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This pdf download document includes all you need to study the Certificate of International Reporting course while not at your computer.

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answers to questions
answers to exercises
mock assessment
You will see that, because of this, the page numbering in this document does not match the page numbering in the online version of the course

These pages require your interaction and can only be seen via the course online.

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Welcome to the course

The primary objectives of this course are:

- To help you understand how International Financial Reporting Standards (IFRS) are used around the world
- To explain the workings of the IASB and how these are being changed
- To examine the fundamental requirements of IFRS on a standard-by-standard basis, for the benefit of preparers, auditors and users of financial statements
- To provide guidance on how to use IFRS in practice, with the aid of questions, cases and exercises

The course includes questions and interactive exercises which you should complete before moving on. Avoid skimming the material in the hope that you will glean the appropriate points - you won‘t, you must set aside time to study the material fully.

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Course contents and the learning process

You can work on this course whenever you like, 24 hours a day, seven days a week.

You decide when you want or need to learn; you decide just how long you will spend reviewing and revising a topic, and you decide when you are ready to move on.

It should take you between 20 and 30 hours to complete, but you can take as long as you wish to complete the course, within the time limit of your course licence.

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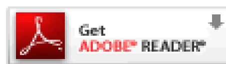

To download the printable copy of this course click the file icon below.

The course contains the following modules:
Module 1 - The nature and operations of the IASB
Module 2 - The status and use of IAS/IFRS around the world
Module 3 - Revenue, presentation and profit
Module 4 - Accounting for assets and liabilities - part 1
Module 5 - Accounting for assets and liabilities - part 2
Module 6 - Group accounting
Module 7 - Disclosure standards
Module 8 - Principal Differences between IFRS & UK GAAP/US GAAP
Module 9 - Forthcoming proposals for change
Mock Assessment

A number of pages in this course refer you to IAS Plus - a website dedicated to international financial reporting standards and to related current issues and developments. It is maintained by Deloitte Touche Tohmatsu.

www.iasplus.com

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Module 1: What you will learn - the nature and operations of the IASB

In this module you learn about the following:

- The origins of the International Accounting Standards Board (IASB)
- The organisation of the IASB
- A list of International Accounting Standards (IASs) and International Financial Reporting Standards (IFRSs)
- The purpose of financial statements - The Conceptual Framework for Financial Reporting
- The future of accounting standards
- Frequently asked questions

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Formation of the IASB

The International Accounting Standards Committee was founded in 1973 after a conference in Sydney in 1972. The IASC was formed through an agreement made by the professional accountancy bodies from Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom with Ireland, and the United States of America.

The accounting "rule makers" in these countries were often not these professional accountancy bodies. In considering the requirements for international accounting standards, it was regarded as too difficult for governments to reach agreement - so the accountancy bodies have worked together to try to devise a consistent set of global guidelines.

From 1973 to 2001 the number of accountancy bodies with membership of the IASC increased to over 140. These accountancy bodies represented over 100 countries, including China, represented by the Chinese accountancy body from 1997.

Accounting standards were set by a part-time, volunteer IASC Board that had 13 country members and up to 3 additional organisational members. Each member was generally represented by two "representatives" and one "technical advisor". The individuals came from a wide range of backgrounds - accounting practice, multinational businesses, financial analysis, accounting education, and national accounting standard-setting. The Board also had a number of observer members.

The IASC concluded in 1997 that, to continue to perform its role effectively, there must be convergence between national accounting standards and practices and global accounting standards. The IASC saw, therefore, a need to change its structure. A new Constitution took effect from 1 July 2000 under which was established a requirement for full constitutional review every five years. At this point a new standards-setting body was formed, named the International Accounting Standards Board (IASB).

On 1 April 2001, the IASB took over from the IASC the responsibility for setting International Accounting Standards.

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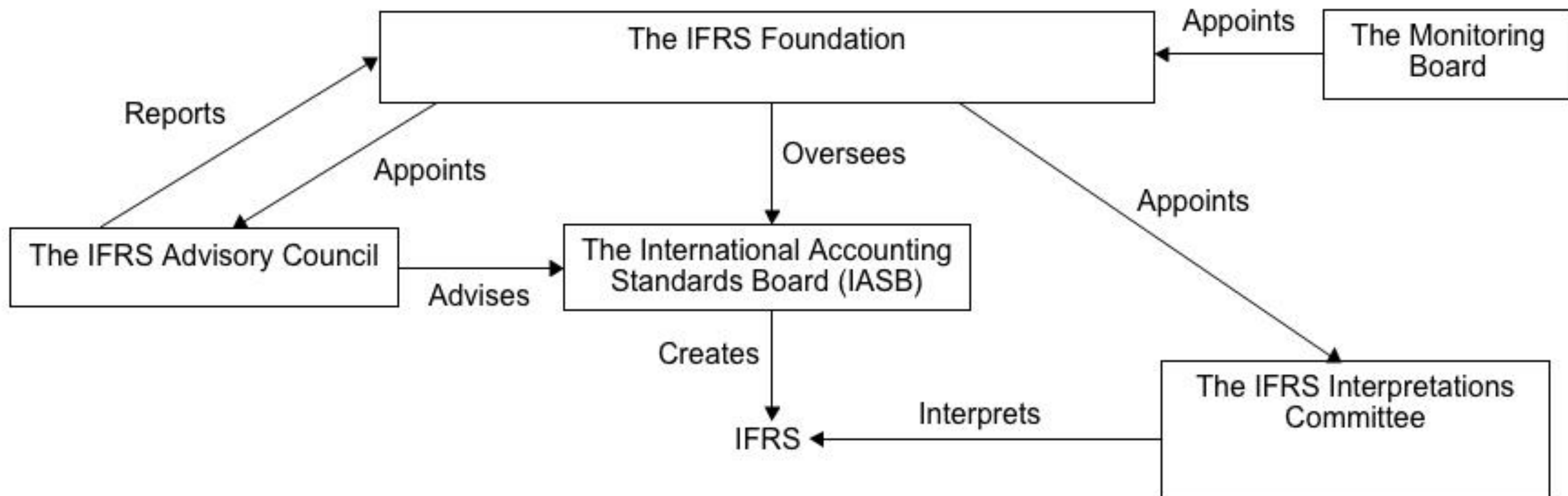
The organisation of the IASB

The IASB sits under the wider parent body the 'IFRS Foundation' and is supported by a number of other groups and advisory panels. Since its creation in 2000, there have been two full constitutional reviews. The latest was completed in March 2010. The key elements of the resulting structure, operational now, are illustrated in the diagram below and discussed further on subsequent pages.



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The organisation of the IASB

The IFRS foundation is the umbrella organisation. It oversees the work of the IASB, its structure and strategy and has fundraising responsibility. It is made up of 22 trustees:

- Six from North America
- Six from Europe
- Six from the Asia/Oceania region
- One from Africa
- One from South America
- Two from any area, subject to maintaining overall geographical balance

The Trustees act by simple majority vote except for amendments to the Constitution, which require a 75% majority.

The latest revision to the constitution of the IFRS foundation in 2012 requires the separation of the roles of Chairman of the IASB and CEO of the IFRS foundation. This change has already been implemented.

The Monitoring Board was created under the latest constitutional review to provide a link between the trustees of the IFRS foundation and public authorities. It participates in, and approves, appointment of trustees of the IFRS foundation. It also provides advice to and meets at least annually with the trustees.

Membership of the monitoring board will initially comprise six specific persons including the responsible member of the European Commission, the chair of the US Securities and Exchange Commission and the Commissioner of the Japanese Financial Services Agency.

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The organisation of the IASB

"The principal responsibilities of the IASB are to develop and issue International Financial Reporting Standards and Exposure Drafts, and approve Interpretations developed by the IFRS Interpretations Committee."

The IASB has sole responsibility for publication of IFRSs.

There are currently 14 full-time members of the Board, comprising independent experts with an appropriate mix of recent practical experience and a broad geographical diversity. Per the constitution the board should ideally comprise 16 members drawn as follows (although it is recognised that this may not be possible at all times):

- Three from North America
- Three from Europe
- Four from the Asia/Oceania region
- One from Africa
- One from South America
- Two from any area, subject to maintaining overall geographical balance.

The Board has full discretion over developing and pursuing its technical agenda. The trustees' annual review of the strategy of the IFRS Foundation, its effectiveness, and the IASB includes consideration, but not determination, of the IASB's agenda.

The publication of a Standard, Exposure Draft, or final Interpretation requires approval by the board.

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The organisation of the IASB

The IASB normally forms Working Groups or other types of specialist advisory groups to give advice on major projects. The Board is required to consult the IFRS Advisory Council on major projects, agenda decisions and work priorities.

The IFRS Advisory Council ('Advisory Council') provides a forum for organisations and individuals with an interest in international financial reporting with the objective of:

- Advising the Board on priorities in the Board's work
- Informing the Board of the views of the organisations and individuals on the Council on major standard-setting projects, and
- Giving other advice to the Board or to the Trustees

Under the constitution of the IFRS Foundation, the Advisory Council should have a minimum of 30 members.

The IFRS Interpretations Committee ('Interpretations Committee') was known as the International Financial Reporting Interpretations Committee (or IFRIC) until the latest constitutional review. The Interpretations Committee has 14 members, appointed by the Trustees.

Its responsibilities are to:

- Interpret the application of International Financial Reporting Standards (IFRSs) and provide timely guidance on financial reporting issues not specifically addressed in IFRSs or IASs
- Publish Draft Interpretations for public comment and consider comments made within a reasonable period before finalising an Interpretation.

Approval of draft or final Interpretations requires that not more than four voting members vote against the Draft or final Interpretation.

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Current IASB standards

International Accounting Standards (IASs) were issued by the IASC from 1973 to 2000. The IASB replaced the IASC in 2001. Since then, the IASB has amended some IASs, has proposed to amend other IASs, has proposed to replace some IASs with new International Financial Reporting Standards (IFRSs), and has adopted or proposed certain new IFRSs on topics for which there was no previous IAS. Through committees, both the IASC and the IASB have also issued Interpretations of Standards. As interpretations have the same status as standards themselves, financial statements may not be described as complying with IFRSs unless they comply with all of the requirements of each applicable standard and each applicable interpretation.

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Current IASB standards

The list below outlines the standards as they currently exist.

IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations
IFRS 6	Explanation for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IFRS 8	Operating Segments
IFRS 9	Financial Instruments
IFRS 10	Consolidated Financial Statements
IFRS 11	Joint Arrangements
IFRS 12	Disclosure of Interests in Other Entities
IFRS 13	Fair Value Measurement
IFRS 14	Regulatory Deferral Accounts
IFRS 15	Revenue from Contracts with Customers
IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 7	Statement of Cash Flows
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events After the Reporting Period
IAS 12	Income Taxes
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Separate Financial Statements (revised 2011)
IAS 28	Investments in Associates and Joint Ventures (revised 2011)
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 30	Disclosure in the Financial Statements of Banks and Similar Financial Institutions
IAS 32	Financial Instruments: Presentation
IAS 33	Earnings Per Share
IAS 34	Interim Financial Reporting
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 40	Investment Property
IAS 41	Agriculture

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Current IASB standards

"You will note that a number of standards seem to be missing, e.g. IASs 3, 4, 5, and 6. This is because they have been replaced by later standards, e.g. IAS 3 (which related to consolidated financial statements) was replaced by the much more detailed standards IAS 27, 28 and (more recently) IFRS 10, 11 and 12."

The above standards are examined in more detail in later modules.

The standards are frequently changed in order to improve and remove options and establish more detailed rules in certain areas. Sometimes standards are amended retaining the same standard number where the scope of the standard has remained broadly the same.

The latest standard (IFRS 15) was issued in May 2014.

The application dates of standards (i.e. when companies start to use the guidance they contain) are normally somewhat after their date of publication, e.g. this latest standard will come in to force for accounting years beginning on or after January 1st 2018. Early application is possible though.

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The Conceptual Framework for Financial Reporting

A major item in the list of publications is the Conceptual Framework for Financial Reporting 2010 (“the conceptual framework”). This establishes the purpose of financial statements and the major principles lying behind their preparation.

The framework suggests that the main purpose of financial statements is to give information to users (particularly investors and creditors) so that they can make financial decisions. The most useful information would therefore be that which enables the prediction of future cash flows. It is clear from this that the purpose of financial statements is little to do with taxation or management accounting. The context is that companies and users are presumed to be living in an international world so that comparisons need to be made across national borders. This also implies that national laws including tax laws have to be ignored when international standards are being drafted.

The framework has a number of purposes, including:

- To assist the Board itself when preparing IFRSs
- To assist national standard –setters when preparing national standards
- To assist companies when preparing financial statements in accordance with IFRSs.
- To assist auditors to form an opinion on the financial statements
- To assist users to understand financial statements

The framework suggests that in order for financial information to be useful, it must possess certain qualitative characteristics. They are:

Fundamental characteristics	Enhancing characteristics
• Relevance • Faithful representation	• Comparability • Verifiability • Timeliness • Understandability

Information must be relevant and faithfully represented to be useful. Its usefulness is enhanced if the information is comparable with other similar information, verifiable as a faithful representation, produced on a timely basis and understandable to users. **One of the key components of the framework is the definition of the five main elements of financial statements. In the statement of financial position, three elements can be found:**

- An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity
- A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits
- Equity is the residual interest in the assets of the entity after deducting all its liabilities

Equity does not need to be defined separately because it is just the arithmetical difference between total assets and total liabilities.

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The Conceptual Framework for Financial Reporting

When determining whether an item meets the definition of an asset, liability or equity, attention should be given to the commercial substance of the item and not simply its legal form.

The framework stresses the definitions of asset and liability such that the definitions of income and expense are secondary, for example, an expense is defined as an increase in a liability or a decrease in an asset. This is in contrast to an alternative framework that has a primary focus on the definitions of income and expenses based upon the accruals concept.

To help explain this, let's take a look at an example. Imagine that a business needs to repair a piece of equipment on the 20th February 20X5. The company has a financial year running from 1st January to 31st December.

Is the repair bill an expense of financial year 20X4 or of 20X5?

Some accounting systems would treat this as an expense of 20X4, as the wear and tear that caused the equipment to breakdown was in 20X4. Not only this, but the repair may be tax deductible in 20X4 if so charged.

The conventional definition of an expense of year X is that it is a payment made in any year that relates to year X.

In this case, it could be argued that the expense relates to 20X4. If this is the case, then at the end of financial year 20X4, a debit has to appear in the accounts for the repair expense, and a credit as a provision for the repair. This will mean that the statement of financial position 31st December 20X4 will show a liability for the "provision for repair".

While it is difficult to say that this way is "wrong", it is certainly different from current practice. The framework suggests that you should ask the question "Is there a liability?" on the 31st December 20X4. The answer is "no". Therefore there is no need for a double entry and so no expense. This is clearer.

The application of the asset/liability framework underpins conventional accounting practice.

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The Conceptual Framework for Financial Reporting

Summary of position

International accounting guidance exists in the IASB's framework, IFRS and Interpretations. The IASB published the framework to outline the concepts that underlie the financial reporting process. The framework is used as a guide by both international and national standard setters to set consistent and logical accounting standards. It also assists preparers and auditors in interpreting standards and dealing with issues that the standards do not cover.

The Standards provide guidance for preparers to deal with the recognition, measurement, presentation and disclosure requirements for transactions and events. Most IFRSs are intended for application across industries. A second tier of guidance comes from the Interpretations developed by the IFRIC. These pronouncements clarify or interpret the standards where there is a need for improved guidance.

The following hierarchy, in decreasing authority of guidance within IFRS, is followed in developing and applying an accounting policy where no IFRS specifically deals with the transaction:

- The requirements and guidance in the International Financial Reporting Standards and IFRIC Interpretations dealing with similar and related issues
- The framework
- The most recent pronouncements from other standard setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practice to the extent that these do not conflict with (a) and (b) above.

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Frequently asked questions

1. Are International Financial Reporting Standards recognised in all financial capital markets in the world?
2. What are accounting standards and what is the difference between IAS and IFRS?

1. International Financial Reporting Standards (IFRSs) have achieved recognition universally as a highly influential set of accounting standards. The IASB says that almost 120 countries have required or permitted the use of IFRSs since 2001. However IFRS has yet to be adopted in the United States of America (see Module 2 for more details).

2. Accounting standards are authoritative statements of how particular types of transactions and other events should be reflected in financial statements. Accordingly, compliance with accounting standards will normally be necessary for the fair presentation of financial statements.

Standards issued by the International Accounting Standards Board are designated International Financial Reporting Standards (IFRSs). Standards originally issued by the Board of the International Accounting Standards Committee (1973-2001) continue to be designated International Accounting Standards (IASs).

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Frequently asked questions

1. What is IOSCO, and what is its link with the IASB?
2. How does the IASB decide what subjects to add to its agenda?
3. Are the IASB's standards always in line with the Conceptual Framework?

1. The International Organization of Securities Commissions (IOSCO) is the representative body of the world's securities markets regulators. High quality financial information is vital to the operation of an efficient capital market, and differences in the quality of the accounting policies and their enforcement between countries leads to inefficiencies between markets. IOSCO has been active in encouraging and promoting the improvement and quality of IFRSs for over ten years.

2. Board members, members of the IFRS Advisory Council, national standard-setters, securities regulators, other organisations and individuals and the IASB staff are encouraged to submit suggestions for new topics that might be dealt with in the IASB's standards.

3. Not exactly. The Conceptual Framework was written after some of the standards. Also, sometimes, practical or political necessity forces the Board to stray from the framework.

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Quick Quiz

Module 1 quick quiz

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Question 1

What is the role of the IFRS Interpretations Committee?

A. To promote generally the acceptability of International Accounting Standards (IASs) and International Financial Reporting Standards (IFRSs) and to enhance their credibility.

B. To advise the IASB board on technical issues in specific projects

C. To consider, on a timely basis, accounting issues that are likely to receive divergent or unacceptable treatment in the absence of authoritative guidance

D. To work generally for the improvement and harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements

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Question 2

Which of the following is not one of the four enhancing qualitative characteristics?

