

First-time Adoption of International Financial Reporting Standards (IFRS 1)

Table of Contents

1. Overview and objective of IFRS 1
2. Key definitions and basic concepts
3. Scope of IFRS 1
4. Core principle of IFRS 1
5. Opening IFRS statement of financial position
6. Recognition and measurement — general principles
7. Mandatory exceptions from retrospective application
8. Optional exemptions from retrospective application
9. Presentation and disclosure
10. Illustrative example — transition reconciliations
11. Practical transition steps (process view)
12. Strategic and conceptual implications
13. Summary — exam-style key points
14. Comprehensive Question Bank (MCQs, Calculations, Integrated Case Studies)

1. Overview and objective of IFRS 1

IFRS 1 governs how an entity prepares its **first financial statements under IFRS** when it previously reported under another GAAP framework.

Objective: The standard aims to ensure that an entity's first IFRS financial statements and any related interim reports:

- **Are transparent and comparable** across all periods presented.
- **Provide a suitable starting point** for accounting under IFRS.
- **Can be produced at a cost that does not exceed the benefits** to users.

In practice, IFRS 1 is a **transition standard**: it is applied once—when an entity first adopts IFRS—and then never again.

2. Key definitions and basic concepts

2.1 First-time adopter

First-time adopter: An entity that presents its **first IFRS financial statements** that contain an explicit and unreserved statement of compliance with IFRS Accounting Standards.

An entity is **not** a first-time adopter if:

- It has previously presented IFRS financial statements with an explicit and unreserved statement of compliance.
- It has previously applied IFRS only for internal purposes or partial information (e.g. segment reporting) without full IFRS financial statements.
- It previously applied IFRS but did not make an explicit and unreserved statement of compliance.

2.2 Date of transition to IFRSs

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

Example:

- First IFRS financial statements: year ended **31 December 20X6**.
- Comparative period: year ended **31 December 20X5**.
- **Date of transition to IFRSs: 1 January 20X5** (the opening financial position date of the comparative period).

2.3 First IFRS reporting period

First IFRS reporting period: The latest reporting period covered by the first IFRS financial statements (e.g. year ended 31 December 20X6 in the example above).

2.4 Previous GAAP

Previous GAAP: The basis of accounting used immediately before adopting IFRS (e.g. local GAAP, national standards).

3. Scope of IFRS 1

IFRS 1 applies when an entity **adopts IFRS for the first time** and prepares:

- A **complete set of financial statements** under IFRS for its first IFRS reporting period; and
- **Comparative information** for at least one prior period, also under IFRS.

The standard does **not** apply to:

- Entities that already report under IFRS and are merely changing accounting policies (IAS 8 applies).
- Entities that adopt IFRS only for specific disclosures or separate reporting packages without full IFRS financial statements.

4. Core principle of IFRS 1

The core principle is that a first-time adopter shall:

1. **Prepare an opening IFRS statement of financial position** at the date of transition to IFRSs.
2. **Apply IFRS retrospectively** to that opening statement of financial position and to all periods presented, **except** where IFRS 1:
 - Requires **mandatory exceptions** from retrospective application; or
 - Permits **optional exemptions** to ease the transition.

This opening IFRS statement of financial position is the **starting point** for all subsequent IFRS accounting.

5. Opening IFRS statement of financial position

5.1 General requirements

At the **date of transition**, the entity must:

- **Recognise all assets and liabilities** required by IFRS.
- **Derecognise items** that were recognised under previous GAAP but do **not** qualify as assets or liabilities under IFRS.

- **Reclassify items** recognised under previous GAAP as one type of asset/liability if IFRS requires a different classification.
- **Measure all recognised assets and liabilities** in accordance with IFRS, subject to exceptions and exemptions.

All resulting adjustments are recognised in **retained earnings (or another appropriate component of equity)** at the date of transition.

5.2 Accounting policies

The entity must use **consistent accounting policies** throughout:

- The **opening IFRS statement of financial position**;
- The **comparative period**; and
- The **current period** in its first IFRS financial statements.

These policies must comply with **all IFRS standards effective at the end of the first IFRS reporting period** (not at the date of transition).

Example: If the first IFRS financial statements are for the year ended 31 December 20X6, the entity applies **all IFRSs effective at 31 December 20X6** to both:

- The 20X6 figures; and
- The comparative 20X5 figures and the opening 1 January 20X5 statement of financial position.

6. Recognition and measurement — general principles

6.1 Retrospective application

Except where IFRS 1 specifies otherwise, the entity applies IFRS **retrospectively** as if it had always applied IFRS. This includes:

- **Assets and liabilities** measured under IFRS from the date they were initially recognised.
- **Income and expenses** recognised in accordance with IFRS in all periods presented.

6.2 Adjustments on transition

All adjustments arising from the transition are recognised in **equity** at the date of transition (usually retained earnings), not in profit or loss of the current period.

Example: Under previous GAAP, development costs were expensed. Under IFRS, certain development costs meet the criteria for capitalisation under IAS 38. On transition:

- The entity recognises an **intangible asset** for eligible development costs.

