

IFRS Foundation

Special Interest Session

First-time Adoption of IFRSs

Wednesday 28 July 2010—at the Mandarin Oriental Hotel (Tokyo)

To provide a comprehensive service for those with a special interest in the first-time adoption of IFRSs the IFRS Foundation will hold an intensive half-day session immediately before their IFRS conference, on the morning of 28 July 2010. The session will focus on the requirements of IFRS 1 First-time Adoption of International Financial Reporting Standards including a first hand experience of implementing IFRSs.

Programme

09:00 ***Registration***

09:30 ***Introduction***

Paul Pacter

*Chairman of the SME Implementation Group and
Member, IASB*

09:35 ***The requirements—first-time adoption of IFRSs (IFRS 1)***

Paul Pacter

*Chairman of the SME Implementation Group and
Member, IASB*

10:45 ***Experience of implementing IFRSs***

Leonardo Ferreira

Partner, Global IFRS and Offerings Services

Deloitte LLP

11:15 ***Round-table Q&A***

Paul Pacter— *Chairman of the SME Implementation Group and*

Member, IASB

Leonardo Ferreira - *Partner, Global IFRS and Offerings Services,*

Deloitte LLP

11:55 ***Concluding comments***

Paul Pacter

*Chairman of the SME Implementation Group and
Member, IASB*



First-time Adoption of IFRSs

IFRS Conference, Tokyo

Paul Pacter
Board Member, IASB
28 July 2010

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Agenda for this morning

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IFRS Conference Tokyo – Special interest Session on First-time Adoption of IFRSs

9:30-9:35	Introduction – Paul Pacter
9:35-10:45	IFRS 1: The Requirements – Paul
10:45-11:15	Experience of Implementing IFRSs – Leonardo Ferreira
11:15-11:55	Round-table Q&A – Paul and Leonardo
11:55-12:00	Concluding Comments – Paul

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Use of International Financial Reporting Standards Around the World

Enhancing Shareholder Value

- **High quality global financial reporting standards – carefully applied – benefit investors, lenders, other capital providers:**
 - Information is understandable
 - Enhance comparability of financial information
 - Capital providers have confidence

Enhancing Shareholder Value

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- **High quality global standards also benefit companies that seek capital:**
 - Reduce their compliance costs
 - Remove uncertainties that affect their cost of capital
- **Improve consistency in audit quality**
- **Facilitate education and training**

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IASB's Objectives

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- **One set of global standards:**
 - International Financial Reporting Standards (IFRSs)
- **Increase number of countries using IFRSs**
- **Separate Standard for SMEs**
 - Based on user needs and cost/benefit

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Use of IFRSs Around the World

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For domestic <u>listed</u> companies:	Number of Jurisdictions
IFRSs required for all	91
IFRSs required for some	6
IFRSs permitted	25

Today, IFRSs are used by listed companies in 122 jurisdictions.

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Use of IFRSs Around the World

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For domestic <u>unlisted</u> (private) companies:	Number of Jurisdictions
IFRSs required for all	25
IFRSs required for some	26
IFRSs permitted	42

Today, IFRSs are used by unlisted companies in 93 jurisdictions.

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Adoption of IFRSs Means All

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- **Ideal: Simply use IFRSs**
 - As issued by IASB. In full.
 - No need for local ‘endorsement’
 - Audit report refers to IFRS
 - But, sovereignty and political issues in some jurisdictions
- **Next best, adopt all IFRSs word for word as national GAAP (local ‘endorsement’):**
 - Sometimes adopted by law
 - Sometimes by professional body

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Issues in Adoption of IFRSs

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- **Problems in local ‘endorsement’:**
 - Tinkering
 - Time delays
 - Cost
 - What does audit report say?
- **Sometimes ‘adapt’ rather than ‘adopt’:**
 - Then this is no longer IFRS
 - Audit report cannot refer to IFRS
 - Financial statements less credible

