Project	**Annual Improvements**
Topic	**IFRS 1 – Accounting policy changes in the year of adoption**

Background

1. IFRS 1 *First-time Adoption of IFRS* requires an entity to use the same accounting policies in its opening IFRS statement of financial position and throughout all periods presented in its first IFRS financial statements. Those financial statements must comply with each IFRS effective at the end of its first IFRS reporting period, with specified exceptions (IFRS 1.7).

2. IAS 34 *Interim Financial Reporting* requires an entity to apply the same accounting policies in its interim financial statements as are applied in its annual financial statements except for accounting policy changes made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements (IAS 34.28).

3. Paragraph 27 of IFRS 1 (revised in 2008) states:

> IAS 8 does not deal with changes in accounting policies that occur when an entity first adopts IFRSs. Therefore, IAS 8's requirements for disclosures about changes in accounting policies do not apply in an entity's first IFRS financial statements.

4. The Board received a request to clarify whether a first-time adopter is exempt from all the requirements of IAS 8 for the interim and annual periods presented in its first IFRS financial statements. If IAS 8 does not apply, what, if any, requirements apply if an entity changes its accounting policies between the first interim financial statements it presents in accordance with IFRSs and the first annual financial statements? In addition, although this was not part of the clarification requested, a similar question arises with respect to changes an entity might make in the IFRS 1 exemptions it chooses to apply.

Objective of this paper

5. This paper considers whether this issue meets the criteria to be included in the annual improvements project and how the standard might be amended to make its requirements clear. Staff recommendations on both questions are included.

Staff analysis

General

6. The Board's approach in developing IFRS 1 was to place all the requirements unique first-time adopters (FTAs) in a separate standard. The Board's benchmark in developing the standard was an entity that plans the transition well in advance and can collect most information needed for its opening IFRS statement of financial position at, or very soon after, the date of transition to IFRSs.

7. The Board also decided that achieving comparability over time within an FTA's first IFRS financial statements and between different entities adopting IFRSs for the first time at a given date was the primary objective of the standard. Therefore, as noted in paragraph 1, IFRS 1.7 requires an FTA to use the same accounting policies in all periods presented in its first IFRS financial statements.

8. In the staff's view, the general exemption from IAS 8 included in IFRS 1.27 (paragraph 3) was meant to apply to the policy changes an FTA makes in switching from previous GAAP to IFRSs. That is, IAS 8 was designed for changes in individual accounting policies rather than a change in an entity's accounting framework. Given the Board's benchmark of an entity that plans its transition well in advance, it would not have expected an FTA to be changing accounting policies between periods in the year of its first IFRS financial statements.

9. Instead of the IAS 8 disclosures for changes in accounting policies, IFRS 1 substituted its own requirements for an entity to explain how the transition from a different accounting framework to IFRSs affected its reported financial position, results and cash flows. In particular, IFRS 1 requires reconciliations of profit or loss and of equity reported under previous GAAP to those under IFRSs

at both the date of transition to IFRSs and the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP.

10. However, the wording of IFRS 1.27 clearly states that IAS 8 does not apply to accounting policy changes during the first IFRS reporting period. The balance of IFRS 1 provides no guidance should such changes occur.

Practice guidance

11. The staff reviewed the IFRS publications of the four major international accounting networks. Three publications specifically discuss this issue. The discussion is reproduced in Appendix A. Although the general approach is similar, the guidance differs in some respects.

12. The firm publications identify two situations in which an entity may change accounting policies during the year of first time adoption:

    (a) a new standard or interpretation is issued that permits early application and the entity decides to apply it early, and

    (b) the entity decides to change a policy voluntarily.

13. In the first case, the new standard or interpretation will include consequential amendments to IFRS 1 if special transitional requirements apply to FTAs. More questions arise if the change is voluntary, such as whether the entity must demonstrate that the new policy is in some way 'more appropriate'.

14. However, from the questions received and the different guidance provided in the firm publications, the staff believes that IFRS 1 should be amended to clarify its requirements in this situation. The staff is also of the view that this amendment should be made as part of the 2009 annual improvements project. It is necessary but not urgent, and it will not be included in any of the Board's major projects.

Question 1
Based on the analysis in paragraphs 6 to 14, the staff recommends that IFRS 1 be amended to clarify its requirements when an entity changes its accounting policies during the year of first time adoption. Does the Board agree? Does the Board agree with the staff's recommendation to include the amendment in the annual improvements project?