- The corresponding adjustment is credited to **retained earnings** at the date of transition.

6.3 Estimates

IFRS 1 requires that **accounting estimates** at the date of transition be **consistent with estimates made under previous GAAP**, unless there is objective evidence that those estimates were in error.

The entity **cannot** use hindsight to:

- Create new estimates for past periods; or
- Revise previous estimates simply because outcomes are now known.

Example: If a provision for warranty claims was estimated under previous GAAP using reasonable assumptions, the entity does not retrospectively change that estimate just because actual claims turned out differently.

7. Mandatory exceptions from retrospective application

IFRS 1 **prohibits** full retrospective application in certain areas because it would require undue hindsight or be impracticable. These are set out mainly in **Appendix B** of IFRS 1.

7.1 Derecognition of financial assets and financial liabilities

The entity shall **not recognise** financial assets or liabilities that were derecognised under previous GAAP before the date of transition, if they would not be recognised under IFRS.

Similarly, if previous GAAP failed to derecognise a financial asset or liability that IFRS would have derecognised, the entity must **derecognise** it at the date of transition.

Retrospective reconstruction of derecognition transactions before a certain date is generally **not required**.

7.2 Hedge accounting

Hedge accounting cannot be applied retrospectively unless the hedge relationship **met all IFRS criteria** at the relevant dates and the entity has **contemporaneous documentation**.

If such documentation does not exist, the entity cannot retrospectively designate hedging relationships.

7.3 Estimates

As noted above, estimates cannot be recreated using hindsight. IFRS 1 prohibits retrospective changes to estimates where the only new information is the outcome of the transaction or event.

7.4 Non-controlling interests (NCI)

Certain aspects of accounting for NCI (e.g. changes in ownership interests without loss of control) are not applied retrospectively in full; instead, IFRS 1 provides specific guidance aligned with IFRS 10 and IFRS 3 transition provisions.

8. Optional exemptions from retrospective application

IFRS 1 provides a series of **optional exemptions** to ease the transition where full retrospective application would be costly or complex. These are mainly in **Appendices C–E**.

An entity may choose to apply **none, some, or all** of these exemptions, but must apply each chosen exemption **consistently** to similar items.

Below are the most commonly tested and practically important exemptions.

8.1 Business combinations (Appendix C)

The entity may elect **not to restate past business combinations** that occurred before the date of transition.

If this exemption is chosen:

- Past business combinations are left as accounted for under previous GAAP, subject to certain adjustments (e.g. recognition of intangible assets and goodwill impairment).
- Goodwill is tested for **impairment** at the date of transition under IAS 36.
- Classification of the combination (acquisition vs. merger) is not revisited, but some reclassifications may be required (e.g. contingent consideration, non-controlling interests).

If the entity **does not** use the exemption, it must restate **all past business combinations** in accordance with IFRS 3, which is often highly complex.

Example — business combinations exemption:

- Entity A acquired Subsidiary B in 20X1 under previous GAAP.
- First IFRS financial statements: year ended 31 December 20X6; date of transition: 1 January 20X5.
- Entity A elects **not** to restate the 20X1 acquisition.
- It keeps the carrying amount of goodwill as per previous GAAP at 1 January 20X5, adjusts for any items that IFRS requires (e.g. recognising intangible assets that meet IAS 38 criteria), and performs an **impairment test** at 1 January 20X5.

8.2 Deemed cost for property, plant and equipment, investment property and intangible assets

IFRS 1 allows an entity to measure certain assets at a **deemed cost** at the date of transition instead of full retrospective cost.

Deemed cost can be:

- **Fair value** at the date of transition; or
- A **previous GAAP revaluation** that is broadly comparable to IFRS fair value or cost.

This exemption is commonly used for:

- **Property, plant and equipment (PPE)** under IAS 16.
- **Investment property** under IAS 40.
- Certain **intangible assets** under IAS 38.

Example — deemed cost PPE:

- Under previous GAAP, land and buildings were revalued in 20X3.
- The revalued amounts approximate IFRS fair value at that date.
- On transition (1 January 20X5), the entity elects to use the **revalued amounts as deemed cost**.
- From 1 January 20X5 onwards, the entity depreciates the buildings under IAS 16 using the deemed cost and appropriate useful lives.

8.3 Cumulative translation differences (CTDs)

For foreign operations, IAS 21 requires cumulative translation differences to be tracked in **other comprehensive income** and recycled on disposal.

IFRS 1 allows an entity to **reset CTDs to zero** at the date of transition.

If this exemption is used:

- CTDs accumulated under previous GAAP are not carried forward.
- On subsequent disposal of a foreign operation, only CTDs accumulated **after the date of transition** are recycled (or reclassified) to profit or loss.

8.4 Share-based payment transactions

IFRS 2 requires recognition of share-based payment expense from grant date. IFRS 1 allows exemptions for:

- Equity-settled share-based payments granted before a specified date; and
- Certain cash-settled arrangements.