A. Understandability

B. Materiality

C. Comparability

D. Timeliness

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Question 3

The definition of an asset includes which of the following terms:

1. Control
2. Future economic benefits
3. Ownership
4. Past transaction

A. All of the above

B. 1, 2, and 4

C. 2, 3, and 4

D. 1, 2, and 3

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Question 4

Faithful representation means that financial information represents the substance of transactions rather than their legal form Which of the following demonstrates a situation where the accounting treatment differs from the legal form of the transaction to ensure faithful representation:

A. An asset is depreciated on the straight-line basis

B. The costs of a patent are capitalised

C. An asset is leased and capitalised by the entity that uses the asset

D. An allowance is made for doubtful debts

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Question 5

The Monitoring Board is responsible for:

A. Approving IFRSs before publication

B. Deciding on a work plan for the IASB

C. Providing a link between the IFRS foundation and public authorities

D. All of the above

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Module 2: What you will learn: the status and use of IFRSs around the world

This module will introduce you to the recommended publication for this course and will cover the following:

- A brief summary of the development of International Financial Reporting Standards (IFRSs) and their adoption
- The growth of the International Accounting Standards Board (IASB)
- IFRS and small and medium-sized entities

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IFRS for SMEs
The annual IASB bound volume and its use
Frequently asked questions

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Introduction: Where have IFRSs been adopted

In many countries, stock exchange listing requirements or national securities legislation permit (or sometimes require) foreign companies that issue securities in those countries to prepare their consolidated financial statements using IFRSs.
Since 1 January 2005, all publicly listed companies in the **European Union** have been required to prepare their financial statements in conformity with IFRSs**.** In the UK, whilst fully listed and AIM listed companies must prepare their financial statements in accordance with IFRSs, other companies may choose to do so.

Both **Australia and New Zealand** have adopted national standards that are IFRS-equivalents. These must be used by all domestic listed companies and large unlisted companies, whilst they are permitted for other companies.

African countries are split between those that require the use of IFRSs, those that permit their use and those that prohibit their use. Countries that require domestic listed companies to use IFRSs include **South Africa, Ghana and Kenya.**

In **Asia,** Hong Kong, and Malaysia have issued national standards that are identical to IFRS, whilst Singapore FRSs are converged with IFRS with some minor exceptions. Korea has translated IFRSs word for word to become Korean GAAP.

India allows IFRS to be used in consolidated financial statements and has developed Ind-AS which are similar to IFRS (although not fully converged). Companies meeting certain thresholds will be required to apply Ind-AS from 2016/2017. In China IFRSs may not be applied, however Chinese Accounting Standards are substantially converged and it is intended that remaining differences will be eliminated over time. Differences between Japanese GAAP and IFRSs have been reduced and new Japanese standards issued in the future will be in line with IFRSs.

Several **South American** economies require the use of IFRSs for domestic listed companies. These include Brazil, Chile, Mexico and Ecuador. Other countries, such as Argentina, require some listed companies to prepare financial statements in accordance with IFRSs. Bolivia and Paraguay allow but do not require the use of IFRSs for domestic listed companies.

In North America, Canada adopted IFRSs in full as Canadian FRSs with effect from 2011. In the USA, domestic listed companies are not permitted to use IFRSs. Although the US standard-setter FASB has recently worked on a number of projects with the IASB and has publicly stated its commitment to IFRSs, it is unlikely that the Securities and Exchange Commission will allow domestic listed companies to use IFRSs in the near future. This is discussed further in Module 9.

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Growth of the IASB and IFRSs: a roadmap

The IASB, the board responsible for issuing IFRSs, has come a long way since its inception in 1973. Here is a brief list of the major developments that have marked the life of the IASB:

1973
- the IASB's predecessor, the IASC, was founded by accountancy bodies from nine countries

1970's-80's
- the codifying of best practice, including many national options

1989
- publication of the first version of the Conceptual Framework for Financial Reporting

1990's
- gradual adoption of IASs as national standards, particularly by Commonwealth countries

1993
- ten revised standards (in force in 1995)

1994+
- adoption of IASs by a number of continental companies for consolidated statements.

1998
- laws to permit use of IASs in France, Germany and Italy and the IASC passes last major core standard (IAS 39, financial instruments)

1999
- IASC restructured, resulting in current IASB.

2000
- International Organisation of Securities Commissions (IOSCO) recommends use of IASs to its members and the EU Commission proposes compulsory use of IASs for listed companies' consolidated statements by 2005

2001
- European Commission presents legislation to require use of IASC Standards for all listed companies no later than 2005
- Trustees bring new structure into effect - 1 April 2001 - "IASC" now becomes "IASB" and assumes responsibility for setting accounting standards, designated International Financial reporting Standards (IFRSs).

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Growth of the IASB and IFRSs: a roadmap

2002

- The IASB meets the US Financial Accounting Standards Board (FASB). They conclude the Norwalk Agreement, a memorandum of understanding that commits the boards to work together to remove differences between IFRSs and US GAAP and to co-ordinate their future work programmes.

2004

- By issuing four IFRSs, two revised IASs and an amendment to the financial instruments standard by the end of March, the IASB brings to completion its “stable platform” of standards for use by companies adopting its standards from January 2005.

2005

- All member states of the EU required to use IFRSs as adopted by the EU for listed companies
- South Africa adopts IFRS for all listed entities
- In Australia IFRS required for all private sector reporting and as the basis for public sector reporting.
- US SEC announces “roadmap” towards the removal by 2008 of the requirement for non domestic companies to reconcile from IFRS to US GAAP when listing in the US

2006

- IASB and FASB agree roadmap for convergence between IFRSs and US GAAP
- China adopts accounting standards substantially in line with IFRSs

2007

- IFRS permitted for foreign issuers in the US

2010

- In Brazil IFRS required for consolidated financial statements of banks and listed companies from 31 December 2010 (and for individual company accounts progressively since January 2008).
- Japan allows use of IFRS for a number of international companies.

2011

- Republic of Korea adopt IFRSs
- In Canada required for all listed entities and permitted for private sector entities including not-for-profit organisations

2012

- IFRS adopted by Russia, Mexico and Argentina

2015

- It is now considered unlikely that IFRSs will be adopted by the US SEC.

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IFRS for Small and Medium–sized Entities (SMEs)

Publication of a new IFRS for SMEs

Because full IFRSs were designed to meet the needs of investors in public companies, they are very detailed and fairly burdensome to implement for smaller companies. In July 2009 the IASB published an International Financial Reporting Standard (IFRS) designed for use by small and medium-sized entities (SMEs).

This new standard is designed for non-publicly accountable entities, and reflects an important development in international reporting, since SMEs are estimated to represent more than 95 per cent of all companies. The IFRS for SMEs is derived from full IFRSs with appropriate modifications based on the needs of users of SME financial statements and cost-benefit considerations (simplifications generally allow only more straightforward accounting policy options and a more concise written style is used throughout).

The IFRS for SMEs is available for any jurisdiction to adopt, whether or not it has adopted full IFRSs. The only restriction is that it may not be used by public entities or financial institutions. As at June 2015, 73 jurisdictions required or permitted use the IFRS for SMEs to be applied by eligible companies.

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

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The annual IASB bound volume and its use

It would be useful for reference purposes to have with you a copy of the bound volume of International Financial Reporting Standards 2015 as, from time to time, this course will direct you towards particular standards to carry out short exercises.

You can purchase this direct from the IASB Shop on the IFRS Foundation web site.

IFRS are available in three formats: the Red Book, the Blue Book and the Green Book.

- The 2015 Red Book includes all Standards and Interpretations as issued at 1 January 2015, including those not yet effective;
- The 2015 Blue Book includes all Standards and Interpretations effective on or before 1 January 2015;
- The 2015 Green Book (‘A Guide through IFRS’) includes all Standards and Interpretations in issue at 1 July 2015 together with annotations and cross references.

All books contain the text of the Conceptual Framework.

The Red Book is most applicable to this course.

You can also access the unaccompanied standards and interpretations, free of charge, using the IFRS Foundation’s basic eifrs service, available at http://eifrs.ifrs.org/eifrs/Menu.

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Frequently asked questions

1. Which national standards are closest to the IASB's?
2. Is it necessary to adhere to all requirements of IFRSs for financial statements to state compliance?

1. Several countries have adopted IFRS to be their own national standards, without any modification. These countries include South Korea, Australia and Hong Kong.

2. Yes, in order to claim compliance with IFRSs, all the requirements of the IFRS must be met. There are no exceptions. Use of local GAAP and IFRS together is not allowed.

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Quick Quiz

Module 2 quick quiz

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Question 1

Which of the following countries prohibits the use of IFRSs by domestic listed companies?

A Brazil
B Russia
C Australia
D China

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Question 2

Which of the following type(s) of entity is (are) eligible to use the IFRS for SMEs?

1 An unlisted bank
2 A listed company that meets size thresholds for a small entity
3 An unlisted company of any size

A 2 only
B 3 only
C 1 and 3
D 2 and 3

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Question 3

What is the Norwalk Agreement?

A An agreement made between EU countries to require domestic listed entities to apply IFRSs by 2005.

B The agreement made by the IASB to adopt all IASs issued by its predecessor, the IASC.

C An agreement between the IASB and FASB to work together to remove differences between IFRSs and US GAAP.

D An agreement between IOSCO and the IASB to promote use of IFRSs for all companies listed on an international stock exchange.

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Question 4

Which of the following statements is true?

A The IFRS for SMEs may only be adopted by jurisdictions that have no national standards.

B The IFRS for SMEs was developed by the IASB based on a number of existing national standards for SMEs

C The IFRS for SMEs may be adopted by any jurisdiction, regardless of whether it has adopted full IFRSs.

D The IFRS for SMEs allows the same accounting options as full IFRSs but reduces the level of required disclosures significantly.

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Module 3: What you will learn: Revenue, presentation and profit

This module begins the process of looking at IFRSs on a topic-by-topic basis. It deals with three introductory standards:

- Presentation of financial statements - IAS 1
- Revenue from contracts with customers - IFRS 15
- Accounting policies, changes in accounting estimates, and errors- IAS 8.

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IAS 1 Presentation of Financial Statements

IAS 1 contains several aspects taken from the Conceptual Framework, including the purpose of financial statements. The standard identifies the objective and content of a set of financial statements and then primarily deals with:

General features of financial statements

Structure and content of financial statements

The objective of general purpose financial statements is to provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making economic decisions. To meet that objective, financial statements provide information about an entity's:

a. Assets
b. Liabilities
c. Equity
d. Income and expenses, including gains and losses
e. Contributions by and distributions to owners, in their capacity as owners
f. Cash flows

(IAS 1 para 9)

That information, along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.

A complete set of financial statements should include:

a. A statement of financial position at the end of the period,
b. a statement of profit or loss and other comprehensive income *(see below)* for the period,
c. A statement of changes in equity for the period
d. A statement of cash flows for the period,
e. Notes, comprising a summary of accounting policies and other explanatory information
f. Comparative information in respect of the preceding period, and
g. A statement of financial position at the beginning of the preceding period where retrospective adjustment is made in accordance with IAS 8

(IAS 1 para 10)

Entities are not required to use the titles listed above in their financial statements (for example, they may instead use 'old' titles such as balance sheet and income statement), but all existing Standards and Interpretations reflect the terminology referred to above.

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IAS 1 Presentation of Financial Statements

General features of financial statements:
- Fair presentation
- Going concern
- Accrual basis
- Materiality and aggregation
- Offsetting
- Frequency of reporting
- Comparative information
- Consistency of presentation

IAS 1 requires that financial statements should present fairly the financial position, performance, and cash flows of an entity. This will nearly always be achieved by compliance with the requirements of IFRSs. In extremely rare circumstances, it may be necessary to depart from a standard in order to achieve a fair presentation. IAS 1 allows departure in such circumstances, but requires extensive disclosures, including the financial impact of the departure from the standard.

Financial statements should be prepared on a going concern basis unless management intends to liquidate an entity or cease trading or has no realistic alternative but to do so. Disclosure is required where financial statements are not prepared on the going concern basis.

Financial statements, other than cash flow information, should be prepared on the accrual basis.

Each material class of similar items should be presented separately. Line items that are not material individually should be aggregated with other line items. This aids understandability.

Assets and liabilities and income and expenses should not be offset unless this is required or permitted by another IFRS.

A complete set of financial statements should be prepared at least annually. Reasons for a reporting period of more or less than a year should be disclosed.

Comparative information should be presented for the preceding period for all amounts reported in the current year financial statements. Additional comparative information may be presented provided that it is prepared in accordance with IFRSs. If the presentation or classification of items is changed, comparative information should be reclassified on the same basis.

Consistent presentation and classification should be retained unless a change is required by an IFRS or another presentation and classification would be more appropriate.

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IAS 1 Presentation of Financial Statements

Structure and content of financial statements:
- **Statement of financial position**
- **Statement of profit or loss and other comprehensive income**
- **Statement of changes in equity**
- **Notes**

IAS 1 does not lay down particular formats for financial statements but does have minimum requirements for the presentation of items on the face of the financial statements

Statement of financial position (SOFP)

- **Certain line items MUST be presented in the statement of financial position.** They are:

- property, plant and equipment - investment property - intangible assets - financial assets - equity accounted investments - biological assets - inventories - trade and other receivables - cash and cash equivalents	- assets held for sale - trade and other payables - provisions - financial liabilities - current tax amounts - deferred tax amounts - liabilities held for sale - non-controlling interests - issued capital and reserves

- **It is necessary to present assets and liabilities on the basis of the distinction between current items and non-current** items except where a presentation based on liquidity is reliable and more relevant.

Current items are those:

- expected to be realised/settled in an entity's normal operating cycle, or
- held primarily for the purpose of trading, or
- expected to be realised/due to be settled within 12 months, or
- in the case of an asset is unrestricted cash or cash equivalent, or
- in the case of a liability has no unconditional right to defer settlement for at least 12 months

Additional information should be disclosed either in the statement of financial position or in the notes, for example:

- classes of property, plant and equipment
- classifications of inventory
- types of provision
- details of classes of share capital
- a description of reserves within equity

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IAS 1 Presentation of Financial Statements

Statement of profit or loss and other comprehensive income (SPLOCI)

- **Other comprehensive income (OCI) is items of income and expense that are not recognised in profit or loss**, for example a revaluation surplus on a non-current asset. In accordance with other IFRS this may or may not be reclassified to profit or loss at a later date.

- **The statement of profit or loss and other comprehensive income may be presented as one single statement or two separate statements** (a statement of profit or loss and a statement disclosing OCI and total comprehensive income).

Profit or loss and total comprehensive income must be allocated between amounts attributable to:

- the non-controlling interest, and
- owners of the parent (see module 6)

- Minimum **disclosure requirements** in the profit or loss **are as follows**:

- revenue
- gains / losses on derecognition of financial assets measured at amortised cost
- finance costs
- impairment losses (and reversals)
- share of profit or loss of associates/joint ventures
- gains/losses on reclassification of financial assets
- tax expense
- single amount for discontinued operations

- **Items in OCI are split between those that can be reclassified to profit or loss and those that cannot be reclassified**.

Sometimes, items of OCI that are not currently recognised in profit or loss may be recognised there at a later date. They should be analysed as follows:

- OCI that will not be reclassified subsequently to profit or loss
- OCI that may be reclassified to profit or loss
- Share of OCI of associate/JV that will not be reclassified to profit or loss
- Share of OCI of associate/JV that may be reclassified to profit or loss

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IAS 1 Presentation of Financial Statements

Statement of profit or loss and other comprehensive income (SPLOCI) continued

- Expenses in profit or loss may be analysed using either the 'nature of expense' or the 'function of expense' method. Examples of each are as follows:

Nature of expense		**Function of expense**	
Revenue	X	Revenue	X
Other income	X	Cost of sales	(X)
Change in inventories	(X)	Gross profit	X
Raw materials used	(X)	Other income	X
Employee benefit expense	(X)	Distribution costs	(X)
Depreciation expense	(X)	Administrative expenses	(X)
Other expenses	(X)	Other expenses	(X)
Profit before tax	X	Profit before tax	X

- When an item of income or expense is material, its nature and amount should be disclosed separately in the statement of profit or loss or in the notes to the accounts.

Statement of changes in equity (SOCIE)

The statement of changes in equity must include:

- total comprehensive income for the period
- for each component of equity the effects of changes in accounting policies and corrections of errors recognised in accordance with IAS 8
- for each component of equity, a reconciliation between the carrying amount at the beginning and end of the period resulting from:
  - profit or loss
  - other comprehensive income
  - transactions with owners in their capacity as owners

Notes to the financial statements

These should:

- present information about the basis of preparation and accounting policies
- disclose information required by IFRSs that is not disclosed elsewhere
- provide other relevant information not presented elsewhere

Exercise - IAS 1 Question 1

Please review the following exercise:

Should the going concern assumption be dropped when part of a reporting entity is suffering financial difficulty?

You should refer to the text of the standard when answering all exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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Exercise - IAS 1 Question 2

Please review the following exercise:

Is consistency of accounting policies from year to year required?

You should refer to the text of the standard when answering all exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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Exercise - IAS 1 Question 3

Please review the following exercise:

Can a loan which is due to be paid back in four months be a non-current liability?

You should refer to the text of the standard when answering all exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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IFRS 15 Revenue from Contracts with Customers

The objective of IFRS 15 is to establish principles in relation to the nature, amount, timing and uncertainly of revenue and cash flows arising from a contract with a customer (paragraph 1). IFRS 15 replaces IAS 11 Construction Contracts and IAS 18 Revenue when it becomes effective in 2018. Note that early adoption is permitted.

IFRS 15 applies a five step model for recognising and measuring revenue:

1. **Identify the contract with the customer**
2. **Identify the separate performance obligations in the contract**
3. **Determine the contract price**
4. **Allocate the transaction price to the performance obligations in the contract**
5. **Recognise revenue when (or as) the entity satisfies a performance obligation**

Step 1: Identify the contract with the customer:

The following conditions must be satisfied for IFRS 15 to apply:

- The contract must be approved by all parties
- The rights in relation to the goods and services to be transferred can be identified
- Payment terms can be identified
- The contract has commercial substance
- Collection of consideration to which the entity is entitled in relation to the exchange of goods and services is probable

(IFRS 15 paragraph 9).