Proposed amendment

15. The staff considered proposing an amendment to IAS 34 as the issue arises when an entity prepares and publishes interim financial reports during its year of adoption. However, in keeping with the Board's approach, we concluded that it was better to keep all of the guidance on first-time adoption within IFRS 1.

16. The staff also concluded that IFRS 1 should continue to specify the required disclosures relating to first-time adoption and an entity's transition to IFRSs rather than referring to IAS 8. However, we think IFRS 1.27 should be amended to explicitly state that:

    (a) IAS 8 does not apply both to the entity's selection of accounting policies at the date of transition to IFRSs and to any changes to those policies made up to the date of the first annual IFRS financial statements, and

    (b) all of IAS 8's requirements related to changes in accounting policies do not apply, rather than only its disclosure requirements.

17. The staff agrees with the firms' guidance that an entity that changes its accounting policies during the year of adoption should restate the reconciliations of profit or loss and of equity that it provides in accordance with paragraphs 24 and 32 of IFRS 1, as well as comparative amounts presented in its interim financial reports in accordance with IAS 34.

18. As noted in paragraph 4, the staff believes that a similar issue arises if an entity changes the IFRS 1 exemptions it chooses to use during the year of first time adoption. Some constituents are concerned that entities may not be aware of the alternatives available when they prepare unaudited interim financial reports during the year of first time adoption and thus may not make fully informed choices. Consequently, they may wish to apply IFRS 1 differently as of the date of transition when they prepare their first annual IFRS financial statements.

19. The staff notes the principle in IAS 34 that frequency of reporting should not affect the outcome. An entity with no obligation for interim reporting would have until the preparation of its first annual IFRS financial statements to finalise its transition in accordance with IFRS 1. The staff thinks this ability should be available to all entities provided that the disclosure of changes as proposed by the staff in Appendix B is complete. Therefore the staff proposes to make this

explicit as part of an amendment to IFRS 1 with respect to accounting policy choices.

Question 2
Based on the analysis in paragraphs 15 to 19, the staff recommends that IFRS 1 be amended as follows: a) amend paragraph 27 as set out in paragraph 16 above, and b) add paragraph 27A and amend paragraph 32 so that the reconciliations required by paragraphs 27 and 32 must be updated for changes the entity makes during the year of first time adoption in accounting policies and in transitional choices made in accordance with IFRS 1. Does the Board agree?

20. Proposed drafting of the amendment is included in Appendix B.

Appendix A

Guidance from firm publications

Ernst & Young

3.6 Changes in IFRS accounting policies before first IFRS financial statements

A1. Some first-time adopters find that they need to change their IFRS accounting policies after they have prepared an IFRS interim report but before their first IFRS financial statements. Normally when an entity changes an accounting policy, it should apply IAS 8 to such a change. However, IFRS 1 specifically states that 'IAS 8 does not deal with changes in accounting policies that occur when an entity first adopts IFRSs.' Instead, the standard requires that a first-time adopter should apply the same accounting policies in its opeining IFRS balance sheet and throughout all periods presented in its first IFRS financial statements. Therefore, the change in accounting policies should be treated as a change in the entity's IFRS opening balance sheet and the policy should be applied consistently in all periods presented under IFRS. In our view, additional disclosures about the nature of the change in accounting policies would generally be appropriate under IAS 1.

KPMG

Accounting policies (6.1.40.40 to 6.1.40.60)

A2. The IFRS accounting policies applied by a first-time adopter in the preparation of an entity's first IFRS interim financial statements may differ from those applied in the preparation of its first annual IFRS financial statements. Differences may arise because new standards or interpretations have been issued between the date of approval of the interim financial information and the approval of the fist annual IFRS financial statements or, rarely, because management reconsiders the IFRS accounting policies that will be applied in preparing its first annual IFRS financial statements.

A3. In our view, IFRS 1 applies to all selections of accounting policies in the first annual IFRS financial statements and to the application and disclosure of those policies. If different policies were applied in the preparation of interim financial statements for part of a period covered by the first annual IFRS financial statements, then IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors is not applicable. This view applies whether the interims were prepared in accordance with IAS 34 Interim Financial Reporting or another basis of preparation, for example using only the recognition and measurement principles of IFRSs as appropriate for interim reporting. It may be appropriate to disclose in the fist annual IFRS financial statements such differences in accounting policy, alongside information provided on the effect of transition to IFRSs.