The entity may elect not to apply IFRS 2 to share-based payments granted before the date of transition (subject to conditions).

8.5 Leases

IFRS 1 provides practical expedients for lease classification and measurement when transitioning to IFRS 16, allowing entities to avoid full retrospective reconstruction of lease data.

8.6 Other exemptions

Other optional exemptions include, among others:

- **Decommissioning liabilities** included in the cost of PPE.
- **Employee benefits** (e.g. actuarial gains and losses).
- **Compound financial instruments** (e.g. convertible debt).
- **Designation of financial instruments** at fair value through profit or loss or through other comprehensive income at the date of transition.
- **Severe hyperinflation** and related reset of opening balances.
- **Government loans** at below-market interest rates (transition relief for IFRS 9/IAS 20).

9. Presentation and disclosure

9.1 Comparative information

The first IFRS financial statements must include:

- At least **one year of comparative information** prepared under IFRS.
- An **opening IFRS statement of financial position** at the date of transition (this is presented, at minimum, in the notes; many entities present it as a third column in the statement of financial position).

Thus, the first IFRS financial statements typically include:

- Statement of financial position:
 - End of current period (e.g. 31 December 20X6).
 - End of comparative period (e.g. 31 December 20X5).
 - Opening IFRS statement of financial position (e.g. 1 January 20X5).
- Statement of profit or loss and other comprehensive income: current and comparative period.
- Statement of changes in equity: current and comparative period.
- Statement of cash flows: current and comparative period.

9.2 Explanation of transition to IFRSs

IFRS 1 requires **extensive disclosures** explaining how the transition from previous GAAP to IFRS affected:

- The entity's **financial position**;

- **Financial performance;** and
- **Cash flows.**

At a minimum, the entity must present:

1. **Reconciliation of equity** under previous GAAP to equity under IFRS:
 - At the date of transition; and
 - At the end of the comparative period.
2. **Reconciliation of total comprehensive income (or profit or loss)** under previous GAAP to total comprehensive income under IFRS for the comparative period.
3. If the entity previously presented a cash flow statement under previous GAAP, a **reconciliation of cash flows** may be required or at least an explanation of material adjustments.

These reconciliations must:

- Identify **major adjustments** (e.g. reclassification, measurement differences, recognition/derecognition).
- Distinguish between **changes in accounting policies** and **corrections of errors**.

10. Illustrative example — transition reconciliations

Assume:

- Entity Z previously reported under Local GAAP.
- First IFRS financial statements: year ended **31 December 20X6**.
- Date of transition: **1 January 20X5**.

10.1 Equity reconciliation at date of transition

Under Local GAAP at 1 January 20X5:

- Share capital: R1,000
- Retained earnings: R500
- Revaluation reserve: R200
- Total equity: R1,700

Adjustments on transition:

1. **Capitalisation of development costs** (IAS 38):
 - Asset recognised: R80
 - Increase in retained earnings: R80
2. **Reversal of revaluation reserve not permitted under IFRS** (e.g. revaluation not meeting IAS 16 criteria):
 - Revaluation reserve: (R50)
 - Retained earnings: (R50)
3. **Recognition of decommissioning provision** (IAS 37 and IAS 16):

- Provision recognised: R40
- Increase in PPE (decommissioning asset): R30
- Net decrease in retained earnings: R10

Opening IFRS equity at 1 January 20X5:

- Share capital: R1,000
- Retained earnings: R520 [500 + 80 – 50 – 10]
- Revaluation reserve: R150 [200 – 50]
- Total equity: R1,670

The reconciliation would show:

- Previous GAAP equity: R1,700
- IFRS adjustments: (R30)
- IFRS equity: R1,670

10.2 Profit reconciliation for comparative period

For year ended 31 December 20X5, Local GAAP profit: R300.

Adjustments:

- Additional depreciation on PPE due to deemed cost: (R15)
- Amortisation of capitalised development costs: (R8)
- Reversal of previous GAAP impairment not allowed under IFRS: R5

IFRS profit: R282 [300 – 15 – 8 + 5].

The reconciliation explains each adjustment and its nature (measurement vs. classification vs. error correction).

11. Practical transition steps (process view)

In practice, entities usually follow a structured process when adopting IFRS 1:

- 1. Define scope and date of transition**
 - Confirm that the entity is a first-time adopter.
 - Determine the first IFRS reporting period and date of transition.
- 2. Inventory of differences between previous GAAP and IFRS**
 - Identify all standards that differ materially from previous GAAP.
 - Focus on high-impact areas (e.g. revenue, financial instruments, leases, PPE, business combinations).
- 3. Decide on optional exemptions**
 - Evaluate cost–benefit of each exemption (e.g. business combinations, deemed cost, CTDs).
 - Document decisions and apply consistently.

