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IFRS Newsletter

First-time Adoption of International Financial Reporting Standards

IFRS1

Deloitte Hungary issues its monthly newsletter to inform its clients about the most recent developments involving International Financial Reporting Standards (IFRSs) and the most critical issues surrounding their adoption. This edition of our newsletter provides a brief overview of IFRS 1, the standard which contains guidance on the first-time adoption of IFRSs.

Adoption of IFRS

On 12 June 2015 the Government approved the schedule for the adoption of the International Financial Reporting Standards (IFRSs) for standalone reporting purposes in Hungary. According to this timeline, the adoption of IFRS will be optional for a number of entities as from 1 January 2016 and compulsory for certain entities as from 1 January 2017. Therefore, if an entity keeps its books and prepares its financial statements for the reporting date under IFRS starting from 1 January 2017, then the comparative information under IFRS must be prepared for 31 December 2016 and an opening balance sheet must be drawn up for 1 January 2016. If, however, an entity adopts IFRS starting from 1 January 2016, the opening balance sheet should be prepared for 1 January 2015.

Tax implications of the transition to IFRS

The adoption of IFRS deserves special attention from a tax perspective as well since, in the absence of special rules, the tax burden could be different due to the differences in the profit figures. As is the case in certain other countries within the region, a possible solution to this would be if the tax base continued to be calculated under the local accounting regulations for tax filing purposes. However, Hungary would rather apply specific rules in the case of taxpayers reporting under IFRS and would eliminate this duality. Naturally, the two main tax types which are expected to be subject to specific rules are corporate income tax and local business tax.

In terms of the transition, the key items which should be reviewed from a regulatory perspective are those where the differences between the two accounting systems could result in double taxation or non-taxation (e.g. where a business transaction is not yet taxable under the Hungarian accounting rules but is already recognised in profit or loss under IFRS). On the other hand, special adjustment items may need to be introduced with respect to differences arising during the normal course of business. Another aspect is that government revenues cannot be reduced as a result of such transition and, therefore, transitional measures and adjustment items are expected to be introduced. A potential solution to this could be if, during a transitional period (for a few years, for example), the tax advance payable would be the amount calculated according to the last Hungarian accounting rules, or if one-off items associated with the above-mentioned transition were subject to a one-off tax liability with respect to the transition.

When is it applicable?

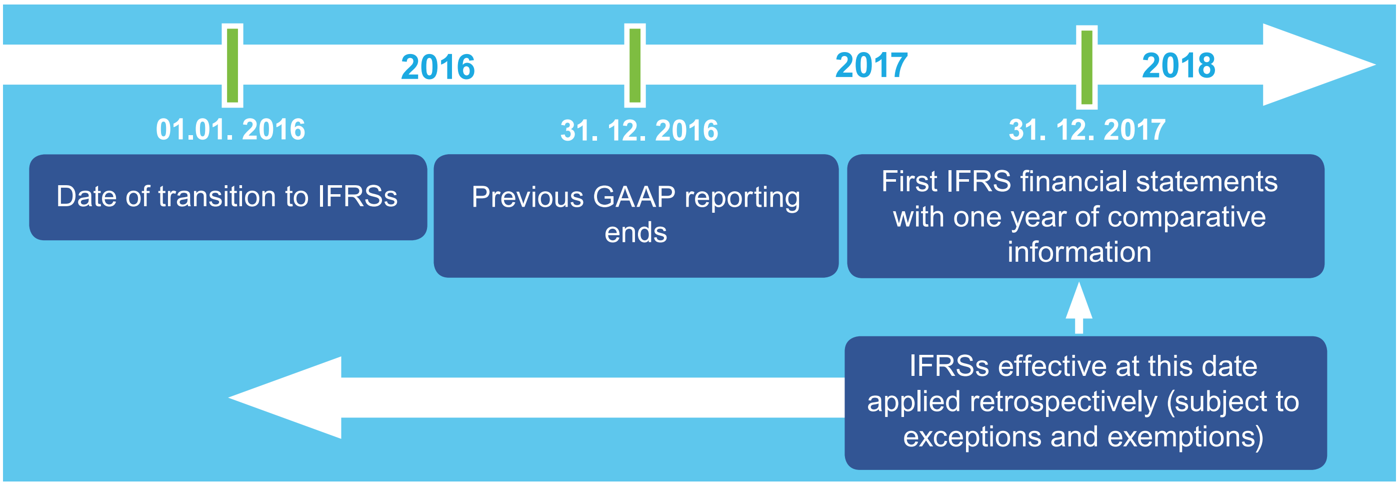
IFRS 1 must be applied **when the entity prepares IFRS financial statements for the first time,** including all interim financial statements prepared under IAS 34 Interim Financial Reporting which cover a part of the first period covered by its IFRS financial statements. An entity is considered a first-time adopter if it is the first time that the entity makes an express and unqualified declaration that its financial statements are based on IFRS.