A4. Notwithstanding our view that changes in accounting polices between an entity's first interim and first annual financial statements are not within the scope of IAS 8, generally it would be expected, and may be requested by some regulators, that the policies adopted in the first annual financial statements be more appropriate, for example on the basis of evolving best practice. When considering whether the policy is more appropriate, the criteria for voluntary changes in accounting policy in IAS 8 may be useful guidance.

PricewaterhouseCoopers

Example 2 – Change in accounting policies during year of first time adoption (page 3008)

A5. Entity B is a first-time adopter of IFRS and prepares its first IFRS financial statements for the year ending 31 December 20X7. It has already published its first interim results to 30 June 20X7 in accordance with IAS 34, 'Interim financial reporting', and IFRS 1, 'First-time adoption of International Financial Reporting Standards'. The interim financial report included the reconciliations of profit or loss and of equity that are required by paragraph [45] of IFRS 1.

A6. Since publishing the interim financial report, entity B's management has concluded that one of entity B's accounting policy choices applied at the interim should be changed for the full year to bring entity B into line with the policy choices taken by its main competitors. Should entity B's management apply IAS 8, 'Accounting policies, changes in accounting estimates and errors', when reflecting and describing this change in the financial statements for the year ending 31 December 20X7?

A7. No. The first annual IFRS financial statements are prepared in accordance with the specific requirements of IFRS 1. Subject to certain specified exceptions, paragraph 7 of IFRS 1 requires that entity B uses the same accounting policies in its opening IFRS balance sheet and throughout all period presented. This overrides IAS 8's provisions about changes in accounting policies. Paragraph [42] of IFRS 1 also explains that IAS 8's requirements for disclosures about changes in accounting policies do not apply in an entity's first IFRS financial statements.

A8. Entity B should include in the notes to the financial statements an explanation of the change in policy that it has made since the interim report. The disclosure note is likely to include information similar to what IAS 8 would otherwise require to help users of the financial statements understand the changes that have been made. Entity B should also ensure that the reconciliations of profit or loss and of equity presented in the first IFRS financial statements in accordance with paragraph [39] of IFRS 1 are updated from those included in the interim report to reflect the amended accounting policy.

Appendix B

Proposed drafting of the amendment to IFRS 1

Paragraphs 27 and 32 are amended (new text is underlined and deleted text is struck through). Paragraph 27A is added.

27. IAS 8 does not ~~deal with~~ <u>apply to the</u> changes in accounting policies ~~that occur when~~ an entity <u>makes when it</u> adopts IFRSs<u> or to changes in those policies until it presents its first IFRS financial statements</u>. Therefore, IAS 8's requirements ~~for disclosures~~ about changes in accounting policies do not apply in an entity's first IFRS financial statements.

27A. If during the period covered by its first IFRS financial statements, an entity changes its accounting policies or its use of the exemptions contained in this IFRS, it shall explain the changes in accordance with paragraph 23 and update the reconciliations required by paragraph 24(a) and (b).

32. To comply with paragraph 23, if an entity presents an interim financial report in accordance with IAS 34 for part of the period covered by its first IFRS financial statements, the entity shall satisfy the following requirements in addition to the requirements of IAS 34:

(a) Each such interim financial report shall, if the entity presented an interim financial report for the comparable interim period of the immediately preceding financial year, include:

(i) a reconciliation of its equity in accordance with previous GAAP at the end of that comparable interim period to its equity under IFRSs at that date; and

(ii) a reconciliation to its total comprehensive income in accordance with IFRSs for that comparable interim period (current and year-to-date). The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for that period or, if an entity did not report such a total, profit or loss in accordance with previous GAAP.

(b) In addition to the reconciliations required by (a), an entity's first interim financial report in accordance with IAS 34 for part of the period covered by its first IFRS financial statements shall include the reconciliations described in paragraph 24(a) and (b) (supplemented by the details required by paragraphs 25 and 26) or a cross-reference to another published document that includes these reconciliations.

(c) <u>If during the period covered by its first IFRS financial statements, an entity changes its accounting policies or its use of the exemptions contained in this IFRS, it shall explain the changes in accordance with paragraph 23 and update the reconciliations required by this paragraph.</u>