4. **Prepare opening IFRS statement of financial position**
 - Recognise/derecognise assets and liabilities.
 - Reclassify items.
 - Measure assets and liabilities under IFRS (subject to exemptions).
5. **Restate comparative period under IFRS**
 - Apply chosen accounting policies consistently.
 - Adjust income statement, OCI, cash flows and equity.
6. **Prepare reconciliations and disclosures**
 - Equity reconciliations at date of transition and end of comparative period.
 - Profit or loss/total comprehensive income reconciliation.
 - Explanation of major adjustments and key judgements.
7. **Finalise first IFRS financial statements**
 - Ensure compliance with IAS 1 presentation requirements.
 - Review consistency, comparability and clarity of disclosures.

12. Strategic and conceptual implications

Transitioning under IFRS 1 is more than a mechanical exercise—it reshapes how the entity presents its financial story:

- **Improved comparability** with global peers.
- **Enhanced transparency** for investors and lenders.
- **Better alignment** with IFRS-based capital markets.

However, it also requires:

- Careful **project management** and cross-functional coordination.
- Robust **documentation** of judgements, exemptions and estimates.
- Clear **communication** with stakeholders about the impact of transition.

13. Summary — exam-style key points

To close the chapter, here are the core exam anchors for IFRS 1:

- **Objective:** High-quality, transparent, comparable first IFRS financial statements with a suitable starting point.
- **Date of transition:** Beginning of earliest comparative period presented under IFRS.
- **Opening IFRS statement of financial position:**
Recognise/derecognise/reclassify/remeasure assets and liabilities; adjustments go to equity.
- **Accounting policies:** Must comply with IFRSs effective at the end of the first IFRS reporting period and be applied consistently to all periods presented.
- **Mandatory exceptions:** Derecognition of financial instruments, hedge accounting, estimates, certain NCI aspects.
- **Optional exemptions:** Business combinations, deemed cost for PPE/investment property/intangibles, cumulative translation differences, share-based payments,

decommissioning liabilities, employee benefits, compound instruments, severe hyperinflation, government loans, and others.

- **Disclosures:** Reconciliations of equity and total comprehensive income, explanation of transition effects, clear distinction between policy changes and error corrections.

14. Comprehensive Question Bank (MCQs, Calculations, Integrated Case Studies)

1. Multiple-choice questions (conceptual and application)

1.1 Core definitions and scope

Q1 IFRS 1 applies when an entity:

- A. Changes one accounting policy under IAS 8.
- B. Adopts IFRS for the first time and presents a full set of IFRS financial statements with an explicit and unreserved statement of compliance.
- C. Adopts IFRS only for segment reporting.
- D. Adopts IFRS for internal management reporting only.

➤ **Answer: B**

Q2 Which of the following best describes the **date of transition to IFRSs**?

- A. The date when the board approves the first IFRS financial statements.
- B. The end of the first IFRS reporting period.
- C. The beginning of the earliest period for which the entity presents full comparative information under IFRS in its first IFRS financial statements.
- D. The date when the entity first started using IFRS for internal reporting.

➤ **Answer: C**

Q3 An entity's first IFRS financial statements are for the year ended **31 December 20X7**, with one year of comparative information. What is the **date of transition to IFRSs**?

- A. 31 December 20X7
- B. 1 January 20X7
- C. 31 December 20X6
- D. 1 January 20X6

➤ **Answer: D**

Q4 Which statement about a **first-time adopter** is correct?

- A. An entity that previously issued IFRS financial statements but did not state compliance is still a first-time adopter.
- B. An entity that previously issued IFRS financial statements with an explicit and unreserved statement of compliance is not a first-time adopter.
- C. An entity that used IFRS only for segment reporting is not a first-time adopter.
- D. Any entity that has ever applied any IFRS standard is not a first-time adopter.

➤ **Answer: B**

Q5 IFRS 1 requires that the accounting policies used in the opening IFRS statement of financial position must:

- A. Comply with IFRSs effective at the date of transition.
- B. Comply with IFRSs effective at the end of the first IFRS reporting period.
- C. Comply with IFRSs effective when the entity first adopted any IFRS internally.
- D. Be the same as those used under previous GAAP.

➤ **Answer: B**

1.2 Opening IFRS statement of financial position

Q6 In preparing the **opening IFRS statement of financial position**, an entity must:

- A. Recognise only those assets and liabilities that were recognised under previous GAAP.
- B. Recognise all assets and liabilities required by IFRS, derecognise items that do not qualify under IFRS, and reclassify items as required.
- C. Recognise only assets and liabilities that are measured at fair value.
- D. Recognise assets and liabilities prospectively from the date of transition only.

➤ **Answer: B**

Q7 Adjustments arising from the transition to IFRS are generally recognised:

- A. In profit or loss of the first IFRS reporting period.
- B. In other comprehensive income of the first IFRS reporting period.
- C. Directly in retained earnings (or another component of equity) at the date of transition.
- D. As prior period errors under IAS 8.

➤ **Answer: C**

Q8 Which of the following is **not** a requirement when preparing the opening IFRS statement of financial position?

- A. Derecognise items that do not qualify as assets or liabilities under IFRS.
- B. Reclassify items where IFRS requires a different classification.