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IFRS 15 Revenue from Contracts with Customers

Step 2: Identify the performance obligations in the contract

At the contract's inception, the entity should assess the goods and services promised to the customer, and identify as a performance obligation each promise to transfer either:

- A good or service that is distinct, or
- A series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer

(IFRS 15 parapraph 22)

A good or service is distinct if both the following criteria apply:

- The customer can benefit from the good or service on its own or in conjunction with other readily available resources
- The entity's promise to transfer the good or service is separately identifiable from other promises in the contract

(IFRS paragraph 27)

A series of distinct goods or services is transferred to the customer in the same pattern if both the following are satisfied:

- Each distinct good or service in the the series that the entity promises to transfer consecutively to the customer would be a performance obligation that is satisfied over time
- A single method of measuring progress would be used to measure the entity's progress towards complete satisfaction of of the performance obligation to transfer each distinct good or service in the series to the customer. (paragraph 23)

Example

Steadman Construction Co is contracted to build an office for a customer. It will design the building, purchase materials, prepare the site, construct the property, install wiring and air conditioning and finish the property.

Although each element of the construction process is capable of being distinct (eg Steadman Co could sell only the design part of the service), in the context of the contract, the company provides a significant service in integrating the input processes to produce a property. Therefore there is a single performance obligation, being the construction of the property.

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IFRS 15 Revenue from Contracts with Customers

Step 3: Determine the transaction price
The transaction price is the amount that the entity expects to be entitled in exchange for the transfer of goods and services, In determining the transaction price, the entity should consider the contract terms and past customary business practices. It should adjust the transaction price for the effects of the time value of money if the timing of payments provides the customer with a financing benefit.

(IFRS 15 paragraph 47)

In certain circumstances, the consideration may not be fixed and may vary (known as variable consideration).This may be due to the use of discounts, refunds, credits, concessions, incentives, bonuses penalties etc. Variable consideration also arises if there is contingent consideration.

Variable consideration is included in the transaction price only to the extent that it is highly probable that its inclusion will not result in a significant revenue reversal in the future when any uncertainty has been subsequently resolved.

(IFRS 15 paragraph 56)

Step 4: Allocate the transaction price to the performance obligations in the contracts

Where a contract has multiple performance obligations, an entity will allocate the transaction price to the performance obligations in the contract by reference to their relative standalone selling prices.

(IFRS 15 paragraph 74)

If a standalone price is not available it should be estimated using methods such as:

- Adjusted market assessment (ie estimating the price that the customer would be willing to pay in the market in which it operated)
- Expected cost plus a margin
- Residual approach (ie taking the total transaction price less the sum of the standalone selling prices of other promises in the contract)

(IFRS 15 paragraph 79)

Any overall discount compared to the aggregate of standalone selling prices is allocated between performance obligations on a relative standalone selling price basis. In certain circumstances, it may be appropriate to allocate the discount to some but not all of the performance obligations.

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IFRS 15 Revenue from Contracts with Customers

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation

Revenue is recognised as **control** is passed, either

- **Over time**, or
- **At a single point in time**

(IFRS 15 paragraph 32)

Control
Control is the ability to direct the use of and obtain substantially all the remaining benefits of an asset. This includes preventing others from directing the use of and obtaining the benefits of the asset. The benefits are the potential cash flows that may be obtained directly or indirectly, including

- Using the asset to produce goods or services
- Using the asset to enhance the value of other assets
- Selling/exchanging the asset
- Pledging the asset as security for a loan
- Holding the asset

(IFRS 15 paragraphs 31-33)

Control passes over time
A performance obligation is satisfied over time if one of the following is met:

- The Customer simultaneously receives and consumes all the benefits provided by the entity as the entity performs
- The Entity's performance creates or enhances as asset that the customer controls as the asset is created
- The Entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date

(IFRS 15 paragraph 35)

Control passes at single point in time
Where control is passed at a single point in time, factors considered in determining that time include:

- Entity has a present right to payment for the asset
- Customer has legal title to asset
- Entity has transferred physical possession of the asset
- Customer has significant risks and rewards related to ownership of the asset
- Customer has accepted the asset

(IFRS 15 paragraph 38)

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IFRS 15 Revenue from Contracts with Customers

Contract costs

IFRS 15 considered the costs of obtaining a contract and the costs of fulfilling a contract.

Costs of obtaining a contract

Incremental costs that are incurred when obtaining a contract are treated as an asset if the entity expects to recover the costs. These costs are limited to the costs that the entity would not have incurred if the contract had not been successfully obtained.

Incremental costs can be expensed if the associated amortisation period would be 12 months or less.

(IFRS 15 paragraphs 91-94)

Costs of fulfilling a contract

Costs to fulfil a contract are only capitalised as an asset if all of the following are satisfied:

- Costs directly relate to the contract
- Costs generate/enhance resources of the entity that will be used in satisfying performance obligations in the future
- Costs are expected to be recovered

(IFRS 15 paragraph 95)

These costs include direct labour, direct materials and the allocation of overheads that related directly to the contract.

(IFRS 15 paragraph 97)

Capitalised costs are amortised on a systematic basis consistent with the pattern of transfer of goods to which the asset relates.

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IFRS 15 Revenue from Contracts with Customers

Presentation in financial statements

Contracts with customers are presented in the statement of financial position as either a contract asset, a receivable or a contract liability, depending on the relationship between the entity's performance and the customer's payment.

(IFRS 15 paragraph 105)

A **contract asset** arises where the entity has transferred a good or service to the customer and its right to consideration is conditional on something other than the passage of time (e.g. performance).

A **receivable** is recognised when an entity's right to consideration is unconditional because only the passage of time is required before payment of the consideration is due.

The entity is not prohibited from using alternative descriptions for these assets as long as they are distinguishable from each other.

A **contract liability** arises where a customer has paid consideration to an entity (or is due to) prior to the transfer of the related goods or services.

Any impairment relating to contracts with customers should be measured according to IFRS 9.

Any difference between the initial recognition of a receivable and the corresponding amount of revenue recognised should be presented as an expense, for example, an impairment loss.

(IFRS 15 paragraphs 107-8)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/en/standards/ifrs/ifrs15.htm

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IFRS 15 Revenue from Contracts with Customers

Example 1: Revenue from contracts with customers

Lingard Co sells a cable TV system to Monica under the following terms on 1 January 20X5:

Monica has to pay a monthly fee of $80 for 12 months. Monica receives a cable TV set top box and access to all the TV channels.

The contract does not contain any other conditions and, once signed, the receipt of the consideration is unconditional.

Lingard Co sells the set top box by itself for $250 and charges monthly access to the TV service without the set top box for $65 a month.

What amount of revenue should Lingard Co recognise in the year ended 31 March 20X5?

Applying IFRS 15:

Step 1: Identify the contract	This is the 12 month commitment from Monica
Step 2: Identify the performance obligations	Lingard Co has two separate performance obligations: • Deliver a set top box • Deliver cable TV access for 12 months
Step 3: Determine the transaction price	$960 (12 x $80)

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IFRS 15 Revenue from Contracts with Customers

Step 4: Allocate transaction price to performance obligations

IFRS 15 states that where a contract has multiple performance obligations, an entity will allocate the transaction price to the performance obligations in the contract by reference to their relative standalone selling prices:

	Standalone price	% total	Revenue
Box	$250	24.3%	$233.00
Monthly access to TV	$65 x 12 = $780 ______	75.7%	$727.00 ______
	$1,030		$960.00

Step 5: Recognise revenue as performance obligations satisfied

When Lingard Co delivers the set top box it should recognise revenue of $233.00.

Lingard Co should recognise revenue in respect of the TV access as access is provided to Monica. Therefore in the year ended 31 March 20X5, revenue of $181.00 ($727 x 3/12) is recognised.

A summary of the journals required in the period 1 January-31 March 20X5 is therefore:

DEBIT	Cash ($80 x 3)	$240
DEBIT	Receivable	$174
CREDIT	Revenue ($233 + $181)	$414

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IFRS 15 Revenue from Contracts with Customers

Example 2: Revenue from contracts with customers
On 1 January 20X5, Escot Co enters into a contract to sell computers at $600 per unit to Holla Co. If Holla Co purchases more than 300 units in a calendar year the prices falls to $575 per unit.

By 31 March 20X5 Escot Co has sold 40 units to the Holla Co and estimates that it will not sell 300 units by 31 December 20X5.

What revenue should Escot Co recognise in the quarter ended 31 March 20X5?

Applying IFRS 15:

Escot Co must consider Holla Co's buying pattern in the first three months of the year in order to determine whether Holla Co will purchase sufficient units to achieve the volume discount.

Based on sales to March, it is highly probable that the volume discount will not be achieved by Holla Co and there will not be a significant reversal of the cumulative amount of revenue recognised for Escot Co.

Therefore, Escot Co should recognise revenue of $24,000 (40 x $600) in the first quarter.

During the next quarter, Holla Co is acquired by another entity that revises Holla Co's purchasing strategy. As a result, Holla Co buys a further 200 computers during the quarter ended 30 June 20X5. Escot Co now estimates that Holla Co's purchases will exceed the 300 unit annual threshold, and so it should retrospectively reduce the price charged.

What revenue should Escot Co recognise in the quarter ended 30 June 20X5?

Applying IFRS 15:

Escot Co should recognise revenue of $114,000 for the quarter ended 30 June 20X5.

This is calculated as $115,000 (200 x $575) less the change in transaction price of $1,000 (40 x $25) for the sales in the period to 31 March 20X5.

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IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

IAS 8 deals with:
- The selection of accounting policies
- Changes in accounting policy
- Changes in accounting estimates
- Errors

Selection of accounting policies

- **Accounting policies should be determined by applying the relevant IFRS or Interpretation**
- In the absence of a Standard or an Interpretation, management must use its judgement in developing and applying an accounting policy that results in information that is relevant and reliable
- Management must refer to, and consider the applicability of, the following sources in descending order:
  - The requirements and guidance in IASB standards and interpretations dealing with similar and related issues
  - The definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the framework

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IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

- Management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with paragraph 11

(IAS 8 paragraphs 7-12)

Changes in accounting policy

- **An entity should select and apply its accounting policies consistently** for similar transactions, other events and conditions
- Changes in accounting policies are rare and should only be made if they
  - Are required by a standard or interpretation, or
  - Result in the financial statements providing reliable and more relevant information
- **A change in accounting policy must be accounted for retrospectively**, as if the new policy had always been in place.This requires restatement of comparative amounts and a prior period adjustment in respect of the cumulative effect of the change as at the start of the earliest comparative period
- The change in accounting policy must also be disclosed

(IAS 8 paragraphs 13, 14, 22, 28, 29)

Changes in accounting estimate

- **Accounting estimates include methods of depreciation, residual values and amounts of provisions**
- Where an estimate is changed, the change is accounted for prospectively by including its effect in the period of the change (and future periods, if relevant)
- Changes in accounting estimates must also be disclosed

(IAS 8 paragraphs 36, 39)

Errors

- **The general principle in IAS 8 is that an entity must correct all material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery.**
- This is achieved by restating the comparative amounts for the prior period(s) presented in which the error occurred, or, if the error occurred before the earliest period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented
- Details of errors should also be disclosed.

(IAS 8 paragraphs 42, 49)

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Frequently asked questions

1. Is there a "true and fair override" in IFRSs?
2. What is the status of interpretations?
3. Suppose that a company has entered into a binding contract to sell an asset soon for a fixed amount. Can revenue be recorded?

1. IAS 1 talks of fair presentation rather than true and fair view. However, there is an override, which is said to be necessary only in very rare circumstances. Substantial disclosures are required.

2. IAS 1 gives interpretations the same status as standards. That is, they must be complied with.

3. The Conceptual Framework would appear to suggest that the gain is both relevant and reliable information. However, IFRS 15 requires control to be passed, so it seems that the gain cannot be recorded yet.

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Quick Quiz

Module 3 quick quiz

Click next to continue

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Question 1

During the year to 30 September 20X8, the following events occurred in relation to Pipe Co. All were material to the company's financial statements:

1. A claim for tax relief, submitted in 20X5, was rejected by the tax authorities. No appeal will be made. The resulting liability of $15,000 was not provided for at 30 September 20X7, since when the 20X7 financial statements had been authorised for issue. The company had expected the claim to succeed.

2. A cut-off error in respect of inventory was discovered, which would have reduced the carrying amount of inventory by $24,000 at 30 September 20X7.

3. Obsolete inventory was written down to its estimated net realisable value of $17,000 at 30 September 20X7. Due to further falls in the selling price of the inventory after 30 September 20X7 the inventory was subsequently sold for $7,000.

The retained earnings at 30 September 20X7, as reported in the 20X7 financial statements was $530,000. What is the restated retained earnings balance at 30 September 20X7 as reported in the 20X8 financial statements?

A. $496,000
B. $506,000
C. $515,000
D. $516,000

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Question 2

Which of the following does IAS 1 not require to be disclosed in the Statement of Changes in Equity (SOCIE)?

A. Total comprehensive income for the period

B. A reconciliation between the carrying amount at the beginning and the end of the period for each component of equity

C. Each item of other comprehensive income

D. The cumulative effect of changes in accounting policy and the correction of material errors

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Question 3

Which line item must be disclosed separately on the face of the Statement of Financial Position (SOFP)?

A. Intangible assets

B. Work in progress

C. Prepayments

D. Accruals

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Question 4

Which of the following line items could be included in a statement of profit or loss and other comprehensive income prepared using the 'nature of expense' method?

1. Changes in inventories of finished goods and work in progress
2. Raw materials and consumables used
3. Consulting expense

A. 1 and 2

B. 1 and 3

C. 2 and 3

D. 1, 2 and 3

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Question 5

Does the Job Co, a software company, has an accounting year-end of 31 December. It makes a sale for $500,000 on 30 June 20X4, to a customer, Brady. This amount includes $470,000 for software and $30,000 for support services for the two years commencing 1 July 20X4. How much revenue should Does the Job Co recognise in the statement of profit or loss in the year ended 31 December 20X4?

A. $500,000

B. $485,000

C. $477,500

D. $470,000

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Module 4: What you will learn: accounting for assets and liabilities - part 1

In this module you will look at the following standards:

- Property plant and equipment - IAS 16
- Intangible assets - IAS 38
- Investment property - IAS 40
- Impairment of assets - IAS 36
- Borrowing costs - IAS 23
- Accounting for government grants and disclosure of government assistance - IAS 20
- Inventories - IAS 2
- Leases - IAS 17
- Non-current assets held for sale and discontinued operations - IFRS 5

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Introduction

"The definition of an asset is: 'a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.'"
Conceptual Framework

The accounting treatment of assets involves a three-stage process:

1. Determining whether an item meets the definition of an asset
2. Determining whether the asset should be recognised in the statement of financial position?
3. Determining how the assets should be measured

Definition of an asset

It should be noted that an asset is not necessarily something which is owned but which is controlled. For example, a company that leases an item to use may have an asset if it controls that item. Of course, for an item to be an asset at all, it must produce some future benefit to the entity.

Recognition of an asset

Not all of an entity's assets should be recognised in the statement of financial position. Some of them cannot be measured with sufficient reliability to be included. It is necessary to have some measure of either cost or value.

Measurement of an asset
Having decided to recognise an asset there might then be several ways in which it could be measured, such as depreciated cost or current market value.

Each IFRS that deals with assets addresses both the recognition and measurement criteria as well as disclosure. This module considers several standards related to assets.

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IAS 16 Property Plant and Equipment

IAS 16 defines property plant and equipment (PPE) as tangible items that:

(a) are held for use in the production or supply or goods or services, for rental to others, or for administrative purposes, and

(b) are expected to be used during more than one period.

Recognition

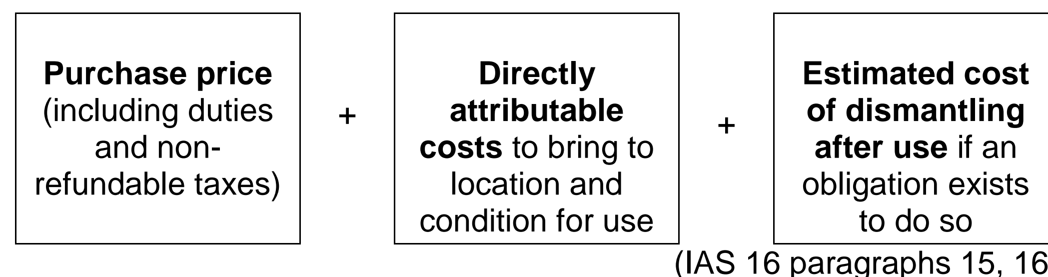
IAS 16 recognition criteria are the same as those of the Conceptual Framework. Therefore PPE is recognised if:

- It is probable that future economic benefits associated with the item will flow to the entity and
- The item's cost can be measured reliably

(IAS 16 paragraph 7)

Measurement

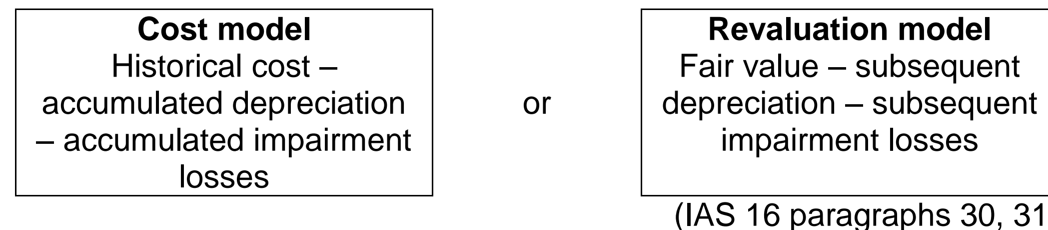
PPE is initially recognised at its cost, which includes all those costs of bringing it to its present condition and location including:



(IAS 16 paragraphs 15, 16)

Capitalisation of subsequent expenditure should occur when it is probable that the asset will produce future benefits in excess of the originally assessed standard of performance.

After initial measurement, an entity may **choose** which measurement model to apply to PPE:



(IAS 16 paragraphs 30, 31)

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IAS 16 Property Plant and Equipment

Revaluation model

Where the revaluation model is applied there are a number of requirements:

1. The model must be applied to all assets within the same class (eg all land and buildings)
2. Revaluations must be carried out with sufficient regularity to ensure that the carrying amount at each reporting date is not materially different from fair value at that date

Fair value is defined by IFRS 13 as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

(IAS 16 paragraphs 31, 36)

Accounting for a revaluation

The fair value of a property may increase or decrease; the accounting entries depend upon whether the fair value has previously increased or decreased:

- An increase in fair value is usually recognised in other comprehensive income (OCI)
- A decrease in fair value is usually recognised in profit or loss
- Where an increase in fair value reverses a previous decrease, it is first recognised in profit or loss to the extent of the previous decrease
- Where a decrease in fair value reverses a previous increase, it is first recognised in OCI to the extent of the previous increase

Amounts recognised in other comprehensive income in respect of revaluations are accumulated in the revaluation reserve (revaluation surplus) in equity.

