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Project **IFRS 10 Transitional requirements**

Topic **Meaning of 'the date of initial application'**

Purpose of the paper

1. The IFRS Interpretations Committee received a request to clarify the meaning of the 'date of initial application' in the transitional requirements of IFRS 10 *Consolidated Financial Statements*. IFRS 10 does not provide a definition of the date of initial application and the submission notes that the definition of the date of initial application is not consistent in the IFRS literature.

2. The issue is whether the date of initial application in IFRS 10 is:

   (a) the beginning of the first reporting period in which the entity adopts this standard (ie the current period), or

   (b) the beginning of the earliest period presented in the first financial statements in which the entity adopts this standard.

3. In other words, for a 31 December year-end reporter that applies IFRS 10 for the first time in 2013 (no early application) and that reports a one-year comparative period, some wonder whether the date of initial application is 1 January 2013 or 1 January 2012.

4. The date of initial application is the date on which an investor assesses whether it controls an entity under the provisions of IFRS 10. The investor is not required to make adjustments to the accounting for its involvement with entities when the conclusion on control has not changed between IAS 27 *Consolidated and Separate Financial Statements* and IFRS 10 at the date of initial application.

Meaning of ‘the date of initial application’ in IFRS 10 according to the IASB staff

5. The intention of the staff when writing the transitional requirements in IFRS 10 was that the date of initial application is the beginning of the first reporting period in which the entity adopts this standard, ie 1 January 2013 for a 31 December year-end reporter that applies IFRS 10 for the first time in 2013 (no early application).

Diversity in practice on the meaning of ‘the date of initial application’ in IFRS 10

6. There are divergent interpretations of the meaning of the date of initial application in IFRS 10. The question has been raised by different parties. We note that the view put forward by one audit firm in their publications is that the date of initial application of IFRS 10 is ‘the beginning of the earliest period presented in the financial statements in the period that IFRS 10 is applied for the first time’, ie 1 January 2012. We are currently conducting outreach activities with the interested party and will provide further information to the Committee at the next meeting.

Staff recommendation

7. We recommend that the Committee should suggest to the Board that it should add a definition of ‘the date of initial application’ to IFRS 10. The definition of the date of initial application would be ‘the beginning of the first reporting period in which the entity adopts IFRS 10’.

8. This amendment could be addressed through the Annual improvements process. A final standard for the next project cycle is expected at the earliest by the beginning of 2013, with an effective date after 1 January 2013. The clarification would be made available through the ED which would be published in the first half of 2012.

Assessment against the new annual improvements criteria

9. We have assessed the proposed amendment to IFRS 10 against the enhanced annual improvements criteria, which are reproduced in full below:

In planning whether an issue should be addressed by amending IFRSs within the annual improvements project, the IASB assesses the issue against the following criteria. All criteria (a)–(d) must be met to qualify for inclusion in annual improvements.

(a) The proposed amendment has one or both of the following characteristics:

(i) clarifying–the proposed amendment would improve IFRSs by:

- clarifying unclear wording in existing IFRSs, or
- providing guidance where an absence of guidance is causing concern.

A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle.

(ii) correcting–the proposed amendment would improve IFRSs by:

- resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirement should be applied, or.
- addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs.

A correcting amendment does not propose a new principle or a change to an existing principle.

Staff analysis—this criterion is satisfied. There is a need for clarification of the transitional requirements in IFRS 10.

(b) The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.

Staff analysis—this criterion is satisfied. The issue is sufficiently narrow to ensure that the proposed change has been considered sufficiently and identified.

(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach a conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.

Staff analysis—this criterion is satisfied. We think that the Board should be in a position to provide a definition of the date of initial application in IFRS 10 on a timely basis.

(d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.

Not applicable.

Question for the Committee
1. Does the Committee agree with the staff recommendation to address this issue through the Annual improvements process? 2. If the Committee does not agree, does the Committee think that this issue should be addressed through a separate amendment with an effective date before the effective date of IFRS 10?

Appendix A: search in the IFRS literature

A1. We searched for the following words in the IFRS literature:

(a) 'date of initial application',

(b) 'date of application',

(c) 'initial application',

(d) 'date of transition'.

Search for 'date of initial application'

Standards in which the date of initial application is the beginning of the earliest period presented in the first financial statements in which the entity adopts this standard

A2. The date of initial application is defined that way only in IAS 19 R *Employee Benefits* published in June 2011.

> IAS 19 R (paragraph 173 a): 'The date of initial application is the beginning of the earliest period presented in the first financial statements in which the entity adopts this standard'.