- C. Measure all recognised assets and liabilities in accordance with IFRS, subject to exceptions and exemptions.
- D. Restate all prior business combinations in accordance with IFRS 3, regardless of cost or complexity.

➤ **Answer: D**

1.3 Mandatory exceptions

Q9 Which area is subject to a **mandatory exception** from retrospective application under IFRS 1?

- A. Business combinations.
- B. Deemed cost for PPE.
- C. Derecognition of financial assets and financial liabilities.
- D. Cumulative translation differences.

➤ **Answer: C**

Q10 Under IFRS 1, hedge accounting:

- A. Can always be applied retrospectively if it is beneficial.
- B. Can be applied retrospectively only if the hedge relationship met IFRS criteria and contemporaneous documentation exists.
- C. Must be discontinued on transition.
- D. Is not permitted in the first IFRS financial statements.

➤ **Answer: B**

Q11 Regarding **estimates** under IFRS 1, which statement is correct?

- A. Estimates under previous GAAP must always be revised using hindsight.
- B. Estimates under previous GAAP are disregarded and replaced with new IFRS estimates.
- C. Estimates under previous GAAP are retained unless there is objective evidence that they were in error.
- D. Estimates are not relevant in the transition process.

➤ **Answer: C**

1.4 Optional exemptions

Q12 The **business combinations exemption** under IFRS 1 allows an entity to:

- A. Restate all past business combinations in accordance with IFRS 3.
- B. Elect not to restate business combinations that occurred before the date of transition.
- C. Ignore goodwill recognised under previous GAAP.

D. Recognise goodwill prospectively only.

➤ **Answer: B**

Q13 Under the **deemed cost exemption** for PPE, which of the following are permitted? (Pick more than one):

- A. Use fair value at the date of transition as deemed cost.
- B. Use previous GAAP revaluations as deemed cost if broadly comparable to IFRS fair value or cost.
- C. Use historical cost under previous GAAP without adjustment.
- D. Only use fair value; previous GAAP revaluations are never permitted.

➤ **Answer: A and B**

Q14 The **cumulative translation differences (CTDs) exemption** allows an entity to:

- A. Reset CTDs to zero at the date of transition.
- B. Continue CTDs from previous GAAP without change.
- C. Recognise CTDs directly in profit or loss at the date of transition.
- D. Ignore CTDs entirely.

➤ **Answer: A**

Q15 Which of the following is an example of an **optional exemption** under IFRS 1?

- A. Derecognition of financial assets.
- B. Hedge accounting documentation.
- C. Share-based payment transactions granted before a specified date.
- D. Use of estimates.

➤ **Answer: C**

1.5 Presentation and disclosure

Q16 The first IFRS financial statements must include:

- A. Only current period figures under IFRS.
- B. Current period figures under IFRS and at least one year of comparative information under IFRS.
- C. Comparative information under previous GAAP only.
- D. No comparative information.

➤ **Answer: B**

Q17 Which reconciliation is **required** under IFRS 1?

- A. Reconciliation of equity under previous GAAP to equity under IFRS at the date of transition and at the end of the comparative period.
- B. Reconciliation of revenue only.
- C. Reconciliation of cash flows only.
- D. No reconciliations are required.

➤ **Answer: A**

Q18 IFRS 1 requires a reconciliation of:

- A. Total comprehensive income (or profit or loss) under previous GAAP to total comprehensive income under IFRS for the comparative period.
- B. Only profit before tax.
- C. Only operating profit.
- D. Only cash flows from operating activities.

➤ **Answer: A**

Q19 In the reconciliations required by IFRS 1, entities must:

- A. Aggregate all adjustments without explanation.
- B. Identify major adjustments and distinguish between changes in accounting policies and corrections of errors.
- C. Only disclose adjustments that increase profit.
- D. Only disclose adjustments that decrease equity.

➤ **Answer: B**

Q20 The opening IFRS statement of financial position is typically presented:

- A. Only in the notes.
- B. In a totally separate report.
- C. As a third statement of financial position (third column) or at least in the notes.
- D. Not presented at all.

➤ **Answer: C**

2. Calculation questions

2.1 Capitalisation of development costs (IAS 38) on transition

Scenario 1: Entity A previously reported under Local GAAP. Under Local GAAP, all development costs were expensed. Under IFRS, certain development costs meet the criteria for capitalisation under IAS 38.

- Date of transition to IFRSs: **1 January 20X5**.
- Eligible development costs incurred in 20X3 and 20X4: **R120**.

- Useful life of the resulting intangible asset: **5 years**, starting **1 January 20X4**.
- No residual value.

Required:

1. Calculate the carrying amount of the intangible asset at **1 January 20X5**.
2. Determine the adjustment to retained earnings at **1 January 20X5**.

