its opening IFRS balance sheet as if the net cash investment method had never been permitted.

IG13 SIC-15 *Operating Leases—Incentives* applies to lease terms beginning on or after 1 January 1999. However, under the [draft] IFRS, an entity applies SIC-15 to all leases, whether they start before or after that date.

## IAS 18 Revenue

IG14 If an entity has received amounts that do not yet qualify for recognition as revenue under IAS 18 (for example, the proceeds of a sale that does not qualify for revenue recognition), the entity recognises the amounts received as a liability in its opening IFRS balance sheet and measures that liability at the amount received.





## IAS 19 Employee Benefits

IG15 At the date of transition to IFRSs, an entity measures net employee benefit assets or liabilities under defined benefit plans in accordance with IAS 19 *Employee Benefits*, except that no actuarial gains or losses remain unrecognised (paragraph 22 of the [draft] IFRS). The transitional provisions in IAS 19 do not apply to an entity's opening IFRS balance sheet (paragraph 9 of the [draft] IFRS).

IG16 An entity's actuarial assumptions at the date of transition to IFRSs are consistent with actuarial assumptions made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 25 of the [draft] IFRS). The entity treats the impact of any later revisions to those assumptions as actuarial gains or losses of the period in which it makes the revisions.

IG17 An entity may need to make actuarial assumptions at the date of transition to IFRSs that were not necessary under its previous GAAP. Such actuarial assumptions do not reflect conditions that arose after the date of transition to IFRSs. In particular, discount rates and the fair value of plan assets at the date of transition to IFRSs reflect market conditions at that date. Similarly, the entity's actuarial assumptions at the date of transition to IFRSs about future employee turnover rates do not reflect a significant increase in estimated employee turnover rates as a result of a curtailment of the pension plan that occurred after the date of transition to IFRSs (paragraph 26 of the [draft] IFRS).

IG18 In many cases, an entity's first IFRS financial statements will reflect measurements of employee benefit obligations at three dates: the reporting date, the date of the comparative balance sheet and the date of transition to IFRSs. To minimise costs, an entity may obtain a full actuarial valuation at one or two of these dates and roll the valuation(s) forward or back to the other date(s). Any such roll forward or roll back reflects any material transactions and other material events (including changes in market prices and interest rates) between those dates (IAS 19, paragraph 57).

## IAS 22 Business Combinations

IG19 See Appendix B of the [draft] IFRS.

## IAS 23 Borrowing Costs

IG20 On first adopting IFRSs, an entity adopts a policy of capitalising borrowing costs (IAS 23 allowed alternative treatment) or not capitalising them (IAS 23 benchmark treatment). The entity applies that policy consistently in its opening IFRS balance sheet and in all periods presented in its first IFRS financial statements.

IG21 If an entity capitalised borrowing costs under previous GAAP, but adopts a policy under the IAS 23 benchmark treatment of not capitalising borrowing costs, it may involve undue cost or effort to quantify the amount of capitalised interest to be excluded from the carrying amount of some assets in the opening IFRS balance sheet. Similarly, if an entity adopts a policy under the IAS 23 allowed alternative treatment of capitalising borrowing costs, but adopted a different policy under its previous GAAP, determining a cost-based measurement for some qualifying assets (as defined in IAS 23) may involve undue cost or effort.

IG22 In both cases discussed in paragraph IG21, if determining a cost-based measurement for property, plant and equipment (including investment property) would involve undue cost or effort, an entity treats the fair value of those items at the date of transition to IFRSs as their deemed cost, unless paragraph 17 or 19 applies (paragraph 16 of the [draft] IFRS). The entity also gives the disclosures required by paragraph 35.

IG23 Under the allowed alternative treatment, IAS 23 requires disclosure of interest capitalised during the period. Neither IAS 23 nor the [draft] IFRS requires disclosure of the cumulative amount capitalised.

IG24 IAS 23 contains transitional provisions that encourage retrospective application, but permit an entity that adopts the allowed alternative treatment to capitalise (prospectively) only those borrowing costs incurred after the effective date that meet the criteria for capitalisation. However, if a first-time adopter adopts the IAS 23 allowed alternative treatment, the [draft] IFRS requires retrospective application of that treatment.