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Issues in Adoption of IFRSs

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- **Applies to which entities?**
 - Listed companies only?
 - Other 'publicly accountable' (eg banks)?
 - Private (SMEs)?
 - Consolidated statements?
 - Separate company statements also?
 - Mandatory? Optional? Audited?
- **Translation**
- **Enforcement and rigorous implementation**

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Fortune Global 500 (July 2009)

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		Based on announced plans	
Which GAAP?	2009	2013	If Japan 2015
IFRS and word-for-word IFRS equivalents	38%	49%	63%
US GAAP	31%	31%	28%
National GAAP	31%	20%	9%
Totals	100%	100%	100%

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Fortune Global 500 (July 2009)

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Increases from 2009 to 2013 (listed companies):

	Switch to IFRSs	No. of G500 co's
Brazil	2010	6
Canada	2012	14
India	2012	7
Malaysia	2012	1
Mexico	2012	4
Singapore	2012 (near IFRS now)	2
South Korea	2011	14
Taiwan	2013	6

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Fortune Global 500 (July 2009)

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After 2013, remaining non-IFRS (listed companies):

	Comments	No. G500 co's.
China	Has adopted main principles from IFRSs	37
Japan	Seriously considering 2015 or 2016	68 (51 J-GAAP & 17 US GAAP)
Russia		8
Saudi Arabia		1
Thailand		1
USA	SEC Roadmap	140

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First-Time Adoption of IFRSs as Your National Standards

Definition of First-time Adoption (FTA)

- **First set of financial statements in which the entity makes an “explicit and unreserved statement of compliance with IFRSs”:**

“...in conformity with International Financial Reporting Standards...”

Two Key Steps

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1. Select accounting policies based on IFRSs in force at end of reporting period of FTA:

- Assume 31 December 2012 for this presentation

2. Prepare at least two years financial statements, and opening balance sheet for the earliest year, using those policies

- Therefore, financial statements for 2012 and 2011 and opening balance sheet at 1 Jan 2011

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Selecting Initial IFRS Accounting Policies

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- **Criteria for selecting accounting policies:**
 - Relevance
 - Reliability
- Many accounting policy decisions depend on circumstances – not “free choice”
- But some are pure “free choice”

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Selecting Initial IFRS Accounting Policies

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- **A few examples of decisions that depend on circumstances:**
 - % of completion versus completed contract
 - Method of depreciation
 - Specific identification or FIFO for inventories
 - Whether to adjust the financial statements for events occurring after end of period
 - Functional currency for translation
 - Whether a transfer of financial instruments is a “sale” or a “collateralised borrowing”

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Selecting Initial IFRS Accounting Policies

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- **A few examples of decisions that depend on circumstances (continued):**
 - Whether to use a pricing model or intrinsic value to measure stock options
 - Whether to separate assets and liabilities into current or noncurrent on the balance sheet
 - Whether to account for an item of equipment in its entirety or by component
 - Whether to measure agricultural assets at fair value through profit or loss

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Selecting Initial IFRS Accounting Policies

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- **On the other hand, IFRSs allow quite a few accounting policy choices that do not depend on circumstances:**
 - **First-time adopters must choose**
 - **Examples on next ten slides**

Accounting Policy Options in IFRSs

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- **IFRS 1 – Options for whether to restate prior periods for some types of transactions at time of FTA:**
 - **I will cover these in detail later in my presentation**
- **IFRS 3 – In an acquisition of less than 100%, measure 100% of goodwill or only parent's share of goodwill**

Accounting Policy Options in IFRSs

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- **IFRS 4** – Option to re-measure insurance liabilities to fair value each period
- **IAS 1** – Present expenses in income statement by nature or by function
- **IAS 1** – One statement of comprehensive income or separate income statement and comprehensive income statement

Note: IASB has proposed to drop the 2-statement option

Accounting Policy Options in IFRSs

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- **IAS 2** – Option to measure inventories such as agricultural produce, minerals, and commodities at net realisable value rather than cost
- **IAS 2** – Inventories at FIFO or weighted average (but LIFO is prohibited)