Standards in which the date of initial application is NOT the beginning of the earliest period presented in the first financial statements in which the entity adopts this standard

A3. In IFRS 9 *Financial Instruments*, the date of initial application is the beginning of the first reporting period in which the entity adopts this IFRS, for entities initially applying this IFRS on or after 1 January 2011.

> IFRS 9 (paragraph 7.2.2): 'For the purposes of the transition provisions in paragraphs 7.2.1 and 7.2.3–7.2.16, the date of initial application is the date when an entity first applies the requirements of this IFRS. The date of initial application may be:
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> (a) any date between the issue of this IFRS and 31 December 2010, for entities initially applying this IFRS before 1 January 2011; or
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> (b) the beginning of the first reporting period in which the entity adopts this IFRS, for entities initially applying this IFRS on or after 1 January 2011.'

A4. IFRS 7 *Financial Instruments: Disclosures* (par. 44I and 44M) and IAS 32 *Financial Instruments: Presentation* (BC 74) also refer to the date of initial application.

A5. In IFRS 7, our understanding is that the date of initial application is the same as in IFRS 9.

> IFRS 7 44I: 'When an entity first applies IFRS 9, it shall disclose for each class of financial assets at the <u>date of initial application:</u>
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> (a) the original measurement category and carrying amount determined in accordance with IAS 39;
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> (b) the new measurement category and carrying amount determined in accordance with IFRS 9;
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> (c) the amount of any financial assets in the statement of financial position that were previously designated as measured at fair value through profit or loss but are no longer so designated, distinguishing between those that IFRS 9 requires an entity to reclassify and those that an entity elects to reclassify.
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> IFRS 7 44M: 'Disclosures—Transfers of Financial Assets (Amendments to IFRS 7), issued in October 2010, deleted paragraph 13 and added paragraphs 42A–42H and B29–B39. An entity shall apply those amendments for annual periods beginning on or after 1 July 2011. Earlier application is permitted. If an entity applies the amendments from an earlier date, it shall disclose that fact. An entity need not provide the disclosures required by those amendments for any period presented that begins before the <u>date of initial application</u> of the amendments.'

A6. In IAS 32, our understanding is that the date of initial application is the beginning of the first reporting period in which the entity adopts this IFRS. We have reproduced below the paragraphs relating to this issue. It is interesting to note that the words 'date of application' are also used, with the same meaning as 'date of initial application'.

A7. The word 'transition' is also used in BC 74. In our view, it means in this context that 'transition' is the beginning of the earliest period presented (there is no requirement to separate such compound instruments on transition if the liability component is no longer outstanding on the date of initial application).

> IAS 32 96A: 'Puttable Financial Instruments and Obligations Arising on Liquidation (Amendments to IAS 32 and IAS 1), issued in February 2008, required financial instruments that contain all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D to be classified as an equity instrument, amended paragraphs 11, 16, 17–19, 22, 23, 25, AG13, AG14 and AG27, and inserted paragraphs 16A–16F, 22A, 96B, 96C, 97C, AG14A–AG14J and AG29A. <u>An entity shall apply those amendments for annual periods beginning on or after 1 January</u>

> 2009. Earlier application is permitted. If an entity applies the changes for an earlier period, it shall disclose that fact and apply the related amendments to IAS 1, IAS 39, IFRS 7 and IFRIC 2 at the same time.'
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> 97C: 'When applying the amendments described in paragraph 96A, an entity is required to split a compound financial instrument with an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation into separate liability and equity components. If the liability component is no longer outstanding, a retrospective application of those amendments to IAS 32 would involve separating two components of equity. The first component would be in retained earnings and represent the cumulative interest accreted on the liability component. The other component would represent the original equity component. Therefore, an entity need not separate these two components if the liability component is no longer outstanding at the date of application of the amendments.'
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> BC74: 'The Board took the view that, in most cases, entities should be able to apply the amendments retrospectively. The Board noted that IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors provides relief when it is impracticable to apply a change in accounting policy retrospectively as a result of a new requirement. Furthermore, the Board took the view that the costs outweighed the benefits of separating a compound financial instrument with an obligation to deliver a pro rata share of the net assets of the entity only on liquidation when the liability component is no longer outstanding on the date of initial application. Hence, there is no requirement on transition to separate such compound instruments.'

Search for 'date of application'

A8. The words 'date of application' are used in IAS 32 (see above) and in IAS 39 (paragraph 108).

A9. In IAS 39, our understanding is that the date of application is the beginning of the first reporting period in which the entity adopts this IFRS. It should also be noted that IAS 39 paragraph 108 uses the words 'beginning of the financial year in which this Standard is first applied'. We have reproduced below the paragraphs relating to this issue.