This is an example of other comprehensive income that will not be reclassified to profit or loss.

Example

Acorn Co bought land for $500,000 on 1 March 20X1, accounting for it using the revaluation model. The land had a fair value of $600,000 at 31 December 20X1, however this had dropped to $450,000 at 31 December 20X2.

At 31 December 20X1 the revaluation increase is accounted for by:

DEBIT	Land	$100,000
CREDIT	OCI (revaluation surplus)	$100,000

At 31 December 20X2 the revaluation decrease is accounted for by:

DEBIT	OCI (revaluation surplus)	$100,000
DEBIT	Profit or loss	$50,000
CREDIT	Land	$150,000

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IAS 16 Property Plant and Equipment

Depreciation

All assets other than land must be depreciated.

The depreciable amount of an asset should be recognised as an expense (depreciated) over its useful life beginning when it is available for use.

The depreciable amount of an asset is cost less residual value expected at the end of the asset's useful life.

Residual value is the amount currently expected to be obtained from a disposal of the asset if the asset were already at the age and condition expected at the time of disposal.

The depreciation method should reflect the expected pattern of the consumption of the economic benefits of an asset by an entity. Methods may include straight line and reducing balance methods.

Residual value, useful life and depreciation methods are all accounting estimates that should be reviewed at each year end. Any changes are applied prospectively in line with IAS 8.

A revalued asset is depreciated by spreading its fair value over its remaining useful life.

(IAS 16 paragraphs 6, 50, 51, 60,61)

Disposal

The gain or loss on the disposal of an asset is calculated as the difference between the proceeds and the carrying amount.

Since the latter could be based on either cost or revaluation, the gain on sale would be lower if an asset had been revalued upwards.

When a revalued asset is disposed of, any revaluation surplus in respect of that asset is considered to be realised and may be transferred to retained earnings. This is a reserves transfer and is disclosed in the statement of changes in equity.

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

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Exercise - IAS 16 Question 1

Please review the following exercise:

A company bought some land for $15m in 20X0, revalued it at various dates up to $23m in 20X7, and sold it for $21m in 20X7, but did not receive any cash until 20X8. Ignoring tax, the gain/loss recorded in 20X7 should be:

A Zero
B A gain of $6m
C A loss of $2m
D A gain of $21m

You should refer to the text of the standard when answering all exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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Exercise - IAS 16 Question 2

Please review the following exercise:

A company owns five properties, all recognised as property, plant and equipment and measured using the cost model. Two of these properties are office buildings in central London. Market information suggests that these two properties have increased in value significantly and management would like to record a revaluation in the accounts to reflect this gain at the year-end. They believe this will provide more relevant information to shareholders and others reviewing the financial statements. Would IAS 16 permit this treatment?

You should refer to the text of the standard when answering all exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

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Module 4: Accounting for assets and liabilities - part 1
Certificate in International Financial Reporting
ACCA

IAS 38 Intangible Assets

"An intangible asset is an identifiable non-monetary asset without physical substance."

(IAS 38 paragraph 8)

To be recognised in the financial statements, an intangible asset must:

(i) meet this definition, and

(ii) meet the IAS 38 recognition criteria

Definition

In order to be considered for recognition as an intangible asset, an item must be:

Identifiable	The item must either be capable of being sold as a single item or must arise from contractual rights.
Non-monetary	The item must not be cash or an asset to be settled in a fixed amount of cash.
An Asset	The item must be controlled by the entity as a result of past events and result in probable future economic benefits.

(IAS 38 paragraph 8)

Therefore:

- internally generated goodwill is not identifiable and cannot be recognised as an intangible asset
- a receivable is monetary and cannot be recognised as an intangible asset
- staff members are not controlled by an entity (an asset) and so cannot be recognised as an intangible asset.

Recognition

The basic IAS 38 recognition criteria are the same as those in IAS 16 and the Conceptual Framework:

- it is probable that future economic benefits associated with the item will flow to the entity and
- the item's cost can be measured reliably

(IAS 38 paragraph 18)

It is usually more difficult for intangible assets to meet these criteria than tangible assets. Generally the cost of most internally generated intangibles cannot be distinguished from the cost of developing a business as a whole.

Certain items are therefore not recognised. IAS 38 prohibits the recognition of internally generated:

- brands - mastheads	- publishing titles - customer lists

(IAS 38 paragraph 63)

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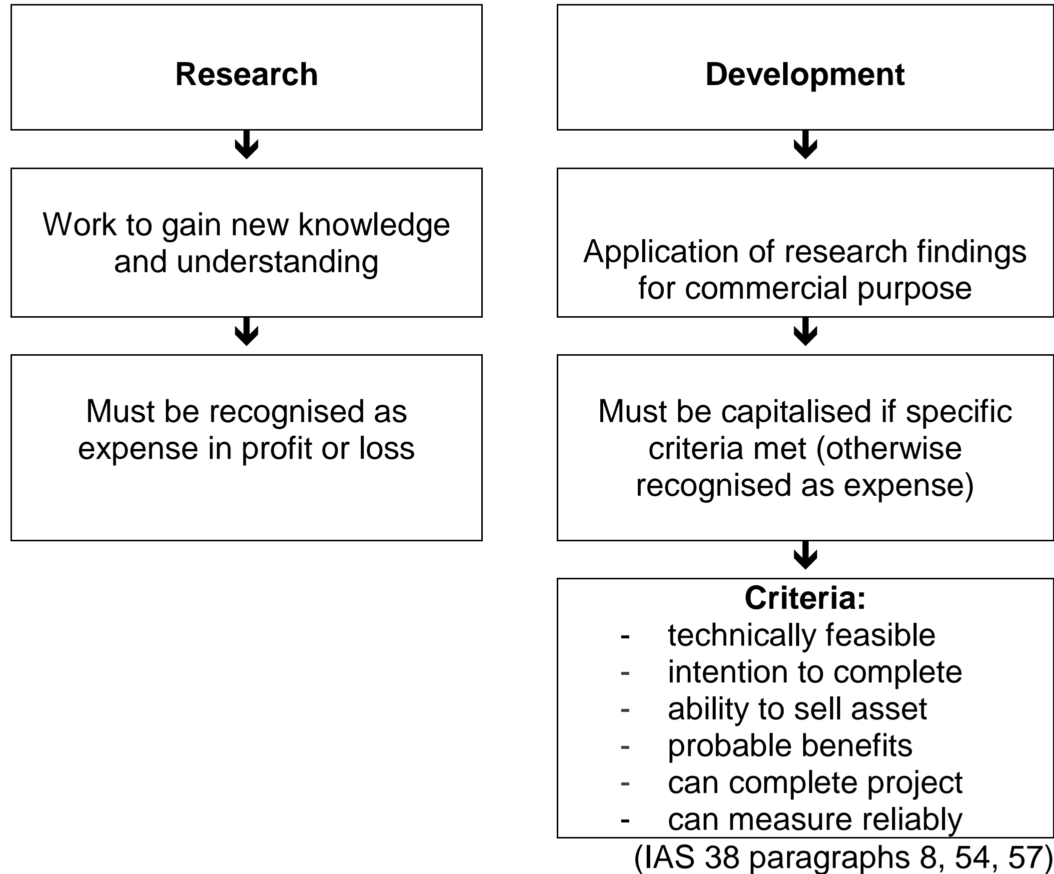
IAS 38 Intangible Assets

Development expenditure

As a result of the difficulties of applying the basic recognition criteria to internally generated assets, IAS 38 provides additional criteria to be applied to research and development expenditure.



(IAS 38 paragraphs 8, 54, 57)

Initial measurement

Intangible assets are initially measured at cost.

- In the case of acquired assets this is purchase cost and directly attributable costs incurred in making the asset ready for use
- In the case of development costs this is costs incurred after the six recognition criteria are all met until the asset is ready for use

(IAS 38 paragraphs 27, 65)

Subsequent measurement

In common with IAS 16, IAS 38 includes both a cost and revaluation model.

The revaluation model can, however only be applied to assets for which fair value can be measured by reference to an active market. This is a market with many buyers and sellers of identical items and publicly available prices. Most intangibles are unique and therefore not part of an active market. Exceptions include airport landing rights and taxicab licences.

(IAS 38 paragraphs 74,75)

Amortisation

Amortisation (depreciation) depends on the useful life of an intangible asset. An asset may have:

- An indefinite life: no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity
- A finite life: a limited period of benefit to the entity.

(IAS 38 paragraph 88)

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IAS 38 Intangible Assets

Intangible asset with a finite useful life

- The cost less residual value of the intangible asset is amortised over its useful life
- The amortisation method should reflect the pattern in which the entity will consume the asset's future economic benefits
- If the pattern cannot be identified reliably, the straight line method should be used
- The amortisation charge is recognised in profit or loss unless another IFRS requires it to be included in the cost of another asset
- The amortisation period should be reviewed at least annually and any change accounted for as a change in accounting estimate
- The asset should also be assessed for impairment in accordance with IAS 36

(IAS 38 paragraphs 97, 100, 104, 111)

Intangible asset with indefinite useful life

- The asset is not amortised.
- Its useful life should be reviewed each reporting period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset.
- If they do not, the change in the useful life assessment from indefinite to finite should be accounted for as a change in an accounting estimate.
- The asset should be assessed for impairment annually.

(IAS 38 paragraphs 107-109)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ias38.htm

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Exercise - IAS 38 Question 1

Please review the following exercise:

Can brand names be capitalised?

You should refer to the text of the standard when answering all exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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Exercise - IAS 38 Question 2

Please review the following exercise:

Can development expenditure be revalued upwards?

You should refer to the text of the standard when answering all exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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IAS 40 Investment Property

"Investment property is property held to earn rentals or capital gain, rather than being owner occupied or held for sale in the ordinary course of business."

Definition

The definition of investment property includes and excludes the following:

Includes	Excludes
• Land held for long term capital appreciation • Land held for an undetermined use • A building leased out under one or more operating leases • A vacant building that is held to be leased out under operating leases • Property that is being developed for use as investment property	• Property intended to be sold in the ordinary course of business • Owner-occupied property • Property held for future owner-occupation • Property occupied by employees. • Owner-occupied property awaiting disposal • Property leased to another entity under a finance lease

(IAS 40 paragraphs 8,9)

Example

Spruce Co acquires a 5 storey property by way of a finance lease. Each storey is a self-contained office space. Spruce Co had the option of acquiring any number of storeys of the building, however decided to acquire all 5, using one for its sales and marketing function, and renting the remaining 4 to other companies under operating leases.

Spruce Co has acquired the property by way of a finance lease. IAS 40 is clear that the definition of investment property includes property that is owned and property held under a finance lease.

Spruce Co occupies 1/5 of the property and rent out 4/5 of the property. In this case IAS 40 requires split-accounting if each portion could be sold or leased out separately under a finance lease. It is clear that this is the case because Spruce Co had the option of acquiring any number of storeys of the building.

Therefore:

- 1/5 of the property is accounted for as owner-occupied property in accordance with IAS 16.
- 4/5 of the property is accounted for as investment property in accordance with IAS 40.

IAS 40 Investment property

Recognition

IAS 40 recognition criteria are the same as those of IAS 16 and the Conceptual Framework.

Measurement

Investing in properties is a way for a company to utilise surplus cash and therefore the accounting treatment applicable to other properties is not necessarily relevant.

IAS 40 allows a choice of applying measurement models:

Cost model		Fair value model
Historical cost – accumulated depreciation – accumulated impairment losses (IAS 16)	or	Fair value at each reporting date with gains/losses in profit or loss. No depreciation

(IAS 40 paragraphs 30, 33-35)

The choice must be applied consistently for all investment properties and a change in model is only permitted where it results in more relevant information. This is unlikely to be the case for a change from the fair value to cost model.

(IAS 40 paragraphs 30, 31)

If the fair value model is applied, individual properties whose fair value cannot be reliably measured should also be measured at cost.

(IAS 40 paragraph 53)

Entities that apply the cost model must disclose the fair value of investment properties in the notes to the financial statements.

(IAS 40 paragraph 79)

Transfers

Transfers to or from investment property arise where there is a change in use.

When a property is transferred from investment property under the fair value model to owner occupied property or inventory**,** the property's deemed cost is its fair value at the date of its change of use.

When an owner occupied property is transferred to investment property measured at fair value, it should be revalued in line with IAS 16 immediately prior to transfer.

When inventory is transferred to investment property measured at fair value, the difference between its carrying amount and fair value is recognised in profit or loss.

(IAS 40 paragraphs 57, 60, 61, 63)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ias40.htm

IAS 36 Impairment of assets

> **"An asset should not be measured in the financial statements at an amount in excess of its value to the reporting entity, whether this is net sales value or value achieved through continued use."**

When the carrying amount of an asset in the financial statements is greater than its value to the business (its recoverable amount), then the asset is impaired and should be written down. The reduction in carrying amount is an impairment loss.

Scope of IAS 36

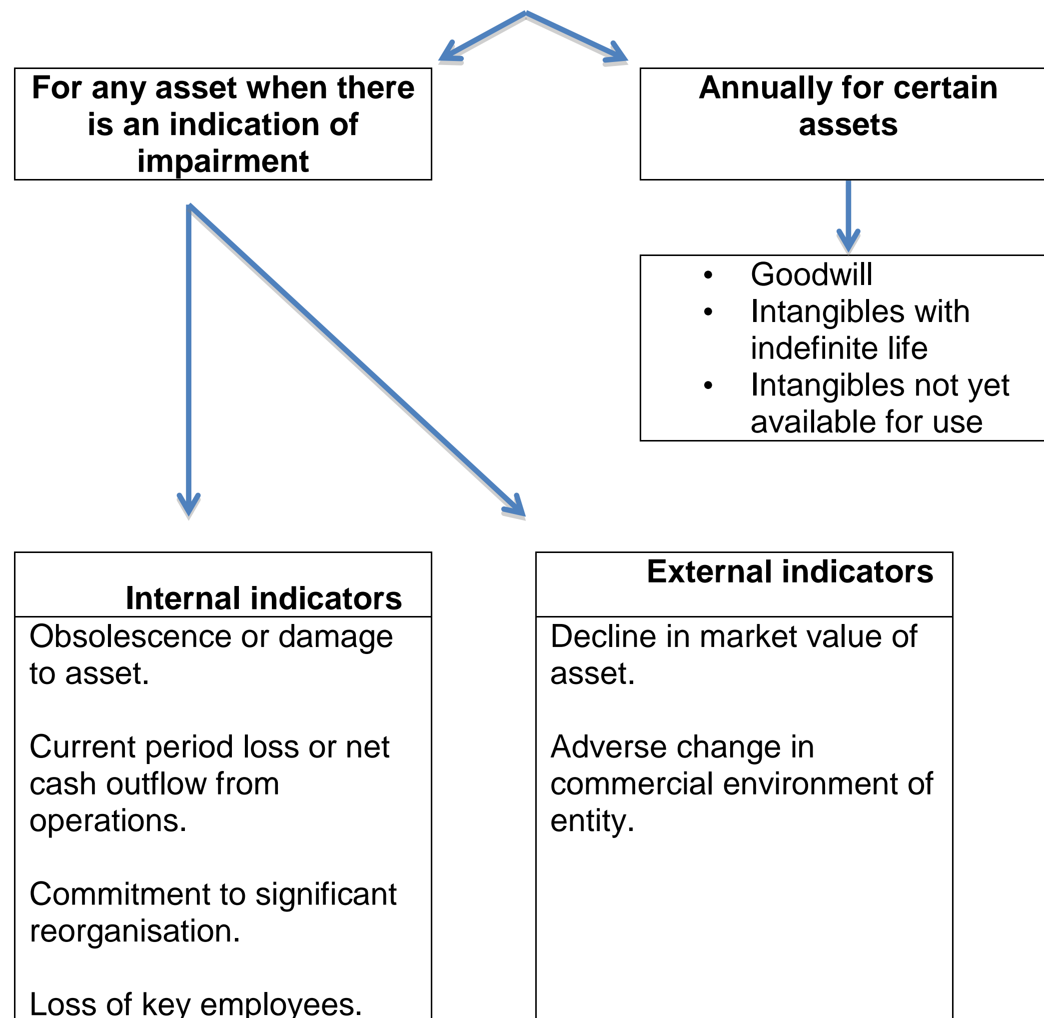
Despite the name of the standard, Impairment of Assets, IAS 36 is not relevant to all assets. It does not apply to the following (largely because the individual standards deal with relevant impairment themselves):

• Inventories (IAS 2) • Receivables (IFRS 15) • Deferred tax assets (IAS 12) • Pension assets (IAS 19) • Financial assets (IFRS 9) • Biological assets (IAS 41)	• Investment property measured at fair value (IAS 40) • Assets within the scope of IFRS 4 • Non-current assets held for sale (IFRS 5)

(IAS 36 paragraph 2)

How often to test for impairment

An impairment test should be performed:



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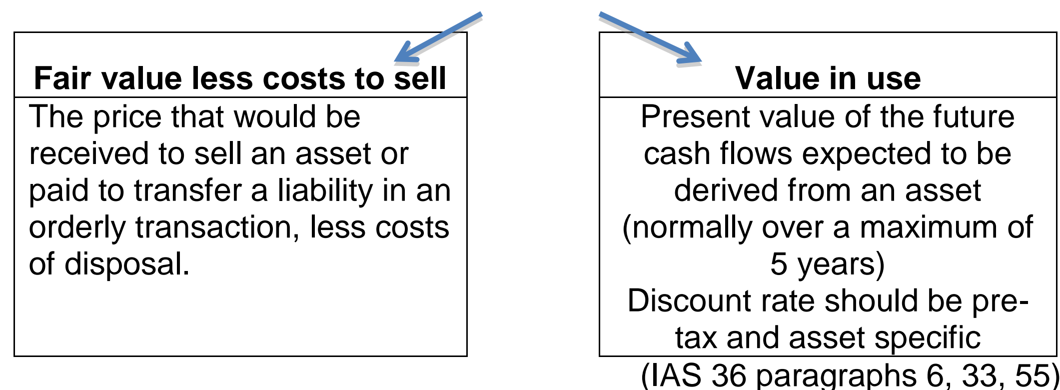
IAS 36 Impairment of Assets

Testing for impairment
Testing for impairment involves comparing:

- The carrying amount of an asset with
- The recoverable amount of the asset

The recoverable amount of an asset if the higher of:



(IAS 36 paragraphs 6, 33, 55)

Accounting for impairment
An impairment exists if carrying amount exceeds recoverable amount; the loss is the difference between these amounts and it is usually recognised immediately in profit or loss.
An exception to this rule exists if there is a revaluation surplus related to the impaired asset. In this case the loss is first recognised in OCI (and debited to the revaluation surplus) and any excess recognised in profit or loss.