## IAS 29 Financial Reporting in Hyperinflationary Economies

IG25 An entity complies with IAS 21 *The Effects of Changes in Foreign Exchange Rates* in determining its functional currency. When the entity prepares its opening IFRS balance sheet, it applies IAS 29 to any periods during which the economy of the functional currency was





hyperinflationary.

IG26 If an entity cannot, without undue cost or effort, determine the impact of past hyperinflation on the measurement of items of property, plant and equipment (including investment property) in its opening IFRS balance sheet, it treats their fair value at that date as their deemed cost at that date (paragraph 16), unless paragraph 17 or 19 is relevant for a revalued amount or fair value determined after the hyperinflation ceased. The entity also gives the disclosures required by paragraph 35.

## IAS 32 Financial Instruments: Disclosure and Presentation

IG27 In its opening IFRS balance sheet, an entity applies the criteria in IAS 32 to classify financial instruments issued (or components of compound instruments issued) as either financial liabilities or equity instruments in accordance with the substance of the contractual arrangement when the instrument first satisfied the recognition criteria in IAS 32 (paragraphs 18 and 26), without considering events after that date (other than changes to the terms of the instruments).

IG28 For compound instruments issued, an entity determines the initial carrying amounts of the components on the basis of circumstances existing when the instrument was issued (IAS 32, paragraph 26). An entity determines those carrying amounts using the version of IAS 32 effective at the reporting date for its first IFRS financial statements.

## IAS 34 Interim Financial Reporting

IG29 IAS 34 applies if an entity is required, or elects, to present an interim financial report in accordance with IFRSs. Accordingly, neither IAS 34 nor the [draft] IFRS requires an entity to:

(a) present interim financial reports that comply with IAS 34; or

(b) prepare new versions of interim financial reports presented under previous GAAP. However, if an entity does prepare an interim financial report under IAS 34 for part of the period covered by its first IFRS financial statements, the entity restates the comparative information presented in that report so that it complies with IFRSs.

IG30 An entity applies the [draft] IFRS in each interim financial report that it presents under IAS 34 for part of the period covered by its first IFRS financial statements. In particular, paragraph 37 of the Exposure Draft would require an entity to disclose various reconciliations.

**Example**

**BACKGROUND**

Entity K's first IFRS financial statements have a reporting date of 31 December 2005, and its first interim financial report under IAS 34 is for the quarter ended 31 March 2005. Entity K prepared previous GAAP annual financial statements for the year ended 31 December 2004, and prepared quarterly reports throughout 2004.

**APPLICATION OF REQUIREMENTS**

In each quarterly interim financial report for 2005, entity K includes reconciliations of:

(a) its equity under previous GAAP at the end of the comparable quarter of 2004 to its equity under IFRSs at that date; and

(b) its profit or loss under previous GAAP for the comparable quarter of 2004 (current and year-to-date) to its profit or loss under IFRSs.

In addition to the reconciliations required by (a) and (b) and the disclosures required by IAS 34, entity K's interim financial report for the first quarter of 2005 include reconciliations of (or a cross-reference to another published document that includes these reconciliations):

(a) its equity under previous GAAP at 1 January 2004 and 31 December 2004 to its equity under IFRSs at those dates; and

(b) its profit or loss for 2004 under previous GAAP to its profit or loss for 2004 under IFRSs.

Each of the above reconciliations gives sufficient detail to enable users to understand the material adjustments to the balance sheet and income statement and distinguish changes in accounting policies from changes in estimates and from the correction of errors. Entity K also explains the material adjustments to the cash flow statement.

## **IAS 36 Impairment of Assets** and **IAS 37 Provisions, Contingent Liabilities and Contingent Assets**





IG31 An entity applies IAS 36 in:

(a) determining whether any impairment loss exists at the date of transition to IFRSs;

(b) measuring any impairment loss that exists at that date, and reversing any impairment loss that no longer exists at that date. An entity's first IFRS financial statements include the disclosures that IAS 36 would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition to IFRSs (paragraph 31(c) of the [draft] IFRS).

IG32 The estimates used to determine whether an entity recognises an impairment loss or provision (and to measure any such impairment loss or provision) at the date of transition to IFRSs are consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those estimates were in error (paragraph 25 of the [draft] IFRS). The entity reports the impact of any later revisions to those estimates as an event of the period in which it makes the revisions.