> IAS 39 80 (last sentence): 'In addition, the foreign currency risk of a highly probable forecast intragroup transaction may qualify as a hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss.'

IAS 39 108: ‘An entity shall not adjust the carrying amount of non-financial assets and non-financial liabilities to exclude gains and losses related to cash flow hedges that were included in the carrying amount before the beginning of the financial year in which this Standard is first applied. At the beginning of the financial period in which this Standard is first applied, any amount recognised outside profit or loss (in other comprehensive income or directly in equity) for a hedge of a firm commitment that under this Standard is accounted for as a fair value hedge shall be reclassified as an asset or liability, except for a hedge of foreign currency risk that continues to be treated as a cash flow hedge.’

IAS 39 108A: ‘An entity shall apply the last sentence of paragraph 80, and paragraphs AG99A and AG99B, for annual periods beginning on or after 1 January 2006. Earlier application is encouraged. If an entity has designated as the hedged item an external forecast transaction that

(a) is denominated in the functional currency of the entity entering into the transaction,

(b) gives rise to an exposure that will have an effect on consolidated profit or loss (ie is denominated in a currency other than the group's presentation currency), and

(c) would have qualified for hedge accounting had it not been denominated in the functional currency of the entity entering into it,

it may apply hedge accounting in the consolidated financial statements in the period(s) before the date of application of the last sentence of paragraph 80, and paragraphs AG99A and AG99B.

IAS 39 108B: ‘An entity need not apply paragraph AG99B to comparative information relating to periods before the date of application of the last sentence of paragraph 80 and paragraph AG99A.’

Transition (paragraphs 103–108C)

IAS 39 AG133: ‘An entity may have designated a forecast intragroup transaction as a hedged item at the start of an annual period beginning on or after 1 January 2005 (or, for the purpose of restating comparative information, the start of an earlier comparative period) in a hedge that would qualify for hedge accounting in accordance with this Standard (as amended by the last sentence of paragraph 80). Such an entity may use that designation to apply hedge accounting in consolidated financial statements from the start of the annual period beginning on or after 1 January 2005 (or the start of the earlier comparative period). Such an entity shall also apply paragraphs AG99A and AG99B from the start of the annual period beginning on or after 1 January 2005. However, in accordance with paragraph 108B, it need not apply paragraph AG99B to comparative information for earlier periods.’

Search for 'initial application'

A10. The words 'initial application' are used in many standards and interpretations (IAS 8, IAS 12, IAS 32, IAS 36, IAS 38, IFRS 1, IFRS 9, IFRIC 4, IFRIC 12 and IFRIC 16). They are also used in the preface to IFRS Foundation and the Due process handbook for the IFRS IC. We will not reproduce all the paragraphs concerned. Our understanding is that 'initial application' is always related to the date when an entity first applies the requirements of an IFRS/IFRIC (see IAS 8 and IFRIC 12 below).

> **IAS 8.19: 'Subject to paragraph 23:**
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> (a) an entity shall account for a change in accounting policy resulting from the initial application of an IFRS in accordance with the specific transitional provisions, if any, in that IFRS; and
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> (b) when an entity changes an accounting policy upon initial application of an IFRS that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.'
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> **IFRIC 12 BC72:** 'IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors states that an entity shall account for a change in accounting policy resulting from initial application of an Interpretation in accordance with any specific transitional provisions in that Interpretation. In the absence of any specific transitional provisions, the general requirements of IAS 8 apply. The general requirement in IAS 8 is that the changes should be accounted for retrospectively, except to the extent that retrospective application would be impracticable.'
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> **Preface to IFRS Foundation:**
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> 'Timing of application of International Financial Reporting Standards
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> 19 IFRSs apply from a date specified in the document. New or revised IFRSs set out transitional provisions to be applied on their initial application.'
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> **Due process handbook for the IFRS IC**
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> '46 IFRIC Interpretations usually apply to periods beginning on or after a specified effective date (usually three months from the date of issue). However, the Interpretations Committee may choose to vary that approach. Transitional provisions that apply on initial application are specified in the Interpretation. In keeping with IFRSs, the presumption is that IFRIC Interpretations will be applied retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. The Interpretations Committee also considers the effect of the transitional provisions on first-time adopters of IFRSs, including the interaction of the

> transitional provisions with those of IFRS 1 First-time Adoption of International Financial Reporting Standards.'

Search for 'date of transition'

A11. The words 'date of transition' are mainly used in IFRS 1. The date of transition is always the date of transition to IFRSs in the first IFRS financial statements.

> IFRS 1 Definition of the date of transition to IFRSs: 'The beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements.'