Accounting Policy Options in IFRSs

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- **IAS 7** – Direct or indirect method for presenting operating cash flows
- **IAS 7** – Option to classify interest and dividends as operating, investing, or financing

Accounting Policy Options in IFRSs

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- **IAS 16** – Measure PP&E using cost-depreciation model or revaluation through equity model
- **IAS 19** – Range of options for recognising actuarial gains and losses (immediately in P&L, immediately in OCI, various ways of spreading)
 - Note: IASB has proposed to stop spreading
- **IAS 20** – Many options for government grants

Accounting Policy Options in IFRSs

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- **IAS 27-28-31** – In separate financial statements, choose cost or fair value for investments in subsidiaries, associates, joint ventures
- **IAS 31** – Equity method or proportionate consolidation for joint ventures
- **IAS 38** – Cost-depreciation model or revaluation through equity model for intangible assets with quoted market prices

Accounting Policy Options in IFRSs

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- **IAS 39** – Hedge accounting is optional
- **IAS 39** – Designate individual financial assets and financial liabilities to be measured at fair value through profit or loss
- **IAS 39** – Option to designate non-trading instruments as available for sale

- **IAS 39** – Option not to separate an embedded derivative and, instead, account for the entire contract at fair value through P&L
- **IAS 39** – Choice of trade date or settlement date accounting

- **IAS 39** – Choose whether to adjust the carrying amount of a hedged item for gains or losses on the hedging instrument
- **IAS 39** – Option to reclassify out of fair-value-through-P&L and out of available-for-sale

Accounting Policy Options in IFRSs

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- **IAS 40** – For investment property, choose the cost-depreciation model or fair value through profit or loss model
- **IAS 40** – Whether to treat land use rights as investment property

Adjustments Required to Move to IFRSs

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- **Five kinds of adjustments from national GAAP to IFRSs:**
 1. Derecognise some old assets and liabilities
 2. Recognise some new assets and liabilities
 3. Reclassifications
 4. Measurement changes
 5. New disclosures

1. Derecognise some old assets and liabilities. Examples:

- No capitalised research, training, pre-operating, or advertising costs
- No accrued liabilities for general reserves, future losses, and most restructurings

2. Recognise some new assets and liabilities. Examples:

- Derivatives and embedded derivatives
- Obligations for defined benefit pension, retiree medical and life insurance, termination benefits, accrued vacation
 - If plan is 'over-funded' employer would have a pension asset

continued...

2. Recognise some new assets and liabilities (more examples):

- Deferred tax assets and liabilities
- Provisions (liabilities) for onerous contracts, litigation, decommissioning, environmental, warranties
- Capitalise development costs
- Capitalise borrowing costs during construction

3. Reclassifications. Examples:

- Dividends declared after balance sheet date are not liabilities
- Treasury stock is not an asset
- Separation of land and buildings acquired jointly
- Liability versus equity:
 - Mandatorily redeemable preferred shares and puttables are a liability
 - Minority interest is in equity

continued...

3. Reclassifications. More examples:

- Equity component of convertible debt, if still outstanding at FTA date
- Defining reportable segments under IFRS 8
- Scope of consolidation
- Some offsetting
- Assets held for sale
- Discontinued operations

4. Measurement changes:

- Measurement principles in IFRSs at 31 Dec 2012 must be applied to measure all recognised assets and liabilities at date of FTA
 - More fair value measurements
 - More present value

4. Measurement changes – examples of differences between IFRSs and US GAAP:

- Share-based payments
- Noncontrolling interest in bus. comb.
- LIFO prohibited under IFRSs
- Reversals of writedowns under IFRSs
- IFRSs allow revaluation of PP&E
- Agricultural assets at FV thru P&L
- Immediately recognise past service cost

4. Measurement changes – examples of differences between IFRSs and US GAAP:

- Definition of borrowing costs
- Must conform subs' accounting policies
- Proportionate consolidation
- Expected value for provisions
- Fair value options for FI are different
- IFRS has no 'shortcut method'
- Investment property at FV thru P&L

5. New disclosures – examples of IFRS requirements:

- Specific line items in financial statements
- One-year comparative information
- Segment liabilities

- **Adjustments to move from previous GAAP to IFRSs at FTA:**
 - Should be recognised directly in retained earnings or, if appropriate, another category of equity, at the date of the opening IFRS balance sheet.