IG33 In assessing whether it needs to recognise an impairment loss or provision (and in measuring any such impairment loss or provision) at the date of transition to IFRSs, an entity may need to make estimates for that date that were not necessary under its previous GAAP. Such estimates and assumptions do not reflect conditions that arose after the date of transition to IFRSs. (paragraph 26 of the [draft] IFRS)

IG34 The transitional provisions in IAS 36 and IAS 37 do not apply to an entity's opening IFRS balance sheet.

IG35 IAS 36 requires the reversal of impairment losses in some cases. If an entity's opening IFRS balance sheet reflects impairment losses, the entity recognises any later reversal of those impairment losses in the income statement (except when IAS 36 requires the entity to treat that reversal as a revaluation). This applies to both impairment losses recognised under previous GAAP and additional impairment losses recognised on transition to IFRSs.

## IAS 38 Intangible Assets

IG36 An entity's opening IFRS balance sheet:

(a) excludes all intangible assets and other intangible items that do not meet the criteria for recognition under IAS 38; and

(b) includes all separately acquired intangible assets that meet the recognition criteria in IAS 38 at the date of transition to IFRSs.

IG37 Under paragraphs 53 and 59 of IAS 38, an entity capitalises the costs of creating internally generated intangible assets prospectively from the date when the recognition criteria are met. Those criteria require an entity to recognise an intangible asset if, and only if:

(a) it is probable that the future economic benefits that are attributable to the asset will flow to the enterprise; and

(b) the cost of the asset can be measured reliably.

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

IG38 IAS 38 does not permit an entity to use hindsight to conclude retrospectively that the recognition criteria discussed in paragraph IG37 are met. Therefore, even if an entity concludes retrospectively that a future inflow of economic benefits is probable and is able to reconstruct the costs reliably, paragraph 53 of IAS 38 prohibits it from capitalising the costs incurred before the date when the entity both:

(a) concludes, based on an assessment made at the date of that conclusion, that it is probable that future economic benefits from the asset will flow to the entity; and

(b) has a system for accumulating the costs of internally generated intangible assets when, or shortly after, they are incurred.

IG39 If an internally generated intangible asset did not meet the criteria for recognition in the opening IFRS balance sheet, but does qualify for recognition under IAS 38 at a later date, its cost is the sum of the expenditure incurred from the date when the asset first meets the recognition criteria in IAS 38.

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IG40 An entity's opening IFRS balance sheet includes an intangible asset if, and only if, it qualifies for recognition under IAS 38 at the date of transition to IFRSs (paragraph 11 of the [draft] IFRS). The deemed cost of an intangible asset acquired in a previous business combination is its carrying amount under previous GAAP immediately following the business combination (paragraph 20(a) of the [draft] IFRS). In consequence, if the entity did not assign an amount to an intangible asset at the date of the business combination, the entity does not recognise that intangible asset in its opening IFRS balance sheet.

IG41 If an entity's amortisation methods and rates under previous GAAP would be acceptable under IFRSs, the entity does not restate the accumulated amortisation in its opening IFRS balance sheet. Instead, the entity accounts for any change in estimated useful life or amortisation pattern prospectively from the period when it makes that change in estimate (paragraph 25 of the [draft] IFRS and paragraph 94 of IAS 38). However, in some cases, an entity's amortisation methods and rates under previous GAAP result in amounts that differ materially from those that would be acceptable under IFRSs (for example, if they were adopted solely for tax purposes and were clearly not a reasonable estimate of the asset's useful life). If so, the entity adjusts the accumulated amortisation in its opening IFRS balance sheet retrospectively so that it complies with IFRSs (paragraph 26 of the [draft] IFRS).

## IAS 39 Financial Instruments: Recognition and Measurement

IG42 An entity recognises and measures all financial assets and financial liabilities in its opening IFRS balance sheet in accordance with the version of IAS 39 effective at the reporting date for the entity's first IFRS financial statements, except as specified in paragraph 24 and Appendix C of the [draft] IFRS, which address hedging.

### Recognition

IG43 An entity recognises all financial assets and financial liabilities (including derivatives) that qualify for recognition under IAS 39 and have not yet qualified for derecognition under IAS 39.

IG44 An entity does not recognise financial assets and financial liabilities that do not qualify for recognition under IAS 39, or have already qualified for derecognition under IAS 39.