Appendix B: IFRS 10 Transitional requirements

Extract from IFRS 10 *Consolidated Financial Statements*: Appendix C - Effective date and transition

Effective date

C1 An entity shall apply this IFRS for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies this IFRS earlier, it shall disclose that fact and apply IFRS 11, IFRS 12, IAS 27 *Separate Financial Statements* and IAS 28 (as amended in 2011) at the same time.

Transition

C2 An entity shall apply this IFRS retrospectively, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as specified in paragraphs C3–C6.

C3 When applying this IFRS for the first time, an entity is not required to make adjustments to the accounting for its involvement with either:

(a) entities that were previously consolidated in accordance with IAS 27 *Consolidated and Separate Financial Statements* and SIC-12 *Consolidation—Special Purpose Entities* and, in accordance with this IFRS, continue to be consolidated; or

(b) entities that were previously unconsolidated in accordance with IAS 27 and SIC-12 and, in accordance with this IFRS, continue not to be consolidated.

C4 When application of this IFRS for the first time results in an investor consolidating an investee that was not consolidated in accordance with IAS 27 and SIC-12 the investor shall:

(a) if the investee is a business (as defined in IFRS 3), measure the assets, liabilities and non-controlling interests in that previously unconsolidated investee on the date of initial application as if that investee had been consolidated (and thus applied acquisition accounting in accordance with IFRS 3) from the date when the investor obtained control of that investee on the basis of the requirements of this IFRS.

(b) if the investee is not a business (as defined in IFRS 3), measure the assets, liabilities and non-controlling interests in that previously unconsolidated investee on the date of initial application as if that investee had been consolidated (applying the acquisition method as described in IFRS 3 without recognising any goodwill for the investee) from the date when the investor obtained control of that investee on the basis of the requirements of this IFRS. Any difference between the amount of assets, liabilities and non-controlling interests recognised and the previous carrying amount of the investor's involvement with the investee shall be recognised as a corresponding adjustment to the opening balance of equity.

(c) if measuring an investee's assets, liabilities and non-controlling interest in accordance with (a) or (b) is impracticable (as defined in IAS 8), the investor shall:

(i) if the investee is a business, apply the requirements of IFRS 3. The deemed acquisition date shall be the beginning of the earliest period for which application of IFRS 3 is practicable, which may be the current period.

(ii) if the investee is not a business, apply the acquisition method as described in IFRS 3 without recognising any goodwill for the investee as of the deemed acquisition date. The deemed acquisition date shall be the beginning of the earliest period for which the application of this paragraph is practicable, which may be the current period. The investor shall recognise any difference between the amount of assets, liabilities and non-controlling interests recognised at the deemed acquisition date and any previously recognised amounts from its involvement as an adjustment to equity for that period. In addition, the investor shall provide comparative information and disclosures in accordance with IAS 8.

C5 When application of this IFRS for the first time results in an investor no longer consolidating an investee that was consolidated in accordance with IAS 27 (as amended in 2008) and SIC-12, the investor shall measure its retained interest in the investee on the date of initial application at the amount at which it would have been measured if the requirements of this IFRS had been effective when the investor became involved with, or lost control of, the investee. If measurement of the retained interest is impracticable (as defined in IAS 8), the investor shall apply the requirements of this IFRS for accounting for a loss of control at the beginning of the earliest period for which application of this IFRS is practicable, which may be the current period. The investor shall recognise any difference between the previously recognised amount of the assets, liabilities and non-controlling interest and the carrying amount of the investor's involvement with the investee as an adjustment to equity for that period. In addition, the investor shall provide comparative information and disclosures in accordance with IAS 8.

C6 Paragraphs 23, 25, B94 and B96–B99 were amendments to IAS 27 made in 2008 that were carried forward into IFRS 10. Except when an entity applies paragraph C3, the entity shall apply the requirements in those paragraphs as follows:

(a) An entity shall not restate any profit or loss attribution for reporting periods before it applied the amendment in paragraph B94 for the first time.

(b) The requirements in paragraphs 23 and B96 for accounting for changes in ownership interests in a subsidiary after control is obtained do not apply to changes that occurred before an entity applied these amendments for the first time.

(c) An entity shall not restate the carrying amount of an investment in a former subsidiary if control was lost before it applied the amendments in paragraphs 25 and B97–B99 for the first time. In addition, an entity shall not recalculate any gain or loss on the loss of control of a subsidiary that occurred before the amendments in paragraphs 25 and B97–B99 were applied for the first time.