Exceptions to Restatement

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- **There are some exceptions to the requirement to restate comparative data using IFRSs at 31 Dec 2012:**
 - Some exceptions are optional
 - Some exceptions are mandatory

Optional Exceptions

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- **Business Combinations:**
 - May keep old GAAP. Need not restate:
 - Initial measurement of goodwill
 - Goodwill written off against equity
 - Carrying amounts of acquired assets and liabilities
 - However, entity may elect to restate old business combinations back to any starting date
 - Must test goodwill for impairment at opening balance sheet date

- **Property, plant and equipment:**
 - May measure at FV at 1/1/2011. This becomes ‘deemed cost’ going forward
 - Also, revaluations under old GAAP can be deemed cost at 1/1/2011
- **Employee benefits:**
 - Can eliminate any deferred actuarial gains and losses under old GAAP even if the entity will continue to use the corridor approach in future

- **Cumulative foreign currency translation adjustments:**
 - Any amount deferred in equity under old GAAP can be eliminated (adjust retained earnings) at 1 Jan 2011
 - If eliminated, gain or loss on future disposal of the foreign operation reflects only translation adjustments arising after 1 Jan 2011

Optional Exceptions

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- **'Split accounting' for convertible debt redeemed before 1 Jan 2011**
- **Entity may designate financial instrument as available-for-sale or fair-value-option at 1 Jan 2011**
 - IAS 39 allows designation only on date instrument is acquired
- **Need not apply IFRS 2 to share-based payments issued before 1 Jan 2011**

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Optional Exceptions added July 2009

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- **Full-cost oil and gas assets**
 - Retrospective application of IFRSs for oil and gas assets is not required. Carrying amount under old GAAP = deemed cost
- **Determining whether an arrangement contains a lease (IFRIC 4)**
 - Determination under old GAAP need not change even if at a date different from what IFRIC 4 would require

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Optional Exceptions

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- **In general IAS 1 requires comparative information for all amounts in financial statements and in the notes**
 - Exemptions for some comparative information for financial instruments (including IFRS 7), insurance contracts, extractive industries, and historical summaries

Mandatory Exceptions

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- **Derecognition of financial assets and liabilities:**
 - Do not “undo” past derecognitions based on new information.
- **Hedge accounting**
 - No new designation of hedge accounting for hedges prior to 1 Jan 2011 if not treated as hedges under old GAAP
- **Estimates**
 - Do not change previous estimates unless there was an error

• **Reconciliations**

1. Of equity at date of transition and at end of latest annual local GAAP statements
 - If IFRSs adopted in 2012, would need reconciliation as of 1/1/11 and 1/1/12
2. Of total comprehensive income under old GAAP to amounts under IFRSs for latest annual local GAAP statements
 - Would need reconciliation for 2011
 - See example – next 5 slides

Example: Reconciliation of Equity at Date of Transition (page 1 of 2)

	Note	Previous GAAP	Adjustment	IFRS
Cash		748	0	748
Trade receivables		3,710	0	3,710
Inventories	4	2,962	400	3,362
Other receivables	5	333	431	764
Total current assets		7,753	831	8,584
Financial assets	3	3,471	420	3,891
Property, plant & equipment	1	8,299	100	8,399
Intangible assets	2	208	(150)	58
Goodwill	2	1,220	150	1,370
Total noncurrent assets		13,198	520	13,718
Total assets		20,951	1,351	22,302

Example: Reconciliation of Equity at Date of Transition (page 2 of 2)

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	Note	Previous GAAP	Adjustment	IFRS
Interest-bearing loans		9,396	0	9,396
Trade and other payables		4,124	0	4,124
Pension liability	6	0	66	66
Restructuring provision	7	250	(250)	0
Current tax liability		42	0	42
Deferred tax liability	8	579	460	1,039
Total Liabilities		14,391	276	14,667
Issued capital		1,500	0	1,500
Cash flow hedging 'reserve'	5	0	302	302
Retained earnings	9	5,060	773	5,833
Total Equity		6,560	1,075	7,635
Total Liabilities and Equity		20,951	1,351	22,302