(IAS 36 paragraphs 60, 61)

Example
An item of plant has a carrying amount (based on historical cost) of $124,000 and a value in use of $117,000. The price the asset could achieve at auction is expected to be $127,000 and fees of 10% would be incurred on a sale.

The asset's recoverable amount is $117,000, being the higher of value in use and fair value less costs to sell ($127,000 x 90% = $114,300).

The asset is impaired by $7,000 and the loss is recognised by:

DEBIT	Profit or loss	$7,000
CREDIT	PPE	$7,000

Cash-generating units

For many assets it is impossible to measure specific cash flows relating to them. Therefore, it becomes necessary to perform impairment testing for the smallest group of assets for which independent cash flows can be measured. This group of assets is called a "cash-generating unit" (CGU).

The carrying amount of the CGU is compared with its recoverable amount. Any impairment loss is allocated:

1. To any goodwill in the CGU
2. To other assets of the CGU (that are within the scope of IAs 36) on a pro rata basis

(IAS 36 paragraphs 66, 104)

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IAS 36 Impairment of Assets

Although not specifically mentioned in IAS 36, it is normal practice to reduce the carrying amount of any damaged or obsolete asset before pro-rating the remaining loss across remaining assets.

The carrying amount of an individual asset should not be reduced below the highest of:

(a) its fair value less costs of disposal
(b) its value in use, and
(c) zero

(IAS 36 paragraph 105)

EXAMPLE

A CGU comprises goodwill with a carrying amount of $20,000, PPE with a carrying amount of $150,000, Intangible assets with a carrying amount of $50,000 and net current assets with a carrying amount of $90,000. The recoverable amount of the CGU is $250,000.

The impairment loss of $60,000 is allocated as follows:

	Carrying amount $	Impairment loss $	After impairment $
Goodwill	20,000	(20,000)	-
PPE	150,000	150/200 x 40 = (30,000)	120,000
Intangibles	50,000	50/200 x 40 = (10,000)	40,000
Net current assets	90,000	Outside scope	90,000
	310,000		250,000

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/en/standards/ias/ias36

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Case study - Impairment of Assets

This case study is loosely based on a real example. Suppose that a Malaysian company, Goodtimes Co, prepares its statements according to IFRSs. It had a flow of net profit as follows:

Year	20X5	20X6	20X7	20X8	20X9
Net Profit (RMB million)	570	630	102	610 (estimate)	590 (estimate)

In the 20X7 Annual Report, the following was noted:

"In December 20X7 a review of our assets indicated that the value of the oil and gas operations in our Sector B production area was lower than we had previously been estimating. Management carried out an impairment test of our oil and gas pipelines by comparing their carrying value with the present value of the expected net cash flows. This resulted in a write down of RMB650 million, and an impairment loss of that size was charged to income".

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Case study - Impairment of Assets

What sorts of estimates are involved in impairment tests?

An impairment test is conducted in accordance with IAS 36.

The test requires a comparison of carrying amount with recoverable amount, which is the higher of fair value less costs to sell and value in use.

In order to determine fair value, IFRS 13 should be applied. This requires that fair value is an 'exit price' i.e. the price that could be achieved for an asset on sale. In some cases (e.g. for a listed investment) this amount can be determined based on quoted prices, and little estimation is required. In other cases such as the oil and gas pipelines it must be determined based on unobservable inputs, in which case there is a greater degree of estimation. A fair value will be more difficult to determine where there is a limited market, which is probably the case for pipelines. Costs to sell is also an estimated amount based on market knowledge.

Estimates of value in use rely on knowing the life of the pipelines to the present owner, the disposal proceeds, the cash flows in and out over the future life, and a suitable pre-tax discount rate. IAS 36 discusses this, but there is still considerable room for manoeuvre.

Do you think that there is any incentive for management to overstate or understate the impairment loss?

The impairment loss for 20X8 is so large in the context of the five year run of profits that analysts may decide to ignore it on the grounds of "unusual" / "abnormal" / "non-recurring". Once the management realises this, they might be tempted to make the loss as big as possible so that future depreciation expenses are lower and gains on disposal higher.

This answer is written in the context of countries where impairment losses are not treated as tax deductible expenses. Of course if they are tax deductible, then a company would usually want to maximise them.

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IAS 23 Borrowing Costs

Eligible borrowing costs associated with the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of that asset.

Eligible borrowing costs

These include simple interest, interest calculated using the effective interest method (IFRS 9), finance charges on finance leases and exchange differences to the extent they are an adjustment to interest costs on foreign currency loans.

Borrowing costs eligible for capitalisation are those that would have been avoided if expenditure on the qualifying asset had not been incurred.

(IAS 23 paragraphs 5,6)

Qualifying assets

These are assets that necessarily take a substantial period of time to get ready for intended use or sale. They may include property, plant and equipment, intangible assets, investment properties and inventories.

(IAS 23 paragraphs 5,7)

Capitalisation period

The capitalisation of eligible borrowing costs:

Commences when	• Expenditure on the asset has commenced, and • Borrowing costs are being incurred, and • Activities to prepare the asset for intended use are in progress (including activities before physical construction begins e.g. planning)
Ceases when	Substantially all of the activities necessary to prepare the asset for intended use or sale are complete.
Is suspended when	Active development of the asset is suspended for an extended period.

(IAS 23 paragraphs 17, 19, 20, 22)

Borrowing costs as an expense

Borrowing costs that are not capitalised are recognised in profit or loss as incurred.

(IAS 23 paragraph 8)

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IAS 23 Borrowing Costs

Calculation of capitalised borrowing costs

The calculation depends on whether funds are borrowed specifically for the development of a qualifying asset or are drawn down from a pool of general borrowings.

Specific borrowings

Where a business borrows specifically to fund a project, the borrowing costs that may be capitalised will be those actually incurred less investment income from the temporary investment of the funds.

(IAS 23 paragraph 12)

General borrowings

Where an entity funds an asset using general borrowings, the borrowing costs that are capitalised are calculated by applying the weighted average cost of borrowing to the expenditure on that specific asset.

(IAS 23 paragraph 14)

Example

Hazlenut Co has the following borrowings outstanding throughout the year ended 31 December 20X4:

- $1million 5% bank loan
- $3 million 7% loan notes

On 1 August 20X4 it drew down $1,500,000 borrowings for the purpose of constructing a new warehouse. Architects began designing the building on this date and construction began on 1 September 20X4.

The property was completed on 30 November 20X5.

The weighted average cost of capital is calculated as:

($1m/$4m x 5%) + ($3m/$4m x 7%) = 6.5%

Borrowing costs are capitalised from 1 August 20X4 to 30 November 20X4. Therefore the amount to be capitalised is:

6.5% x $1,500,000 x 4/12 months = $32,500.

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

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IAS 20 Accounting for Government Grants and Disclosure of Government Assistance

"The objective of IAS 20 is to prescribe the accounting for, and disclosure of, government grants and other forms of government assistance."

Types of grant

Capital	Contribute to the acquisition of an asset
Revenue	Grant for other purposes e.g. to employ additional staff

Recognition

A grant is only recognised in the financial statements if there is reasonable assurance that:

- The entity will comply with grant conditions
- The grant will be received

(IAS 20 paragraph 7)

A grant is recognised as income in profit or loss in the period in which the expenditure to which is contributes is recognised:

- A capital grant is recognised over the useful life of the asset as depreciation is recognised
- A revenue grant is recognised when the costs of complying with the grant are recognised

(IAS 20 paragraph 12)

Presentation

Capital	Either: 1. Recognise grant as a reduction in the carrying amount of the asset, so resulting in a depreciation charge net of grant income, or 2. Recognise grant as deferred income and release to profit or loss as grant income
Revenue	Recognise as deferred income and release to profit or loss either: 1. As a separate line of income, or 2. Netted off against the related expenditure If related costs have already been recognised, grant income is recognised when receivable

(IAS 20 paragraphs 20, 24, 29)

Government assistance

Significant government assistance is disclosed as a note in the financial statements.

(IAS 20 paragraph 36)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/en/standards/ias/ias20

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Exercise - IAS 20 Question

Please review the following exercise:

An entity has received a government grant relating to an asset that is expected to last for ten years. It is highly probable that the conditions of the grant will continue to be met. Does the Conceptual Framework suggest the same recognition requirement as IAS 20?

You should refer to the text of the standard when answering all exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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IAS 2 Inventories

"The objective of IAS 2 is to prescribe the accounting treatment for inventories. It provides guidance for determining the cost of inventories and for subsequently recognising an expense, including any write-down to net realisable value. It also provides guidance on the cost formulas that are used to assign costs to inventories."

Measurement of closing inventoryC
Closing inventory is measured at the lower of:

Cost	And	**Net realisable value**
Includes all costs of purchasing inventory and bringing it to its present location and condition		Estimated selling price in the ordinary course of business less estimated costs of completion and sale

(IAS 2 paragirahssss

(IAS 2 paragraphs 6, 9, 10)

Cost

Cost includes:

- Costs of purchase (including import duties, taxes, transport, and handling costs) net of trade discounts received
- Costs of conversion (including a systematic allocation of fixed and variable manufacturing overheads. The allocation of fixed overheads is based on normal production capacity; the allocation of variable overheads is based on actual production capacity)
- Other costs incurred in bringing the inventories to their present location and condition.

Cost excludes abnormal waste, storage costs, selling costs and administrative overheads unrelated to production.

(IAS 2 paragraphs 11-16)

Determining cost

The standard cost and retail methods may be used for the measurement of cost, provided that the results approximate actual cost.

IAS 2 allows a choice of formulae to determine cost where the specific cost is not obvious. FIFO or weighted average are the permitted treatments. LIFO is not permitted under IAS 2.

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IAS 2 Inventories

The same cost formula should be used for all inventories with similar characteristics. For groups of inventories that have different characteristics, different cost formulas may be justified.

(IAS 2 paragraphs 21, 23, 25)

Writing down to net realisable value (NRV)

Inventories are written down to NRV item by item.

Raw materials held for use in the production of inventories are not written down below cost if the finished goods into which they will be incorporated are expected to be sold at or above cost.

(IAS 2 paragraphs 29, 32)

Recognition of an expense

The carrying amount of inventories is recognised as an expense when those inventories are sold.

Any write-down to NRV is recognised as an expense in the period in which the write-down occurs.

(IAS 2 paragraph 34)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

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IAS 17 Leases

"IAS 17 classifies leases as either finance or operating leases. The accounting treatment of each is distinct. The accounting treatment for a lessor mirrors that of the treatment for a lessee."

Finance lease or operating lease?

A finance lease is a lease that transfers substantially all the risks and rewards associated with the leased asset to the lessee.
Operating leases are all other types of lease.

IAS 17 states that the following situations (individually or together) would normally indicate a finance lease:

- Transfer of ownership of the asset by the end of the lease term
- The lessee has the option to purchase the asset at end of the lease term and pricing means this is reasonably certain to be exercised
- The lease term is for the major part of the asset's useful life
- At the start of the lease the present value of minimum lease payments is substantially all of the fair value of the asset
- The asset is so specialised that only the lessee can use it without major modification

Note that there is no numerical indicator of a finance lease; a lease term for the **major part** of useful life or minimum lease payments **substantially equal** to fair value indicate a finance lease, but these terms are not quantified.

It follows that the classification of leases requires a high degree of judgement, and there may be differing outcomes for similar leases.
(IAS 17 paragraphs 3, 17)

Operating leases – lessee accounting

Total lease payments are recognised as an expense spread over the lease term on a straight-line basis.
Disclosure is required of future minimum lease payments under non-cancellable operating leases.
(IAS 17 paragraph 33)

Example
A company rents an asset under an operating lease for 5 years at a rate of $5,000 per annum starting on 1 January 20X4. The asset is provided rent-free for the first 6 months of the lease term. $2,500 is paid on 31 December 20X4.

Total lease payments are $22,500 ($5,000 x 4.5years). This is spread over the five year term giving an annual expense of $4,500.
The financial statements at 31 December 20X4 include an operating lease expense of $4,500 and an accrual of $2,000.

Finance leases – lessee accounting

The leased asset and a corresponding finance lease obligation are recognised at the lower of the fair value of the asset and the discounted minimum lease payments.

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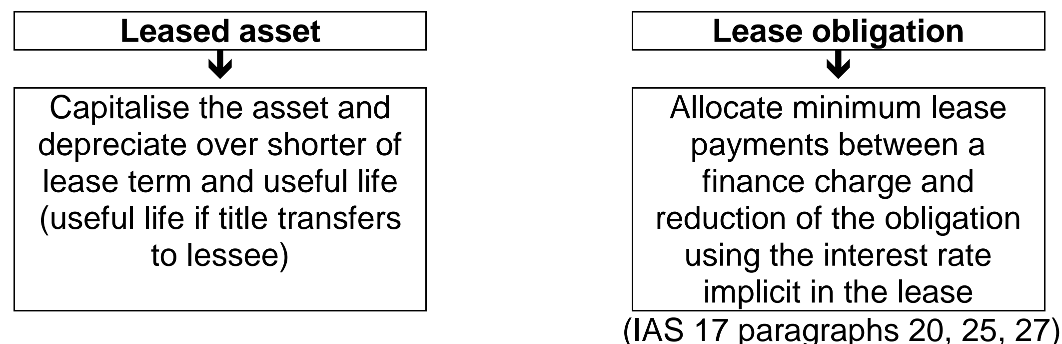
IAS 17 Leases

These are subsequently accounted for by:



(IAS 17 paragraphs 20, 25, 27)

Example

Joze Co enters a 4-year finance lease agreement on 1 January 20X4. The asset had a fair value of $600,000 and the lease required annual payments of $175,000 in arrears. Legal title will not transfer to Joze Co. The interest rate implicit in the lease is 6.5%. Joze Co has a 31 December year end.

The asset and obligation are initially recognised on 1 January 20X4 at $600,000.

The asset is depreciated over 4 years giving a charge of $150,000 in 20X4 and a carrying amount at 31 December 20X4 of $450,000.

The obligation accrues interest throughout the year at 6.5%, giving a 20X4 finance cost of $39,000. This amount is credited to the obligation.

$175,000 of the obligation is repaid, giving a final carrying amount at 31 December 20X4 of $464,000 ($600,000 + $39,000 - $175,000).

Lessor in brief

Operating leases – lessor accounting

A lessor retains an asset leased under an operating lease in its statement of financial position. The carrying amount of the asset is increased by any initial direct costs incurred in arranging the lease.

Lease income is recognised as income on a straight line basis over the lease term.

(IAS 17 paragraphs 49, 50, 52)

Finance leases – lessor accounting

Although the lessor owns an asset leased out under a finance lease, the statement of financial position shows a receivable rather than the leased asset.

Lessors recognise finance income as a constant return on the net investment in the lease.

(IAS 17 paragraphs 36, 39)

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IAS 17 Leases

Sale and leaseback transactions

Companies may sell assets and then lease them back in order to realise cash. The lease must be identified as either an operating or finance lease in the same way as other leases.

- **If a sale and lease back transaction results in a finance lease**, the asset is derecognised and then recognised as a leased asset at fair value in accordance with IAS 17. In substance, however, there has been no sale. Therefore rather than recognising a profit on disposal of the asset, this amount is deferred and amortised over the lease term

- **If a sale and leaseback transaction results in an operating lease**, a disposal is recognised; the correct treatment of the resulting profit or loss depends on the selling price of the asset:

Selling price = fair value	Profit or loss is recognised immediately
Selling price < fair value	Profit or loss is recognised immediately unless loss is compensated for by low future lease payments. In this case loss is deferred and amortised over lease term
Selling price > fair value	Excess profit over fair value is deferred and amortised over the lease term

(IAS 17 paragraphs 59, 61)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ias17.htm

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Exercise - IAS 17 Question

Please review the following exercise:

Is the IAS 17 accounting treatment of leases consistent with the Conceptual Framework's definition of asset and liability?

You should refer to the text of the standard when answering exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

"IFRS 5 defines a non-current asset held for sale and discontinued operations and states the accounting and presentation requirements for each."

Non-current assets held for sale and discontinued operations should be identified in financial statements in order to provide information to users that is relevant to predictions of future performance.
Non-current assets held for sale and discontinued operations should be identified in financial statements in order to provide information to users that is relevant to predictions of future performance.

Definition of non-current assets held for sale (HFS)

A non-current asset is classified as HFS if:management is committed to a plan to sell

- The asset is available for immediate sale in its present condition, and its sale must be highly probable.
  To be highly probable:
  - Management must be committed to a disposal plan;
  - An active programme to locate a buyer is initiated;
  - The asset is being marketed for sale at a price reasonable in relation to its fair value;
  - The sale is highly probable, within 12 months of classification as held for sale (subject to limited exceptions);
  - It is unlikely that significant changes will be made to the disposal plan; and
  - Actions required to complete the disposal plan indicate that it is unlikely that the plan will be significantly changed or withdrawn.

(IFRS 5 paragraph 8)

Measurement of non-current assets HFS
Immediately before transfer to the HFS category, a non-current asset must be measured in accordance with applicable IFRSs (eg a property held under the IAS 16 revaluation model is revalued to fair value).

On transfer to HFS, a non-current asset is measured at the lower of carrying amount and fair value less costs to sell.

Any resulting impairment loss is recognised in profit or loss.

Depreciation ceases on classification as HFS.

At subsequent reporting dates an asset HFS is remeasured to the lower of carrying amount and fair value less costs to sell.
(IFRS 5 paragraphs 15, 19, 20, 25)

Presentation of non-current assets HFS

Non-current assets HFS are presented separately from other assets.
(IFRS 5 paragraph 38)

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IFRS 5 Non-current Assets Held for Sale and Discontinued Operations

Disposal groups HFS

A disposal group is a group of assets, possibly with some associated liabilities, which an entity intends to dispose of in a single transaction.