For instance, an entity is treated as a first-time adopter if:

- Until now it has prepared its financial statements under another accounting system and now makes the transition to IFRS;
- Until now it has prepared IFRS financial statements for internal use only, but from now on it will make them available to third parties as well and makes the unqualified declaration therein;
- Until now it has prepared reporting packages for consolidation purposes which did not comply with all disclosure requirements.

Transition schedule

IFRS financial statements must present at least one comparative period. This implies that data in the statement of financial position, the statement of comprehensive income, the statement of changes in equity and the statement of cash flows must be available for at least two periods. In reality, reporting data for two periods would require the data for three periods to be recalculated instead of two since the opening values of the comparative data must also be prepared for statements and the related data. Thus, IFRS 1 requires the transition to take place as of the first day of the earliest comparative period. The entity must apply the same accounting policies in its opening IFRS balance sheet and for all periods reported in its first IFRS financial statements.



Principles and accounting policies

The entity must prepare and disclose an opening balance sheet for the date of transition according to the following principles:

- All assets and liabilities where recognition is mandatory under IFRSs must be recognised
- All assets and liabilities where recognition is not allowed under IFRSs must be derecognised
- Assets and liabilities must be measured and classified in accordance with IFRSs

The effects of the differences between the two accounting systems must be recognised in retained earnings in the opening balance sheet.

Recognition and derecognition examples under IFRSs:

Recognise

- Pension liabilities
- Deferred tax assets and liabilities
- Finance lease assets and liabilities
- Provisions, only if legal or constructive
- Derivative financial instruments

Derecognise

- Provisions, if no present obligation
- General reserves as liabilities
- Treasury shares as assets
- Intangible assets not meeting recognition criteria

Reclassification examples under IFRSs:

Financial assets →	**Four categories under IAS 39**
Financial liabilities →	**Liability or equity under IAS 32**
Offsetting →	**Presentation of gross amounts unless IFRSs allow offsetting**
Statement of financial position →	**Generally separate presentation of non-current and current assets under IAS 1**
Securities in statements of cash flows →	**Classified as cash equivalents only if maturity <3 months from date of acquisition**

Measurement examples under IFRSs:

Financial instruments →	**Fair value or amortised cost under IAS 39**
Employee benefits →	**Apply IAS 19**
Provisions →	**Best estimate under IAS 37**
Impairment of assets →	**Apply IAS 36**

Prohibitions and exemptions

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IFRS 1 prohibits retrospective application in the following areas:

- Accounting estimates
- Derecognition of financial assets and financial liabilities
- Hedge accounting
- Non-controlling interests
- Preferential loans (government grants)
- Embedded derivatives (if IFRS 9 is applied)
- Classification and measurement of financial assets (if IFRS 9 is applied)

In addition to the prohibitions, the standard provides for a number of exemptions that can be applied when preparing the opening balance sheet; in these areas, retrospective application is either not mandatory or simplified.

Such exemptions are available to entities in the following areas:

- Business combinations
- Share-based payment transactions
- Insurance contracts
- Deemed cost
- Leases
- Effects of changes in exchange rates

Disclosures

There are two distinct types of disclosure requirements in terms of the transition to IFRS: disclosures related to the execution of the transition and disclosures related to the first IFRS financial statements. The purpose of the first group is to build a bridge between past reports and first-time IFRS reporting, and the main tool for doing so is the so-called reconciliation. As part of this reconciliation, the differences between the values calculated under the previous GAAP and the values according to IFRS must be broken down into key components and the reasons behind the differences must be explained. The components of equity must be reconciled for the date of transition and for the reporting date of the last financial statements under the previous GAAP. In addition, total comprehensive income must be reconciled for the last period reported under the previous GAAP. IFRS 1 requires the application of the disclosure requirements under other IFRSs and prescribes additional disclosures as well.

The first IFRS financial statements must contain the following:

- Three Statements of Financial Position
- Two Statements of Comprehensive Income
- Two Statements of Changes in Equity
- Two Statements of Cash Flows

and the related notes.

Contact us

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For further information on IFRS, please visit the following website:

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