Solution:

1. **Cost of intangible asset:** R120
2. **Amortisation:**
 - Asset available for use from 1 January 20X4.
 - Annual amortisation:

$$\text{Amortisation per year} = \frac{120}{5} = 24$$

- Amortisation for 20X4: R24

3. **Carrying amount at 1 January 20X5:**

$$\text{Carrying amount} = 120 - 24 = \mathbf{R96}$$

4. **Retained earnings adjustment:**
 - Under previous GAAP, the full R120 was expensed.
 - Under IFRS, only R24 would have been expensed by 1 January 20X5.
 - Therefore, retained earnings at 1 January 20X5 must be **increased** by the difference:

$$\text{Adjustment to retained earnings} = 120 - 24 = \mathbf{R96}$$

Answer:

- Intangible asset at 1 January 20X5: **R96**.
- Retained earnings increase: **R96**.

2.2 Decommissioning provision and PPE (IAS 37/IAS 16) on transition

Scenario 2: Entity B operates an oil platform. Under previous GAAP, no decommissioning provision was recognised. IFRS requires recognition of a decommissioning provision and inclusion of the related cost in PPE.

- Date of transition: **1 January 20X5**.
- Estimated decommissioning cost at the end of the asset's life (31 December 20X9): **R100**.
- Discount rate: **5%** per annum.
- Asset was put into use on **1 January 20X0** with a useful life of **10 years**.

Required:

1. Calculate the present value of the decommissioning provision at **1 January 20X0**.
2. Determine the carrying amount of the decommissioning asset at **1 January 20X5**.
3. Calculate the adjustment to retained earnings at **1 January 20X5**.

Solution:**1. Present value of decommissioning provision at 1 January 20X0:**

The decommissioning cost of R100 is payable at 31 December 20X9 (10 years from 1 January 20X0).

$$PV = \frac{100}{(1 + 0.05)^{10}}$$

$$(1.05)^{10} \approx 1.6289$$

$$PV \approx \frac{100}{1.6289} \approx 61.4$$

So, initial decommissioning provision and corresponding asset cost: **R61.4**.

2. Carrying amount of decommissioning asset at 1 January 20X5:

- Useful life of asset: 10 years (from 1 January 20X0 to 31 December 20X9).
- Annual depreciation of decommissioning asset:

$$\text{Depreciation per year} = \frac{61.4}{10} = 6.14$$

- By 1 January 20X5, **5 years** of depreciation have occurred (20X0–20X4).

$$\text{Accumulated depreciation} = 6.14 \times 5 = 30.7$$

- Carrying amount at 1 January 20X5:

$$\text{Carrying amount} = 61.4 - 30.7 = \mathbf{R30.7}$$

3. Adjustment to retained earnings at 1 January 20X5:

Under previous GAAP:

- No decommissioning provision.
- No decommissioning asset.

Under IFRS:

- Provision recognised at 1 January 20X0: R61.4.

- Asset recognised at 1 January 20X0: R61.4.
- Depreciation of asset over 5 years: R30.7.
- Unwinding of discount (interest expense) over 5 years must also be recognised.

Step 1: Provision at 1 January 20X5

The provision grows with unwinding of discount.

$$\text{Provision at 1 January 20X5} = 61.4 \times (1.05)^5$$

$$(1.05)^5 \approx 1.2763$$

$$\text{Provision} \approx 61.4 \times 1.2763 \approx \text{R}78.4$$

Step 2: Impact on retained earnings

- Depreciation expense (20X0–20X4): R30.7 (reduces retained earnings).
- Unwinding of discount (interest expense) over 5 years:

$$\begin{aligned} \text{Total interest} &= \text{Provision at 1 January 20X5} - \text{Initial PV} \\ &= 78.4 - 61.4 = \text{R}17.0 \end{aligned}$$

- Total expense recognised under IFRS over 5 years:

$$30.7 + 17.0 = \text{R}47.7$$

Under previous GAAP, none of these expenses were recognised.

Therefore, at 1 January 20X5:

- Retained earnings must be **decreased** by R47.7.
- PPE (decommissioning asset) is increased by R30.7.
- Provision is increased by R78.4.

Answer:

- Present value of decommissioning provision at 1 January 20X0: **R61.4**.
- Carrying amount of decommissioning asset at 1 January 20X5: **R30.7**.
- Retained earnings decrease at 1 January 20X5: **R47.7**.

2.3 Deemed cost for PPE (IAS 16) on transition

Scenario 3: Entity C owns a building. Under previous GAAP, the building was revalued on **1 January 20X3** to **R500**, and this revaluation is broadly comparable to IFRS fair value. The original cost was R400, and accumulated depreciation at that date was R80 (→ carrying amount R320).

- Date of transition: **1 January 20X5**.
- Useful life of the building: **40 years** from 1 January 20X0.
- No residual value.
- Entity elects to use the **revalued amount (R500) as deemed cost** at 1 January 20X3.

Required:

1. Determine the carrying amount of the building at **1 January 20X5** under IFRS.
2. Explain the impact on retained earnings at 1 January 20X5 compared with previous GAAP.