- A disposal group is classified as HFS if it meets the same criteria as those for an asset HFS
- A disposal group acquired exclusively with a view to subsequent disposal is classified as HFS if the sale is expected to take place within 12 months of acquisition and the other conditions are met within 3 months of the acquisition
- The assets and liabilities of a disposal group are remeasured in accordance with IFRSs before classification as HFS; on classification they are measured at the lower of carrying amount and fair value less costs to sell
- Impairment losses are recognised in accordance with IAS 36 (against goodwill in the first place and then against other non-current assets on a pro rata basis)
- Depreciation is not charged on the assets of a disposal group HFS
- Assets and liabilities of a disposal group HFS are presented separately from other assets and liabilities in the statement of financial position. They are not offset.

Assets classified as held for sale, and the assets and liabilities included within a disposal group classified as held for sale, must be presented separately on the face of the statement of financial position

Discontinued operations

A discontinued operation is a component of an entity that either has been disposed of or is classified as HFS and:

- Represents a separate major line of business or geographical area of operations
- Is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations, or
- Is a subsidiary acquired exclusively with a view to resale

Disclosure of discontinued operations

The main requirement is that in the statement of profit or loss and other comprehensive income the result for the discontinued operation, combined with any gain or loss on disposal, or on remeasurement of assets HFS, should be disclosed separately from the results of continuing operations.

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ifrs05.htm

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Exercise - IFRS 5 Question

Please review the following exercise:

If shares are sold such that a subsidiary becomes an associate, is the definition of a discontinued operation met?

You should refer to the text of the standard when answering all exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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Frequently asked questions

1. Click here to enter text What is the difference between “fair value” and “net realisable value” (NRV)?
2. Because an upwards revaluation results in increased depreciation and an eventual decreased gain on sale, would this not discourage revaluation?
3. IAS 16’s rule on the recognition of the gain on revalued assets seems to mean that some realised gains never appear as income. Can this be right?

1. NRV is a market price net of selling costs. Fair value is an exit price (selling price) with costs neither deducted or added. For some assets (e.g. buildings) in some countries, transaction costs could be substantial.

2. It is not the IASB’s intention to discourage the use of relevant current values. IAS 16 permits a transfer to be made from the revaluation reserve to retained earnings equal to the excess depreciation charge after revaluation. IT also permits the transfer of any remaining revaluation reserve to retained earnings on disposal. This maintains ‘realised’ profits at the same level as if a revaluation hadn’t taken place.

3. That is, indeed, the implication. The revaluation gain appears in other comprehensive income, and this is not reclassified to profit or loss when the underlying asset is disposed of. It should, however, be noted that the revaluation gain is presented in the same statement as profit or loss (the statement of profit or loss and other comprehensive income).

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Quick Quiz

Module 4 quick quiz

Click next to continue

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Question 1

Sandy Co enters into an operating lease agreement on 1 July 20X2. The lease term is 5 years. Annual rental payments in advance are $1,500. To incentivise Sandy to enter into the lease, the lessor has agreed to a six-month rent-free period, so that the first rental payment will be made on 1 January 20X3. What operating lease expense should be recognised in profit or loss for the year ended 31 December 20X2?

A. An expense of $750

B. An expense of $675

C. Income of $750

D. No income or expense

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Question 2

During 20X5, Project Co constructed a new head office building costing $2m. It took 6 months to complete and the work was funded from existing loan finance, with the full $2m drawn down at the start of the project:

- $1m loan at an interest rate of 6%
- $1.5m loan at an interest rate of 4%
- $0.5m loan at an interest rate of 5%

In accordance with IAS 23, what amount of borrowing costs are capitalised in 20X5?

A. $48,333

B. Nil

C. $42,500

D. $96,667

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Question 3

New Designs Co is working on a ground breaking piece of machinery for use in toy manufacture. If successful the new machine should improve efficiency ten-fold, and New Designs Co's management is in no doubt that it would be sought after by all of the major toy manufacturers.

The company began work on the project on 1 February 20X2. At this point management set aside money to fund the project and set up a new laboratory where the work would take place. By 31 July 20X2 the company had produced a prototype and by 30 September it had completed successfully a rigorous testing process to check that the product conformed to safety requirements.

New Designs Co launched the product to market on 1 December 20X2. Costs incurred on the project were as shown below:

	$'000s		**$'000s**
February	450	July	450
March	450	August	600
April	450	September	650
May	500	October	200
June	550	November	100

How much, if any, of the expenditure is capitalised in the year ended 31 December 20X2?

A. $100,000
B. $1,550,000
C. Nil
D. $300,000

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Question 4

Zone Co, a company specialising in the provision of sports equipment, purchased a property, which the management decided to rent out for two years to Partition Co by way of an operating lease for $5,000 per calendar month. Which of the following is true?

A. The property should be capitalised as property, plant and equipment and depreciated over an appropriate useful life.

B. A lease receivable should be recognised in accordance with IAS 17.

C. The property should be classified as an investment property and measured using either the cost or the fair value model.

D. Zone Co should not record the purchase of the property as the company will not occupy or use it.

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Question 5

Which of the following conditions is not required for an asset to be classified as held for sale under IFRS 5?

A. Management is committed to a plan to sell

B. The selling price must be in line with current fair value

C. Asset has not been revalued

D. Sale is highly probable

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Module 5: What you will learn - Accounting for assets and liabilities - part 2

This module deals with a number of IFRSs that give rise to the recognition of liabilities:

- Fair value measurement - IFRS 13
- Financial Instruments: Presentation - IAS 32, Recognition and measurement - IFRS 9 and Disclosure IFRS 7
- Provisions, contingent liabilities and contingent assets - IAS 37
- Events after the reporting period - IAS 10
- Employee benefits - IAS 19
- Income taxes - IAS 12
- Shared-based payment - IFRS 2
- Agriculture - IAS 41
- Exploration for and evaluation of mineral resources - IFRS 6

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IFRS 13 Fair Value Measurement

"IFRS 13 establishes a single source of guidance for the fair value measurement of assets and liabilities when this is required by other IFRS. It was issued in 2011 and became effective in 2013."

Scope of IFRS 13

IFRS 13 does not prescribe when fair value should be used, only how to determine it when required by another standard.

This standard is applicable to all transactions and balances requiring measurement at fair value under another standard, with the exception of:

- Share-based payments (IFRS 2)
- Leases falling within the scope of IAS 17
- Measurements that are similar to, but are not, fair value eg net realisable value (IAS 2)

(IFRS 13 paragraph 6)

Definition of fair value

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

(IFRS 13 Appendix A)

Measurement approach

In order to measure fair value the entity must determine:

1. The asset or liability to be measured
2. For a non-financial asset, the valuation premise that is appropriate for the measurement (highest and best use)
3. The principal market or most advantageous market for the asset or liability
4. An appropriate valuation technique to use (to reflect the assumptions market participants would use when valuing the asset or liability)

(IFRS 13 paragraph B2)

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IFRS 13 Fair Value Measurement

1. Asset or liability The characteristics of the asset or liability being measured should be considered when determining fair value if these would be relevant to buyers and sellers in the market.

Example

Greenfield Co owns land that is subject to a legal right for an electricity company to run power lines across it. The land could be sold for $3million without these lines and $2.7million with them.

The legal right would be transferred to a purchaser of the land and therefore it must be taken into account when determining fair value. Fair value is $2.7million.

2. Highest and best use

The fair value of a non-financial asset is determined based on highest and best use from the point of view of market participants, even if the reporting entity intends a different use.

The highest and best use must be physically possible, legally permissible and financially feasible.

(IFRS 13 paragraph 27)

Example

Redletter Co owns land that is currently used for industrial purposes. It could be sold for $1.5million on this basis. Nearby sites have been developed as residential sites and there is no legal restriction to prohibit Redletter Co from selling the land for this purpose. Such a sale would achieve a price of $1.8million.

The fair value is $1.8million, based on the highest and best use.

3. Principal or most advantageous market

The principal market is that with the most volume of activity for the asset or liability. The most advantageous market is that which maximises the amount that would be received to sell an asset (or paid to settle a liability) after taking into account transaction and transport costs.

Fair value is determined based on the principal market; where there is no principal market, it is based on the most advantageous market.

(IFRS 13 paragraph 16)

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IFRS 13 Fair Value Measurement

Example

Bluebell Co sells its product in China for $40 and in France for $38. Transaction costs are $1 per item in China and $3 per item in France. Transport per item to China is $8 and transport per item to France is $5.
If France were the principal market, the fair value of Bluebell Co's product would be $33 ($38 less $5 transport costs, which form part of fair value).

If there were no principal market, fair value is based on the most advantageous market. In China, net proceeds per item would be $31 ($40 - $1 - $8). In France net proceeds per item would be $30 ($38 - $3 - $5). Therefore China is the most advantageous market. The fair value of Bluebell Co's product would be $32 ($40 less $8 transport costs).

Note that transaction costs are taken into account when determining the most advantageous market but are not part of fair value.

4. Valuation technique
IFRS 13 discusses three valuation approaches:

1. Market approach - uses prices and other relevant information generated by market transactions involving identical or similar assets or liabilities
2. Cost approach – uses current replacement cost
3. Income approach – uses discounted future cash flows or income and expenses

Any one, or where appropriate a combination, of these valuation techniques should be selected and consistently applied.

In order to use a valuation technique, 'inputs' are required. For example, an income approach requires cash flow estimations and appropriate discount rates.

Inputs used to measure fair value are divided into three categories:

Level 1	Quoted prices in active markets for identical assets and liabilities
Level 2	Observable inputs other than those classified as level 1
Level 3	Unobservable inputs

The standard required entities to use Level 1 inputs when the relevant information is available (e.g. to value quoted shares). Where such information is not available then Level 2 inputs should be used. Level 3 should only be used as a last resort.

(IFRS 13 paragraphs 61, 62, 71, 76-90)

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IFRS 13 Fair Value Measurement

Financial instruments

IFRS 13 includes specific guidance on measuring the fair value of financial instruments. For example:

- When measuring fair value, assume a transfer of a liability or own equity instrument (i.e. assume the liability remains outstanding but is passed to a 3rd party, not that the liability is paid off or settled)
- Reflect non-performance risk where a liability is concerned (including the entity's own credit risk)

(IFRS 13 paragraphs 34, 42)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ifrs13.htm

Disclosure

Detailed disclosure requirements are prescribed by the standard, for the most part following the fair value hierarchy described. The disclosures are both qualitative and quantitative.

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Financial instruments

The topic of financial instruments is sufficiently complex that it is split into 3 standards:
- **IAS 32, which deals with presentation issues**
- **IFRS 9, which deals with recognition and measurement and**
- **IFRS 7, which deals with disclosure**

IFRS 9 is a new standard, issued in full in 2014 and effective for accounting periods beginning on or after 1 January 2018. It was developed over a number of years in response to calls for less complex accounting for financial instruments. The standard replaces IAS 39 Financial Instruments: Recognition and Measurement.

Definitions

Key elements of definitions are provided below. For full definitions refer to paragraph 11 of IAS 32.

Financial instrument - any contract that gives rise to a financial asset in one entity and a financial liability or equity instrument of another entity (e.g. debentures are a financial instrument as the issuing company has a liability and the investing entity has a financial asset, or right to receive cash).

Financial asset - cash, an equity instrument of another entity (i.e. an investment) or a contractual right to receive cash (e.g. trade receivables).

Financial liability - a contractual obligation to deliver cash or another financial asset to another entity.

Equity - any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Note that investments in subsidiaries, associates and joint ventures and employee benefit obligations are excluded from the scope of IAS 32 and IFRS 7.

Financial instruments may be **primary instruments** (e.g. amounts receivable or payable, loans, equity investments) or they may be **derivative instruments**. A derivative financial instrument derives its value from the price or rate of an underlying item e.g. forward contracts.

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Financial instruments

"IAS 32 Presentation of Financial Instruments establishes the principles for classifying financial instruments into financial assets, financial liabilities and equity."

Equity or liability?

Financial instruments used to raise funds must be classified as either equity or liability. Determining whether an instrument is equity or a liability is not always straightforward and IAS 32 requires that the substance of the contractual arrangement is considered. The critical feature of a liability is an obligation to deliver cash or another financial instrument.

Classification of shares

- If an entity has issued preference shares that are redeemable on a specified date then the shares must be treated as a liability.
- If an entity has issued ordinary shares, it has no contractual obligation to pay a dividend and so the shares are equity.

If an entity has issued irredeemable preference shares these may be equity (if there is no contractual obligation to deliver cash) or may be a liability (if there is a contractual obligation to deliver cash for example the dividend is cumulative).

Convertible instruments

Most convertible loan stock and convertible preference shares are classified as compound instruments and so are 'split accounted'.

The instrument is split into a liability and an equity component at initial recognition and each is accounted for separately. This reflects the economic reality that the instrument has characteristics of both debt and equity.

The liability component is measured at the present value of the cash flows associated with a similar liability with no conversion rights attached. The difference between this figure and the value of the compound instrument as a whole is the value of the equity part.

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Financial instruments

Example
On 1 January 20X0, an entity issues convertible loan notes for $500,000. Interest is payable annually in arrears at 6%. The market rate of interest for similar loan notes with no conversion rights attached is 7%. The loan notes are redeemable on 31 December 20X3.

The liability component is initially measured at:

Date	Cash flow	Discount factor	Present value
31.12.X0	(30,000)*	1/1.07	$28,037
31.12.X1	(30,000)	$1/1.07^2$	$26,203
31.12.X2	(30,000)	$1/1.07^3$	$24,489
31.12.X3	(530,000)	$1/1.07^4$	$404,334
			$483,063

*$500,000 x 6% = $30,000

Therefore the equity component is $500,000 - $483,063 = $16,937

On 1 January 20X0, the entity will record a liability equal to $483,063 and $16,937 in a separate reserve in equity, which represents the value of the option to convert to shares at a later date.

Subsequently the discount of 7% will unwind, creating a finance charge each year in the statement of profit or loss and increasing the value of the liability in the statement of financial position. Each annual payment of interest at 6% (i.e. $30,000) will reduce the liability. (In addition IFRS 9 rules will probably require the liability to be remeasured to fair value).

Note that not all convertible instruments are split accounted; any convertible instrument that could not result in an exchange of a **fixed** number of shares for a **fixed** amount of debt is classified as a liability in its entirety (e.g. convertible debt denominated in foreign currency)

Interest and dividends

The presentation of the returns on financial instruments should follow the above classifications. For example, any instrument recognised as debt should have a return recognised as a finance cost, even if it is legally called a dividend.

Offsetting

Offsetting of financial assets against financial liabilities is only allowed when there is a legally enforceable right of set off which the entity intends to use.

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ias32.htm

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Financial instruments

"IFRS 7 specifies financial instrument disclosures. IFRS 13 disclosures are also relevant where a financial instrument is measured at fair value."

An entity must group its financial instruments into classes of similar instruments and, when disclosures are required, make disclosures by class.

The two main categories of disclosures required by IFRS 7 are:

a. Information about the significance of financial instruments
b. Information about the nature and extent of risks arising from financial instruments

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ifrs07.htm

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Financial instruments

"IFRS 9 deals with the recognition and measurement of financial assets and liabilities, the impairment of financial assets and hedging."

Recognition

An entity shall recognise a financial asset or financial liability when the entity becomes a party to the contractual provisions of the instrument. Note that this recognition rule differs from that seen in the Conceptual Framework and several other standards.

Measurement of financial assets

All financial assets are initially measured at fair value plus transaction costs with the exception of 'financial assets at fair value through profit or loss', which are measured at fair value only (no transaction costs).

Subsequent measurement is at:

- Amortised cost if certain conditions are met
- Fair value through other comprehensive income (FVTOCI) if certain conditions are met, or
- Fair value through profit or loss (FVTPL) otherwise or if designated as such to avoid an accounting mismatch

Recognition is at amortised cost if:

- The asset is held within a business model for which the objective is to collect contractual cash flows
- The contractual terms of the asset give rise to cash flows on specific dates that are payments of principal and interest.

Recognition at FVTOCI if:

- The asset is held within a business model for which the objective is to collect contractual cash flows **and** sell financial assets
- The contractual terms of the asset give rise to cash flows on specific dates that are payments of principal and interest.

Therefore, normally:

- **Investments in equity instruments must be measured at FVTPL** as they do not result in cash flows on specific dates.
- **Investments in debt instruments** may be measured at amortised cost or FVTOCI or FVTPL depending on the circumstances.
- **Derivatives** are measured at FVTPL

An irrevocable election may be made at initial recognition to measure an equity investment at FVTOCI.

(IFRS 9 paragraphs 4.1.1-4.1.5)

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Financial instruments

Gains and losses

Interest and dividend revenue on all financial assets is recognised in profit or loss.

Impairment losses on all financial assets are recognised in profit or loss.

Other gains or losses on remeasurement to fair value are recognised as follows:

Debt investment at FVTOCI	OCI (and reclassified to profit or loss on disposal of the investment)
Equity investment at FVTOCI	OCI (but not reclassified to profit or loss on disposal of the investment)
FVTPL	Profit or loss

(IFRS 9 paragraphs 5.2.1-5.2.3)

Measurement of financial liabilities

There are two categories of financial liability:

- Those held for trading or designated at fair value through profit or loss (FVTPL)
- Any other financial liability

An entity can only choose to designate a liability at FVTPL if doing so eliminates or significantly reduces an accounting mismatch. The result is that most financial liabilities will fall into the second 'default' category of the two listed above. **Financial liabilities are initially measured at fair value plus transaction costs** with the exception of those held for trading or designated 'at fair value through profit or loss', which are held at fair value only (no transaction costs).**After initial recognition** liabilities held for trading or those designated at FVTPL are held at fair value. All other financial liabilities are held at amortised cost.

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Financial instruments

Impairment of financial assets
IFRS 9 uses an expected loss approach to the impairment of financial assets. This approach results in impairments (called credit losses by IFRS 9) being recognised before indicators of impairment exist.

The general approach to credit losses is as follows:

- At initial recognition, 12 month expected credit losses are recognised.
- Beyond this, a 3 stage approach is taken:

Stage	Approach
Stage 1	If credit risk has not increased significantly since initial recognition, recognise 12 month expected credit losses.
Stage 2	If credit risk (the risk of default) has increased significantly since initial recognition, recognise lifetime expected credit losses, and calculate interest on gross asset.
Stage 3	If there is evidence of impairment at the reporting date, recognise lifetime expected credit losses, and calculate interest on asset net of impairment.