Appendix C: Submission

We would like to clarify with you the transitional accounting aspects with respect to IFRS 10 – *Consolidated Financial Statements* (IFRS 10). The effective date of IFRS 10 is for periods beginning on or after 1 January 2013. Specifically, we would like to clarify what the 'date of initial application' of IFRS 10 is, (assuming a 31 December year-end reporter), either 1 January 2012 or 1 January 2013. We have had several debates in this regard and there appears to be differing views as to the application of the transitional requirements of IFRS 10.

1) Consistency with other standards and the use of the reference; date of initial application

One of the reasons for our question is to ensure that our interpretation of the date of initial application is consistent with that applied/ interpreted with reference to other standards.

Eg1) IFRS 9 defines the date of initial application as the **date when an entity first applies the requirements of this IFRS** [IFRS 9.7.2.2(b)]. Further one is required to apply IFRS 9 retrospectively (with some exceptions) and financial assets that are derecognized prior to the date of initial application shall be treated in terms of IAS 39);

This implies that for a 1 January 2013 reporter that the date of initial application is 1 January 2013 – assuming that we elect to apply IFRS 9 for our 2013 annual financial period.

Eg2) *Disclosures – Transfers of Financial Assets* (Amendments to IFRS 7) issued in October 2011, paragraph 44M states that: *"An entity shall apply those amendments for annual periods beginning on or after 1 July 2011. Earlier application is permitted. If an entity applies the amendments from an earlier date, it shall disclose that fact. An entity need not provide the disclosures required by those amendments for any period presented that begins before the* ***date of initial application of the amendments****.'*

This implies that we can apply the requirements of IFRS 7 (amendments) from 1 January 2013 (being the date of initial application) – the transitional requirements then specifically state that we need not provide comparative disclosures.

With reference to IFRS 10, we note the following:

- IFRS 10.C2: IFRS 10 shall be applied retrospectively, except as specified in C3-C6.
- IFRS 10.C4: *'when the application of this IFRS for the first time results in the investor consolidating an investee that was not consolidated in accordance with IAS 27 and SIC-12 the investor shall measure the assets, liabilities and non-controlling interests in that previously unconsolidated investee on the date of initial application as if that investee had been consolidated (and thus applied acquisition accounting in accordance with IFRS 3) from the date when the investor obtained control of that investee on the basis of the requirements of this IFRS.'*
- IFRS 10.C4(c)(i) states that if the above is impracticable, the deemed acquisition date shall be the beginning of the earliest period, which may be the current period.

We question whether the reference to initial application in IFRS 10 (being application for the first time) is consistent with IFRS 9 (being the date when the entity first applies the requirements of this IFRS [IFRS 9]), or whether IFRS 9 is referring to the date of initial application as 1 January 2013 and IFRS 10 as 1 January 2012, as implied by the following:

View 1: Assuming that 1 January 2012 is the date of initial application, then that would be the date on which we should apply the requirements of IFRS 10 in determining which entities are required to be consolidated and which should not, with the assets and liabilities being measured on that date as though we had always controlled the entity. Similar provisions would apply to entities that we do not control that we previously did state we controlled in terms of IAS 27 (except that the retained interest will be measured).

View 2: Assuming that 1 January 2013 is the date of initial application, then IFRS 10 appears to imply that one should consider the prevailing facts and circumstances in terms of IFRS 10 on 1 January 2013 and apply that retrospectively (i.e. consolidate or not consolidate) to the date on which we obtained control. That application should then be applied retrospectively to restate the group's 2012 financial results on the basis of circumstances that existed as at 1 January 2103. Similarly to the application of IFRS 9 (i.e. consider business model and contractual terms of instruments as at 1 January 2013 and if assets had been derecognized prior to 1 January 2013 then those assets would be treated in terms of IAS 39 for comparative reporting purposes), if we controlled an entity in terms of IAS 27 on 31 December 2011 but lost control and still had no control in terms of IFRS 10 prior to 1 January 2013 (date of initial application), then we would continue to apply IAS 27 to the previous year's financial statements (i.e. 2012 comparative statements). Naturally this could result in a mixture of IAS 27 and IFRS 10 application for the comparative financial statements, but it is no different to what results through application of IFRs 9. C4(c)(i) does not however appear to support this given its reference to impracticability and the application of that paragraph to the current period.

Considering the date on which the amendments were issued and the time until which the requirements are to be applied, we question whether it was the IASB's intention that View 2 be applicable in line with similar principles that are applicable to IFRS 9. If the date of initial application is 1 January 2012, then one needs to ensure that all circumstances are evaluated on 1 January 2012 thereby leaving much less time to apply the standard than if 1 January 2013 was considered to be the date of initial application.