Solution:

1. Depreciation under IFRS using deemed cost:

- Deemed cost at 1 January 20X3: R500.
- Remaining useful life at 1 January 20X3:
 - Total life: 40 years (from 1 January 20X0).
 - By 1 January 20X3, 3 years have passed.
 - Remaining life: 37 years.
- Annual depreciation from 1 January 20X3:

$$\text{Depreciation per year} = \frac{500}{37} \approx \text{R}13.51$$

- Depreciation for 20X3 and 20X4 (2 years):

$$13.51 \times 2 \approx \text{R}27.02$$

- Carrying amount at 1 January 20X5:

$$500 - 27.02 \approx \text{R}472.98 \text{ (round to R473)}$$

2. Impact on retained earnings:

Under previous GAAP, depreciation would have been based on the revalued amount or original cost depending on local rules. For exam purposes, assume:

- Previous GAAP continued to depreciate based on original cost (R400) over 40 years.
- Annual depreciation under previous GAAP:

$$\frac{400}{40} = \text{R}10$$

- Depreciation for 20X3 and 20X4:

$$10 \times 2 = \text{R}20$$

Under IFRS (using deemed cost):

- Depreciation for 20X3 and 20X4: R27.02.

Difference in depreciation (IFRS vs previous GAAP) over 2 years:

$$R27.02 - R20 = \mathbf{R7.02}$$

Therefore, at 1 January 20X5:

- Retained earnings under IFRS are **lower** by R7.02 compared with previous GAAP (due to higher depreciation).
- PPE carrying amount is **higher** under IFRS (R473 vs what would have been under previous GAAP, namely R360).

Answer:

- Building carrying amount at 1 January 20X5 under IFRS: **R473**.
- Retained earnings under IFRS are lower by **R7** compared with previous GAAP.

3. Integrated case study

3.1 Case facts

Entity D — First-time adoption of IFRS

Entity D previously reported under Local GAAP. It is now preparing its first IFRS financial statements for the year ended **31 December 20X6**, with one year of comparative information (20X5).

- **Date of transition to IFRSs: 1 January 20X5.**

The following information relates to differences between Local GAAP and IFRS:

1. Development costs (IAS 38)

- Under Local GAAP, all development costs were expensed.
- Under IFRS, certain development projects meet the criteria for capitalisation.
- Eligible development costs:
 - Incurred in 20X3: R60
 - Incurred in 20X4: R40
- The project was completed and available for use on **1 January 20X5**.
- Useful life: **5 years** from 1 January 20X5.

2. Decommissioning provision (IAS 37/IAS 16)

- Entity D operates a mine. Under Local GAAP, no decommissioning provision was recognised.
- IFRS requires recognition of a decommissioning provision and inclusion of the related cost in PPE.

- Estimated decommissioning cost at the end of the mine's life (31 December 20X9): **R200**.
- Discount rate: **4%** per annum.
- Mine was put into use on **1 January 20X0** with a useful life of **10 years**.
- 3. **Foreign operation — cumulative translation differences (IAS 21)**
 - Entity D has a foreign subsidiary.
 - Under Local GAAP, cumulative translation differences (CTDs) at 1 January 20X5 were **R50 (debit)** in equity.
 - Entity D elects the **CTD exemption** under IFRS 1 and resets CTDs to zero at the date of transition.
- 4. **Business combination (IFRS 3)**
 - Entity D acquired Subsidiary E on **1 July 20X2**.
 - Under Local GAAP, goodwill of **R150** was recognised and not amortised.
 - Entity D elects **not to restate** this business combination under IFRS 1.
 - Goodwill is tested for impairment at 1 January 20X5; recoverable amount indicates an impairment loss of **R30**.
- 5. **Previous GAAP equity**
 - At 1 January 20X5, equity under Local GAAP was:
 - Share capital: R1,000
 - Retained earnings: R600
 - Foreign currency translation reserve (CTDs): R(50) (debit balance)
 - Total equity: R1,550

3.2 Required

1. Prepare the **IFRS adjustments** at 1 January 20X5 for each of the items (1)–(4).
2. Prepare a **reconciliation of equity** under Local GAAP to equity under IFRS at 1 January 20X5.
3. Explain briefly how these adjustments would be presented in the **IFRS 1 reconciliation note** in the first IFRS financial statements.

3.3 Suggested solution

3.3.1 Development costs (IAS 38)

Step 1: Determine cost of intangible asset

- Eligible development costs: R60 (20X3) + R40 (20X4) = **R100**.
- Asset available for use: 1 January 20X5.

Under IFRS:

- Intangible asset recognised at 1 January 20X5: **R100**.
- No amortisation before 1 January 20X5 (asset not yet available for use).

Under previous GAAP:

- R100 expensed in 20X3 and 20X4.