12 month expected credit losses are lifetime losses expected to arise from a default within 12 months.
Lifetime credit losses are expected losses arising from a default at any time in the life of the asset.

(IFRS 9 paragraphs 5.5.1-5.5.8)

Example

On 1 January 20X4, Barkers Co purchased a debt investment, measuring it at par of $500,000. At this date there is a 3% probability that the borrower will default, resulting in a 100% loss. At 31 December 20X4 it is expected that the borrower will breach loan covenants and there is a 30% probability of them defaulting over the remainder of the term.

At 1 January 20X4 an impairment allowance of 3% x $500,000 = $15,000 is recognised (based on 12 month credit losses).

At 31 December 20X4, there is a significant increase in the risk of default and so the impairment allowance is based on lifetime credit losses. It is increased to 30% x $500,000 = $150,000. Interest revenue continues to be calculated based on $500,000.

If the loan covenants had been breached at 31 December 20X4 (ie stage 3 had been reached), interest revenue would have been calculated based on $500,000 - $150,000 = $350,000.

Credit losses are recognised in profit or loss and, depending on the asset, may be net off against the carrying amount of the asset in the statement of financial position or recognised as a separate credit balance.

(IFRS 9 paragraphs 5.5.8 and B8E)

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Financial Instruments

Hedge accounting

Hedge accounting constitutes an extra, special set of rules that can be applied to financial instruments when an entity enters a hedging arrangement.

An entity can designate a hedging instrument so that its change in fair value is offset against the change in fair value of a hedged item in the same statement (usually the statement of profit or loss), thus reducing volatility in the financial statements.

For example, if an entity has committed to pay an amount of foreign currency in six months, it might enter into a forward contract to buy the currency at a future date at a pre-determined exchange rate. Thus it avoids the risk of the foreign currency rising in value before the date of payment.

There are three types of hedge:

1. A fair value hedge (hedges changes in the value of a recognised asset or liability)
2. A cash flow hedge (hedges exposure to variability in future cash flows)
3. A net investment hedge (hedges exposure to changes in the value of a foreign operation)

Hedge accounting is only allowed when certain conditions are met:

- The hedging relationship consists only of eligible hedged items and eligible hedging instruments as defined by IFRS 9
- At the inception of the hedge there is formal documentation of the relationship
- Hedge effectiveness criteria are met

(IFRS 9 paragraph 6.4.1)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ifrs09.htm

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Exercise - IFRS 9 Question 1

Please review the following exercise:

How can an auditor tell whether a financial asset should be measured at fair value through profit or loss, fair value through other comprehensive income or at amortised cost?

You should refer to the text of the standard when answering all exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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Exercise - IFRS 9 Question 2

Please review the following exercise:

Ulms Co purchased two financial assets on 1 January 20X5. The first asset is a $2 million 6% bond issued at par by Greyfox Co. The bond is redeemable on 1 January 20X7 at a premium of $200,000, and Ulms Co expects to hold the bond until maturity. Repayments of $120,000 are made in arrears on 31 December each year. The effective rate on the bond is 10.88%.

The second asset is 300,000 equity shares in Bruno Co, purchased for $12.50 each. At 31 December 20X5 the fair value of a share in Bruno is $16.60.

Explain how the financial instruments should be measured in the financial statements of Ulms Co.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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IAS 37 Provisions, Contingent Liabilities and Contingent Assets

"IAS 37 deals with accounting for uncertainty."

Key definitions of IAS 37:

Provision

- A liability of uncertain timing or amount.

Liability

- Present obligation as a result of past events, for which
- Settlement is expected to result in an outflow of resources (payment)

Contingent liability

- A possible obligation depending on whether some uncertain future event occurs, or
- A present obligation that is not probable or cannot be measured reliably

Contingent asset

- A possible asset that arises from past events, and
- Whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity

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IAS 37 Provisions, Contingent Liabilities and Contingent Assets

Provisions - recognition

A provision is a liability of uncertain timing or amount. A provision can only be recognised when three criteria are met:

1	There is a present obligation as a result of a past event.
2.	It will result in a probable outflow of economic benefits
3.	A reliable estimate can be made of the obligation

(IAS 37 paragraph 14)

- A present obligation can be either legal or constructive. A legal obligation arises from legal contracts, statute or other operation of the law. A constructive obligation arises when an entity has created an expectation in others that it will meet certain responsibilities.
- A probable outflow of benefits is defined as 'more likely than not'. This is taken to mean more than a 50% probability.
- IAS 37 clarifies how a provision should be measured. Except in rare cases, an estimate of an obligation that is sufficiently reliable can be made.

A provision is recognised as a current or non-current liability and the corresponding debit is usually recognised in profit or loss.

Example

Store Co operates clothes shops in a country where laws require that goods can be returned by customers for a refund within 30 days of purchase. Store Co's advertising slogan is 'Satisfaction guaranteed, but 90 days to return if not'.

Store Co has a liability of uncertain timing and amount: at any given date it may have to refund goods sold in the previous 90 days. A legal obligation exists to refund goods sold in the previous 30 days and a constructive obligation exists in respect of the other 60 days.

The related past events are sales to customers. Therefore, assuming that customer refunds are probable and a reliable estimate can be made of the amount (probably based on past experience), a refunds provision should be made.

Provisions – measurement

A provision must be measured at the best estimate of expenditure expected to settle the obligation at the reporting date.

- In the case of a single obligation, the best estimate may be the single most likely outcome or it may be higher or lower, depending on other possible outcomes
- In the case of a large population of items, expected values are used

(IAS 37 paragraphs 36, 39,

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IAS 37 Provisions, Contingent Liabilities and Contingent Assets

Example

A washing machine manufacturer offers a free one year warranty with goods supplied. In 20X1 it supplied 100,000 machines. It is expected that in 20X2 15% of these will require minor repairs at an average cost of $50 and 4% will require major repairs at an average cost of $150.

A provision is therefore made in the 20X1 financial statements for:

(100,000 x 15% x $50) + (100,000 x 4% x $150) = $1,350,000

A provision should be discounted where the effect of this is material. The discount rate should be a pre-tax rate reflecting market assessments of the time value of money and risks specific to the liability.

(IAS 37 paragraphs 45, 47)

Changes in and the use of provisions

If a provision is increased or decreased due to a change in estimated outflow of economic benefits, the corresponding debit or credit entry is usually made to profit or loss.

A provision may only be used for the purpose that it was set up.

(IAS 37 paragraphs 59, 61)

Reimbursements

Expenditure to settle a provision may be recoverable from a third party. In this case the reimbursement is recognised as an asset only if it is virtually certain that it will be received if the obligation is settled.

(IAS 37 paragraphs 53, 54)

Examples

- A provision may not be made for a future operating loss
- A provision should be made for the costs of an onerous contract (a contract in which the unavoidable costs of fulfilling the contract exceed any revenue expected from it)
- A provision is made for restructuring only if there is a constructive obligation to restructure at the reporting date (eg there is a formal plan that has been announced to employees). In this case only the direct costs of restructuring are provided for
- A provision is made in respect of standard warranties (purchased extended warranties are not within the scope of IAS 37)
- Where an entity that acquires or sets up operations in a certain location is required to decommission its operations or restore the location at the end of the operations' useful lives, the costs of decommissioning should be provided for. In this case the debit entry on the setting up of the provision is recognised as part of the cost of the associated asset in accordance with IAS 16

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IAS 37 Provisions, Contingent Liabilities and Contingent Assets

Example

Transit Co operates several bus routes in a foreign country. New laws were introduced there on 1 October 20X4 requiring seatbelts to be fitted to all public buses. Non-compliance would result in fines. The authorities have been vigilant in checking buses and charging fines since the law was introduced.

At the year ended 31 December 20X4, Transit Co has only installed seat belts on half of its buses. The cost to install them in the other half is $40,000. Unless the seat belts are installed the company is liable for fines of $25,000.

In respect of the fitting of seatbelts Transit Co does not have a present obligation to pay $40,000 as an obligating event has not occurred (ie the fitting of the seatbelts). It does, however, have a present legal obligation in respect of the fines (the obligating event being the non-compliance of Transit Co with the law). Payment is probable (given that the authorities have been vigilant have charged fines) and therefore a provision of $25,000 should be made.

Example

Oil Co constructed an oil platform in 20X2 at a cost of $12 million. The company is legally required to decommission the platform at the end of its useful life at a cost with present value of $2million. The company is also legally required to restore the seabed at this time. This is gradually eroded as oil is extracted. Restoration costs (at present value) are estimated at $10 per barrel extracted. At 31 December 20X2, 50,000 barrels had been extracted.

A provision is recognised at the time of construction for $2 million. This is debited to property, plant and equipment, giving a total cost of the oil platform of $14million.

An additional provision is made as barrels of oil are extracted. This will increase throughout the useful life of the platform. At 31 December 20X2 it amounts to $10 x 50,000 = $500,000. The corresponding entry is to profit or loss.

The appendix to IAS 37 includes several examples of situations in which provisions are and are not made.

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IAS 37 Provisions, Contingent Liabilities and Contingent Assets

Contingent Liabilities

A contingent liability is defined in two different ways:

1. Possible obligations
2. Existing obligations at the reporting date which are not recognised as liabilities either because they will probably not lead to an outflow or are not able to be measured reliably

(IAS 37 paragraph 10)

Contingent liabilities are not recognised but are disclosed where they are material in size and the probability of payment is greater than remote.

Contingent Assets

A contingent asset is defined as

- A possible asset that arises from past events, and
- Whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity

Contingent assets are disclosed if they are considered probable and otherwise they are not represented in the financial statements.

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ias37.htm

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Exercise - IAS 37 Question

Please review the following exercise:

A provision can only be recognised when there is an obligation at the reporting date. Should a provision be recognised for the possible loss of a law case?

You should refer to the text of the standard when answering exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

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Case study - Provisions, Contingent Liabilities and Contingent Assets

Newberg is a German company. On the right you can see Newberg's statement of profit or loss for 20X1 and 20X2.

On the following page you can see some accounting policies and notes. The facts are loosely based on a real case, but the company, year and exact numbers have been changed.

Consolidated statements of income (in billions Euro)	20X1	20X2
Sales	32	38
Cost of goods sold	(10)	(12)
	------	------
Gross profit	22	26
Marketing and distribution	(8)	(10)
Research and development	(5)	(6)
Administrative	(2)	(2)
Other expenses	(1)	(1)
	------	------
Operating profit	6	7
Non-operating income	3	3
	------	------
Results before special charges and taxes	9	10
Special charges		
Acquired in-process research and development	-	(9)
Restructuring	-	(6)
Taxes		
On result before special charges	(2)	(2)
Benefit from special charges	-	3
	------	------
Net income (loss)	7 ------	(4) ------

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Case study - Provisions, Contingent Liabilities and Contingent Assets

Extracts from significant accounting policies and notes

Basis of preparation of financial statements. The consolidated financial statements of the Newberg Group are prepared in accordance with International Financial Reporting Standards.

Consolidation policy. The consolidated financial statements of the Group include the parent and the companies which it controls (subsidiaries). Control is normally evidenced when the Group owns, either directly or indirectly, more than 50% of the voting rights of a company's share capital.

Changes in group organisation. On 24 June 20X2, a subsidiary of Newberg entered into an agreement with the shareholders of Orange Co to purchase all of the issued and outstanding common shares. Completion of the transaction was not possible until certain regulatory clearances had been obtained. In view of the overall materiality of the transaction and the advanced state of the integration planning, the consolidated financial statements of the Group give effect to the acquisition of Orange Co from 31 December 20X2.

Obtaining clearance from the regulatory authorities caused a delay in completing the transaction. These final clearances were received on 24 February 20X3 and the purchase of the shares was completed on 10 March 20X3.

The acquisition was accounted for using the acquisition method of accounting. Accordingly, the cost of the acquisition, including expenses incidental thereto, was allocated to identifiable assets and liabilities and to in-process research and development based on their estimated fair values. The portion of the acquisition cost allocated to in-process research and development was charged in full against income. This approach is consistent with the Group's accounting policy for research and development costs. After consideration of these items, the excess of the acquisition cost over the fair values was recorded as goodwill.

When you have studied the notes and table please go to the next page to see a question relating to the case study.

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Case study Question - provisions, contingent liabilities and contingent assets

Please review the following case study question:

Do you think that a provision for restructuring costs should have been set up at 31 December 20X2? (Other questions on this case will be asked in Module 6).

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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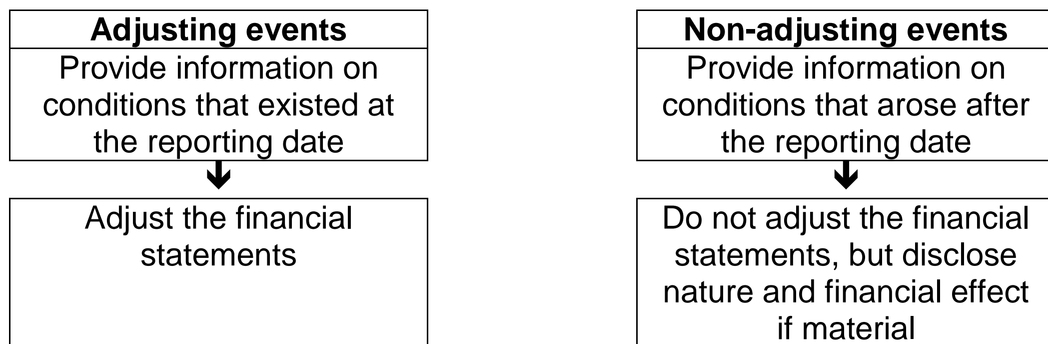
IAS 10 Events After the Reporting Period

"IAS 10 requires that in some cases the financial statements are adjusted for events occurring after the reporting date but before they are authorised for issue. This provides users with relevant information in a timely fashion."

The standard deals with two types of event that occur after the reporting date:



IAS 10 provides examples of adjusting and non-adjusting events:

Adjusting

- The settlement of a court case that confirms a present obligation at the reporting date
- The receipt of information that confirms an asset was impaired at the reporting date
- The determination of cost of an asset purchased before the reporting date (or proceeds of an asset sold before the reporting date)
- The discovery of fraud or errors meaning the financial statements are incorrect

(IAS 10 paragraph 9)

Non-adjusting

- Acquisition of disposal of subsidiaries
- Announcement of plan to close a division
- Purchases or disposals of assets
- Destruction of property by fire or flood or similar
- Announcing or starting a restructuring
- An issue of shares
- Changes in tax rates
- Commencement of litigation
- Entering into commitments or issuing guarantees

(IAS 10 paragraph 22)

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IAS 10 Events After the Reporting Period

If dividends on ordinary shares are declared, after the reporting date then these are non-adjusting and should not be recognised as liabilities. They should however be disclosed.

(IAS 10 paragraph 12,13)

If an event after the reporting period results in an entity no longer being a going concern, then the accounts should be prepared on the break up basis. This of course does not apply if only part of the entity is not a going concern. The reporting unit is the whole of the entity and the status of going concern should be assessed for that whole reporting entity.

(IAS 10 paragraph 14)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ias10.htm

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Module 5: Accounting for assets and liabilities - part 2
Certificate in International Financial Reporting
ACCA

Exercise - IAS 10 Question

Please review the following exercise:

Can proposed dividends be a liability?

You should refer to the text of the standard when answering exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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IAS 19 Employee Benefits

> **"The Basic Principle of IAS 19:**
> **The cost of providing employee benefits should be recognised in the period in which the benefit is earned by the employee, rather than when it is paid or payable."**

This standard applies to all employee benefits except those to which IFRS 2 "Share Based Payment" applies. It deals with:

- short-term employee benefits
- post-employment benefits (pensions)
- other long-term benefits
- termination benefits

Short-term employee benefits

These include bonuses, sick pay, holiday pay and maternity leave, and are recognised:

- As an expense when the employee provides benefit, andas an expense when the employee provides benefit, and
- As a liability to the extent they are unpaid

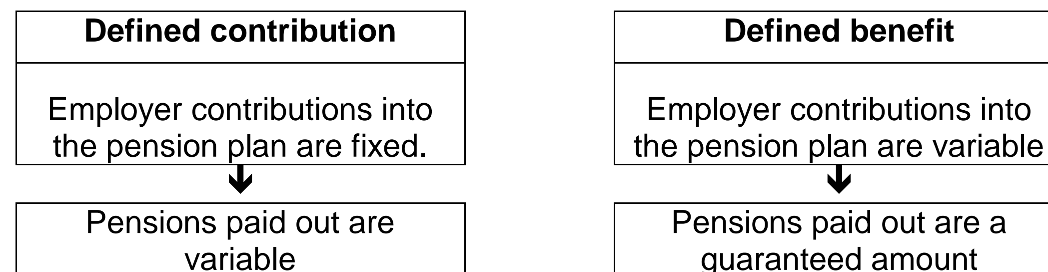
(IAS 19 paragraph 11)

IAS 19 deals specifically with short-term paid absences and for bonus plans. In each case the standard requires an entity to establish whether there is a liability at the reporting date and to account for any liability. Only accumulating paid absences (those that can be carried forward such as holiday pay) are recognised as a liability.

(IAS 19 paragraphs 16 and 19)

Post-employment benefits (Pensions)

IAS 19 deals with two types of pensions: defined contribution and defined benefit plans. In both cases the employer (and sometimes employee) contribute to a pension plan (which invests the contributions) throughout the employee's working life. When the employee retires, they are entitled to a pension.



In a defined contribution plan, the employee's pension depends upon how well the pension plan investments have performed.

In a defined benefit plan, the employer is advised what contributions are required in order that the plan has sufficient assets to meet the guaranteed amount of pension.

(IAS 19 paragraph 8)

In a country with special forms of employee benefit systems such as multi-employer plans and government plans, these are accounted for on the basis of their legal and institutional arrangements.

(IAS 19 paragraphs 32 and 43)

Defined contribution plans

The accounting for defined contribution plans is relatively straightforward: contributions are recognised as an expense in the period in which they are payable. An accrual or prepayment may result.

(IAS 19 paragraphs 32 and 43)

Defined benefit plans

The accounting treatment of defined contribution plans is not suitable for defined benefit plans as a result of the variability of contributions.