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### Embedded derivatives

IG45 When IAS 39, paragraph 23, requires the entity to separate an embedded derivative from a host contract, their initial carrying amounts at the date when the instrument first satisfies the recognition criteria in IAS 39 reflect circumstances at that date (IAS 39, paragraph 23). If the entity cannot determine those initial carrying amounts reliably, it treats the entire combined contract as a financial instrument held for trading (IAS 39, paragraph 26). This results in fair value measurement (except when the entity cannot determine a reliable fair value, see IAS 39, paragraph 70), with changes in fair value recognised in the income statement.

### Measurement

IG46 An entity applies the criteria in IAS 39 to identify those financial assets and financial liabilities that are measured at fair value and those that are measured at amortised cost. In particular:

(a) to comply with IAS 39, paragraph 90, classification of financial assets as held-to-maturity investments reflects the entity's intent and ability at the date of transition to IFRSs. Furthermore, sales or transfers of held-to-maturity investments before the date of transition to IFRSs do not trigger the "tainting" rules in IAS 39, paragraph 83.

(b) to comply with IAS 39, paragraph 10, the category of "loans and receivables originated by the entity" necessarily refers to the circumstances at origination.

(c) under IAS 39, paragraph 10, derivative financial assets and derivative financial liabilities are always deemed held for trading. The result is that an entity measures all derivative financial assets and derivative financial liabilities at fair value and (except for cash flow hedges) recognises changes in their fair value in the income statement.

(d) to comply with IAS 39, paragraph 107, an entity classifies a non-derivative financial asset or financial liability in its opening IFRS balance sheet as held for trading if, and only if:

(i) the entity designates that asset at the date of transition to IFRSs as held for trading;[2] or

(ii) the asset or liability was acquired or incurred principally for the purpose of selling or repurchasing it in the near term or was, at the date of transition to IFRSs, part of a portfolio of identified financial instruments that were managed together and for which there was evidence of a recent actual pattern of short-term profit-taking.

(e) to comply with IAS 39, paragraph 10, available-for-sale financial assets are a residual category of financial assets that do not fall into any of the previous categories.

IG47 For those financial assets and financial liabilities measured at amortised cost in the opening IFRS balance sheet, an entity determines their cost on the basis of circumstances existing when the assets and liabilities first satisfied the recognition criteria in IAS 39. However, if the entity acquired those financial assets and financial liabilities in a past business combination, their carrying amount under previous GAAP immediately following the business combination is their deemed cost under IFRSs at the date of the business combination (paragraph 20(a) of the [draft] IFRS).

IG48 An entity's estimates of loan impairments at the date of transition to IFRSs are consistent with estimates made for the same date under previous GAAP (after adjustments to reflect any difference in accounting policies), unless there is objective evidence that those assumptions were in error (paragraph 25 of the [draft] IFRS). The entity treats the impact of any later revisions to those estimates as impairment losses (or, if the criteria in IAS 39 are met, reversals of impairment losses) of the period in which it makes the revisions.

IG49 On remeasuring an available-for-sale financial asset to fair value at the date of transition to IFRSs, an entity includes any resulting adjustment of the carrying amount determined under previous GAAP for that date in a separate component of equity, rather than in retained earnings.

[2] This proposal reflects the IASB's proposed improvements to IAS 39. Among other things, these permit an irrevocable designation (at inception or, if later, at the date of transition to IFRSs) of any financial instrument as held for trading (see Exposure Draft *Amendments to IAS 32, Financial Instruments: Disclosure and Presentation, and IAS 39, Financial Instruments: Recognition and Measurement*).

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On subsequent derecognition or impairment of the available-for-sale financial asset, the entity transfers the related adjustment to the income statement[3] (paragraph 103(b)(ii) of IAS 39).

### Hedge accounting

IG50 Paragraph 24 and Appendix C of the [draft] IFRS deal with hedge accounting.

## IAS 40 Investment Property

IG51 An entity that adopts the fair value model in IAS 40 measures its investment property at fair value at the date of transition to IFRSs. The transitional requirements of IAS 40 do not apply.

IG52 An entity that adopts the cost model in IAS 40 applies paragraphs IG3-IG10 on property, plant and equipment.

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[3] Paragraph IG49 reflects the proposal in the June 2002 Exposure Draft of amendments to IAS 39. Among other things, this would remove the existing option in IAS 39 for an entity to recognise changes in the fair value of available-for-sale financial assets in the income statement.

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