Adjustment at 1 January 20X5:

- Recognise intangible asset: **Dr Intangible asset R100.**
- Increase retained earnings: **Cr Retained earnings R100.**

3.3.2 Decommissioning provision and PPE (IAS 37/IAS 16)

Step 1: Present value of decommissioning provision at 1 January 20X0

- Decommissioning cost: R200 at 31 December 20X9 (10 years from 1 January 20X0).
- Discount rate: 4%.

$$PV = \frac{200}{(1 + 0.04)^{10}}$$

$$(1.04)^{10} \approx 1.4802$$

$$PV \approx \frac{200}{1.4802} \approx 135.1$$

Initial provision and corresponding increase in asset's cost at 1 January 20X0: **R135.1.**

Step 2: Depreciation of decommissioning asset to 1 January 20X5

- Useful life: 10 years (20X0–20X9).
- Annual depreciation:

$$\frac{135.1}{10} = R13.51$$

- Depreciation for 5 years (20X0–20X4):

$$13.51 \times 5 = R67.55$$

- Carrying amount of decommissioning asset at 1 January 20X5:

$$135.1 - 67.55 = R67.55$$

Step 3: Provision at 1 January 20X5 (unwinding of discount)

$$\text{Provision at 1 January 20X5} = 135.1 \times (1.04)^5$$

$$(1.04)^5 \approx 1.2167$$

$$\text{Provision} \approx 135.1 \times 1.2167 \approx R164.4$$

Step 4: Impact on retained earnings

Under IFRS:

- Depreciation expense (20X0–20X4): R67.55.
- Interest expense (unwinding of discount):

$$164.4 - 135.1 = R29.3$$

- Total expense:

$$R67.55 + R29.3 = R96.85$$

Under previous GAAP:

- No decommissioning asset or provision; no related expenses.

Adjustment at 1 January 20X5:

- Recognise provision: **Dr Retained earnings R96.85** (cumulative expense).
- Recognise PPE (decommissioning asset): **Dr PPE R67.55**.
- Recognise provision: **Cr Provision R164.4**.

(Entries can be split between initial recognition and cumulative expense; for reconciliation, the net effect is what matters.)

3.3.3 Cumulative translation differences (CTDs) exemption

Under Local GAAP:

- CTDs at 1 January 20X5: R(50) (debit balance in equity).

Entity D elects to **reset CTDs to zero** at the date of transition.

Adjustment at 1 January 20X5:

- Remove CTDs balance: **Dr Retained earnings R50**.
- **Cr Foreign currency translation reserve R50** (to eliminate the debit).

Effect:

- CTDs reserve becomes zero.
- Retained earnings decrease by R50.

3.3.4 Business combination — goodwill impairment

Goodwill under previous GAAP: R150 (not amortised).

Entity D elects **not to restate** the business combination. Under IFRS, goodwill is tested for impairment at 1 January 20X5.

Impairment identified: R30.

Adjustment at 1 January 20X5:

- Recognise impairment: **Dr Retained earnings R30.**
- **Cr Goodwill R30.**

Goodwill carrying amount at 1 January 20X5: R120.

3.3.5 Reconciliation of equity at 1 January 20X5

Previous GAAP equity:

- Share capital: R1,000
- Retained earnings: R600
- CTDs (debit): R(50)
- Total equity: R1,550

IFRS adjustments (cumulative effect on equity):

1. **Development costs:**
 - Retained earnings **increase**: +R100
2. **Decommissioning provision and asset:**
 - Retained earnings **decrease**: –R96.85
 - PPE **increase**: +R67.55
 - Provision **increase**: +R164.4
3. **CTDs reset to zero:**
 - Retained earnings **decrease**: –R50
 - CTDs reserve **increase**: +R50 (to eliminate debit; net CTDs = 0)
4. **Goodwill impairment:**
 - Retained earnings **decrease**: –R30
 - Goodwill **decrease**: –R30

Net impact on retained earnings:

$$+100 - 96.85 - 50 - 30 = -R76.85$$

Retained earnings under IFRS at 1 January 20X5:

$$600 - 76.85 = R523.15$$

Equity under IFRS at 1 January 20X5:

- Share capital: R1,000
- Retained earnings: R523.15

- CTDs reserve: R0
- Total equity:

$$1,000 + 523.15 = R1,523.15$$

Reconciliation summary:

- Previous GAAP equity: R1,550
- IFRS adjustments: –R26.85 (difference between 1,550 and 1,523.15)
- IFRS equity: R1,523.15

3.3.6 Presentation in IFRS 1 reconciliation note

In the first IFRS financial statements, Entity D would present:

- **Reconciliation of equity** at 1 January 20X5 (date of transition) from Local GAAP to IFRS, showing:
 - Development costs capitalised (increase in intangible assets and retained earnings).
 - Decommissioning provision and asset (increase in PPE and provision, decrease in retained earnings).
 - CTDs reset to zero (reclassification within equity, impact on retained earnings).
 - Goodwill impairment (decrease in goodwill and retained earnings).
 - **Narrative explanations** of each adjustment, distinguishing:
 - **Changes in accounting policies** (e.g. capitalisation of development costs, recognition of decommissioning provision).
 - **Use of optional exemptions** (e.g. CTDs reset, business combinations not restated).
 - Similar reconciliations for:
 - Equity at 31 December 20X5.
 - Total comprehensive income for the year ended 31 December 20X5 (showing the impact of IFRS adjustments on profit and OCI).
-