Example: Reconciliation of Equity – Notes

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1	Depreciation had been based on local tax law.
2	Training cost 150 was recognised as an acquired asset in an earlier business combination. Transferred to goodwill under IFRS.
3	Financial assets are all FVTPL under IFRS but were at amortised cost under local GAAP.
4	Overhead 400 had been excluded from inventory under local GAAP.
5	Unrealised gain 431 on FX forward is recognised, less related deferred tax 129, credit to hedging reserve 302.
6	Pension liability of 66 is recognised under IFRS but not local GAAP.
7	Restructuring provision cannot be accrued under IFRS.
8	The above adjustments increased deferred tax liability by 460 net.
9	Net after-tax effect of all of the above on retained earnings is 773.

 IFRS™

Example: Reconciliation of Comprehensive Income

	Note	Previous GAAP	Adjustment	IFRS
Revenue		20,910	0	20,910
Cost of sales	1,2,3	(15,283)	(97)	(15,380)
Gross Profit		5,627	(97)	5,530
Other income	6	0	180	180
Distribution costs	1	(1,907)	(30)	(1,937)
Administrative expenses	1,4	(2,842)	(300)	(3,142)
Finance income		1,446	0	1,446
Finance costs		(1,902)	0	(1,902)
Profit before tax		422	(247)	175
Tax expense	5	(158)	74	(84)
Profit (loss) for the year		264	(173)	91
OCI: Cash flow hedge	7	0	(40)	(40)
Tax relating to OCI	8	0	(29)	(29)
Other comprehensive income		0	(69)	(69)
Total comprehensive income		264	(242)	22

Example: Reconciliation of Comprehensive Income – Notes

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- 1 Increase in pension liability of 130 during the year resulted in increases in cost of sales (50), distribution cost (30), and administrative expense (50).
- 2 Cost of sales 47 higher under IFRS due to including overhead.
- 3 The adjustment of depreciation did not have a material effect on profit.
- 4 Reversal of 250 restructuring provision increased admin. expense.
- 5 Adjustments 1-4 above reduced deferred tax expense by 128.
- 6 Increase in FV of financial assets of 180 is in other income.
- 7 Fair value FX derivative decreased by 40.
- 8 Adjustments 6-7 above increased deferred tax expense by 29.

- **Newly recognised impairment losses**
- **Material adjustments from old cash flow statement to IAS 7 cash flow statement**

- **Depends on each company's situation**
- **And date of transition to IFRSs**
- **Here are some examples of potential adjustments if Japan adopted IFRSs today:**
 1. Report discontinued operations separately
 2. Remeasure depreciation to reflect pattern of using up the benefits of the asset
 3. Recognise impairment of PP&E if discounted cash flows are less than carrying amount
 4. Must capitalise borrowing costs

What will be the impact in Japan?

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- **More potential adjustments:**
 5. Measure identifiable assets and liabilities acquired in a business combination at their fair values, not at acquiree's book values
 6. Do not capitalise start-up and reorganisation costs
 7. Measure provisions using expected values
 8. Do not defer past service cost for retirees
 9. Do not deduct minority interest in measuring Profit or Loss.

What will be the impact in Japan?

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- **More potential adjustments:**
 10. Reverse impairment of financial instruments if original cause for decline has now changed
 11. More fair value hedges, fewer cash flow hedges
 12. Cannot amortise goodwill (J-GAAP is 20 years)
 13. Capitalise certain development costs
 14. Insurance companies cannot accrue provisions for catastrophe losses

What will be the impact in Japan?

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Some of these differences may disappear due to ASBJ convergence projects, or due to changes to IFRSs, between now and when IFRSs might be adopted in Japan.

Thank you for your attention

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Q&A session after Leonardo's presentation

Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.