Instead, a net defined benefit pension asset or liability is recognised in the statement of financial position. This is calculated as the difference between:

- The fair value of the pension plan assets at the reporting date, and
- The present value of the defined benefit obligation at the reporting date

IAS 19 includes guidance on how to establish the present value of the obligation using the projected unit credit method. This method is also used to determine current service cost ie the increase in the pension obligation as a result of an additional year's employee service.

Each individual element of change in the value of plan assets and defined benefit obligation from one year to the next is accounted for separately:

	Plan assets	PV of obligation	
At start of year	X	X	
Contributions	X		DR plan assets CR cash
Paid out as pensions	(X)	(X)	DR obligation CR plan assets
Current service cost		X	Dr profit/loss CR obligation
Net interest	X	X	DR plan assets CR obligation DR/CR profit/loss
Remeasurements (balancing figure)	X/(X)	X/(X)	DR/CR plan assets DR/CR obligation DR/CR OCI
At end of year	**X**	**X**	

Net interest is calculated on the value of the assets and obligation at the start of the year by reference to interest rates on high quality corporate bonds. It represents:

- The expected return on the investments that form the plan assets
- The unwinding of the discount on the obligation

(IAS 19 paragraph 120)

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Remeasurements are the difference between calculated plan assets and defined benefit obligation having taken account of contributions, pensions paid, current service cost and interest, and the actual year end value of each. Remeasurements represent:

- The difference between the actual and expected return on plan assets, and
- The effect of changes in actuarial assumptions in the case of the obligation

These are never reclassified to profit or loss.

(IAS 19 paragraph 122)

Actuarial assumptions are those assumptions that must be made in order to estimate the value of the defined benefit obligation. They include salary increase, mortality rates and retirement age.

(IAS 19 paragraph 76)

Remeasurements of the defined benefit obligation may be referred to as actuarial gains and losses.

Past service costs may occur in some years, for example if plan benefits are increased. These are recognised in profit or loss immediately.

Where an entity has a surplus in a defined benefit plan, the net defined benefit asset can be recognised but the amount is restricted to the asset ceiling, being the present value of economic benefits available as a result of the surplus (eg refunds or reduction in contributions).

(IAS 19 paragraphs 8 and 64)

Long term employee benefits

Other long-term benefits are recognised in the same way as post-employee benefits however all amounts are recognised in profit or loss, including remeasurements.

(IAS 19 paragraph 155)

Termination benefits

Termination benefits are recognised as a liability and expense at the earlier of:

- When the entity can no longer withdraw from the offer of termination benefits, and
- When the entity recognises costs for restructuring in line with FRS 37

(IAS 19 paragraph 165).

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ias19.htm

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Exercise - IAS 19 Question 1

Please review the following exercise:

Do possible future pay rises give rise to a present liability for pensions?

You should refer to the text of the standard when answering all exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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Exercise - IAS 19 Question 2

Please review the following exercise:

When a defined benefit plan is enhanced, when should the cost of improving the benefits for existing pensioners be recognised?

You should refer to the text of the standard when answering all exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

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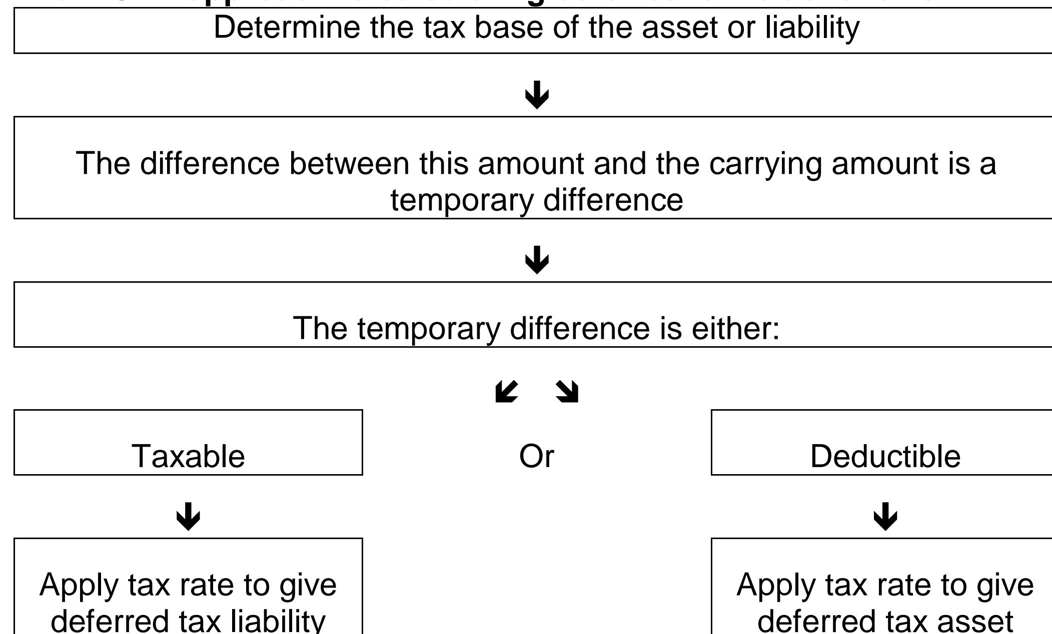
IAS 12 Income Taxes

"IAS 12 deals mainly with deferred tax. It requires that deferred tax is recognised for temporary differences."

Deferred tax is an accounting adjustment to take account of the future tax impact of an asset or liability currently recognised in the statement of financial position.

Calculation of deferred tax

The IAS 12 approach to calculating deferred tax is as follows:



Tax base is the amount that is attributed to an asset or liability for tax purposes:

- In the case of an asset, the amount that will be deductible for tax purposes in the future eg the tax written down value of a non-current asset
- In the case of a liability, usually the carrying amount less any amount that will be deductible for tax purposes in the future

(IAS 12 paragraphs 7, 8)

Taxable temporary differences arise where the carrying amount of an item exceeds its tax base. In other words more tax relief has already been given than the carrying amount in the statement of financial position would suggest. Therefore future tax will be higher than might be expected.

Deductible temporary differences arise where the carrying amount of an item is less than its tax base. In other words less tax relief has already been given than the carrying amount in the statement of financial position would suggest. Therefore future tax will be lower than might be expected.

The applicable tax rate is that which is expected to apply when the carrying amount of the item is recovered. Normally this is a current rate although if new tax laws have been enacted it may be future rates. The tax rate should reflect the manner of recovery (so may be an income tax rate if an asset is to be used to generate income or a capital tax rate if the asset will be sold to generate income).

(IAS 12 paragraph 47)

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IAS 12 Income Taxes

Example

Luella Co buys an item of plant on 1 January 20X7 at a cost of $400,000. The plant has a useful life of 10 years and benefits from a 20% writing down allowance for tax purposes. Luella has a year end of 31 December and pays tax at a rate of 30%.

There is no deferred tax impact on acquisition of the asset because carrying amount is equal to tax base at $400,000.

At 31 December 20X7:

- The carrying amount of the asset is 9/10 x $400,000 = $360,000
- The tax base of the asset is 80% x $400,000 = $320,000
- There is therefore a temporary difference of $40,000
- This is a taxable temporary difference
- It results in a deferred tax liability of 30% x $40,000 = $12,000

Accounting for deferred tax

The corresponding entry when recognising a deferred tax asset or liability is usually profit or loss. Taking the above example, the correct entry to recognise the deferred tax liability is:

DEBIT	Tax charge in profit or loss	$12,000
CREDIT	Deferred tax liability	$12,000

If, however, deferred tax relates to an underlying item that is recognised in OCI or directly in equity, then the deferred tax impact is also recognised in OCI or equity. For example:

- The deferred tax impact of a revaluation is recognised in OCI
- The deferred tax impact of prior period error is recognised in equity

(IAS 12 paragraph 58)

From year to year, only the change in the deferred tax amount is recognised.

An entity should calculate the deferred tax impact of all relevant items in its statement of financial position and, providing that the tax arises in a single jurisdiction, and there is a right of set off, present a net deferred tax asset or liability.

(IAS 12 paragraph 74)

A deferred tax asset is only recognised to the extent that it is probable that future taxable profits will be available to utilise the benefit.

(IAS 12 paragraph 56)

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IAS 12 Income Taxes

Additional points

- Tax losses carried forward result in a deferred tax asset
- Deferred tax liabilities should be recognised for all temporary differences, except those relating to non-deductible goodwill and the initial recognition of certain assets and liabilities in transactions that affect neither accounting profit nor taxable profit.
- There are also special rules for investments in subsidiaries associates and joint ventures. They amount to saying that temporary differences that are unlikely to reverse where the investor is in control of that process (for example, by being able to stop the payment of dividends) need not be accounted for
- Deferred tax amounts should not be discounted

(IAS 12 paragraphs 15, 24, 34, 39, 53)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ias12.htm

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Exercise - IAS 12 Question

Please review the following exercise:

A deferred tax liability is recognised on the revaluation of an asset that is intended for continuing use in the business. Does this meet the Conceptual Framework's definition of liability?

You should refer to the text of the standard when answering exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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Case study Question - deferred tax

Please review the following exercise:

Suppose that a company, Acrobat, applies IFRS.
It purchases a machine for $10,000 in early 20X8. The machine is expected to last for ten years and to have no residual value. The accounting year is the calendar year. The company is fairly small and is able to claim 40% tax depreciation (capital allowances) in the year of purchase. Suppose also, that Acrobat buys land at $3m in early 20X8, and revalues it to fair value of $5m at 31 December 20X8. What are the temporary differences in 20X8?

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

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IFRS 2 Share-Based Payment

"IFRS 2 deals with transactions in which an entity received goods or services in return for its own equity instruments or an amount of cash based on the value of its equity instruments."

The basic principle of IFRS 2 is that an entity should recognise an expense related to goods or services received when they are received, even if payment is at a future date and made in equity instruments.

The standard deals with three types of share-based payment:

- **An equity settled share-based payment** is a transaction in which a company grants equity instruments to another party in exchange for goods and services. The most common example of such a transaction is where employees receive share options in exchange for services rendered.
- **A cash settled share based payment** is where another party (again usually an employee) receives a cash payment the amount of which depends on the share price of the company
- **Share-based payments in which the entity or counterparty has a choice of cash or equity instruments**

Equity-settled share based payments

These are recognised by:

DEBIT Expense / asset
CREDIT Equity

The issue is how the transaction is measured and when it is recognised.

If the transaction is with an employee, it is measured by reference to the fair value of the equity instruments granted at the grant date. If the transaction is with a third party, it is measured at the fair value of goods or services received.

If the transaction relates to goods or services already received (ie the equity instruments vest immediately), the transaction is recognised in full on the grant date. If the transaction requires the counterparty to meet specified conditions over a future period (vesting period), then the transaction is recognised over that period.

(IFRS 2 paragraphs 10, 14, 15)

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IFRS 2 Share-Based Payment

Example

A company grants three directors 200 share options on 1 January 20X6, and these vest (ie the director becomes entitled to them) after two years, providing that the director still works for the company. This is expected to be the case. Each option has a fair value of $3 at the grant date.

The total expense to be recognised is $1,800 (3 directors x 200 options x $3). This is spread over the two year vesting period giving an expense of $900 in each year.

At the end of year 1 the balance in equity is $900; at the end of year two it is $1,800. Assuming that the options are exercised, the equity balance is transferred to the share capital account.

The measurement of equity-settled share-based payments must take into account the number of instruments expected to vest (become an entitlement).

In the above example, suppose that one director left unexpectedly during the second year. In that case the accounting entry in year one would remain the same (an expense of $900 credited to equity). In year 2, however, the expense would be adjusted to take account of the fact that only 2 directors' share options would vest:

- total expense $1,200 (2 directors x 200 x $3)
- year 2 expense therefore $300 ($1,200 - $900)

Cash-settled share-based payments

These are recognised by:

DEBIT Expense / asset
CREDIT Liability

The fair value of the liability is re-measured at each reporting date as the amount of cash expected to be paid.

(IFRS 2 paragraph 30)

Example

On 1 January 20X4 a company grants a director share appreciation rights whereby she is entitled to cash equivalent to 1,000 shares on 31 December 20X5, assuming she remains in employment.

The share price is $3.40 on 31 December 20X4 and $4.05 on 31 December 20X5.

At 31 December 20X4 a liability and expense are recognised of $1,700 (1,000 x $3.40 x 1/2years). At 31 December the total liability is $4,050 (1,000 x $4.05). Therefore the year 2 expense is $2,350 ($4,050 - $1,700).

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IFRS 2 Share-Based Payment

Share-based payments with a choice of settlement

- Where the counterparty has the choice of settlement, the entity is deemed to have granted a compound instrument and a separate equity and liability component are recognised
- Where the entity has the choice of settlement, the whole transaction is treated as either equity-settled or cash-settled depending on whether the entity has an obligation to settle in cash

(IFRS 2 paragraphs 35, 41)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

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IAS 41 Agriculture

"IAS 41 provides guidance on accounting for biological assets and agricultural produce."

Biological assets

A biological asset is a living plant or animal. Bearer plants (a plant that bears produce for more than one period such as a tea bush) are biological assets, however are not within the scope of IAS 41. Instead IAS 16 Property, Plant and Equipment applies to these.

(IAS 41 paragraphs 1,5)

Agricultural produce

Agricultural produce is the harvested produce of biological assets at the point of harvest (thereafter it becomes inventory).

(IAS 41 paragraph 5)

Accounting treatment

Biological assets and agricultural produce are measured at each reporting date at their fair values less costs to sell.

(IAS 41 paragraphs 12, 13)

If fair value cannot be reliably determined, then measure at cost.
(IAS 41 paragraph 30)

Gains and losses arising on initial recognition of biological assets and agricultural produce are recognised in profit or loss.

(IAS 41 paragraphs 26 and 28).

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For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

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IFRS 6 Exploration for and Evaluation of Mineral Resources

IFRS 6 imposes few requirements on companies that are engaged in exploration for and evaluation of mineral resources.

IFRS 5 requires entities to develop a policy for the extent to which such expenditure should be capitalised and to disclose that policy clearly in the financial statements. It does not, however, specify the capitalisation policy.

(IFRS 6 paragraph 6, 7)

The standard also requires entities recognising exploration and evaluation assets to perform an impairment test on those assets when facts and circumstances suggest that the carrying amount of the assets may exceed their recoverable amount.

(IFRS 6 paragraph 18)

IFRS 6 requires disclosure of information that identifies and explains the amounts recognised in its financial statements arising from the exploration for and evaluation of mineral resources, including:

- Its accounting policies for exploration and evaluation expenditures including the recognition of exploration and evaluation assets
- The amounts of assets, liabilities, income and expense and operating and investing cash flows arising from those assets

(IFRS 6 paragraph 23, 24)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ifrs06.htm

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Frequently asked questions

1. If a company's board of directors has decided to restructure part of its business, should the company not make a provision for the restructuring, redundancy costs, etc?
2. Surely it gives useful information to the users of financial statements to show a proposed dividend as a liability?
3. Can a deferred tax asset be shown in the financial statements if the company is making losses?

1. It depends on the facts. A board decision does not of itself create an obligation to a third party, and the board could change its mind. In such cases, IAS 37 does not allow a provision. This may not be "prudent" but this is overridden by the need to comply with the Conceptual Framework's definition of a liability. Only when the decision is communicated to those affected by the restructuring would it be appropriate to recognise a provision.

2. IAS 10 is based on the idea that it is not useful to show something as a liability that does not meet the definition of a liability. The information about the proposed dividend can be given in the notes.

3. It is unlikely as it must be probable that future taxable profits will be available against which to use the asset.

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Quick Quiz

Module 5 quick quiz

Click next to continue

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Question 1

Dodo Co is preparing its financial statements to 31 December 20X3. The accounts are due to be finalised on 31 March 20X4.

Which of the following should not be adjusted in the financial statements?

A. On 1st February Dodo Co receives written confirmation that a customer, Looney Bin Co, has gone into Liquidation. At the year end the balance due from Looney Bin Co was material.

B. On 27th March torrential rain causes one of three warehouses to flood, damaging some of the inventory held there. Dodo Co continues to trade successfully although at a reduced level.

C. Dodo Co manufactures a specialist component for the computer hardware industry. It costs $3.35 to produce and would normally sell for $5.20. At the year end this component is held in inventory at cost. However, due to the launch of an updated product, this component is only selling for $2.90.

D. On 15th March a legal case against Dodo Co arising prior to 31 December 20X3 is settled for $300,000. In the draft financial statements a provision is included for substantially more.

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Question 2

The management team at Super Safe Co try to be as prudent as possible when preparing the annual financial statements. Under IAS 37 which of the following should they provide in the financial statements:

A. The overall operating loss they expect the company to record in the following financial year.

B. Costs associated with the restructuring of their sales and marketing division. Plans have been drafted by the board but not yet announced.

C. The loss they are anticipating on a non-cancellable contract they have in place to buy rubber matting at $15 per metre. The contract runs until the end of next year and they are currently able to sell the matting for $12 per metre.

D. All of the above.

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Question 3

A company purchased an item of plant for $270,000 on 1 January 20X0. The plant is depreciated in the financial statements on a straight-line basis over 5 years. For tax purposes the plant is has a life of 3 years and benefits from allowances on a straight-line basis. What is the deferred tax balance in respect of the plant on 31st December 20X1?

The applicable rate of corporate income tax is 30%.

A. Liability of $10,800

B. Asset of $10,800

C. Liability of $21,600

D. Asset of $21,600

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Question 4

IC Co manufactures fridge freezers and with each one sold offers a free guarantee. In one year the company expects to sell 30,000 fridge freezers. Of these management expect 1% to be returned under the guarantee requiring major repair work costing on average $300. Management also expect 5% to be returned requiring minor repairs costing on average $100.

How should the company treat this guarantee policy in their financial statements?

A. Recognise a provision of $240,000 in the statement of financial position and disclose details in the notes.

B. Disclose the details of the guarantee policy in the notes to the financial statements

C. Disclose the details of the guarantee policy in the notes, including an estimate of the likely cost to the company of fulfilling the guarantee.

D. No disclosure of the guarantee policy is required.

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Question 5

Sha La La Co recently suffered a small fire in one corner of its warehouse. The company has placed a claim with its insurer for $220,000 to cover the cost of repairing the damage. Sha La La Co has not had confirmation yet, but management of the company believe it is more likely than not that the claim will be paid.

How should the company treat this in the annual financial statements?

A. Nothing should be recognised or disclosed in relation to the claim until the company is certain of the outcome.

B. A receivable for the full amount should be recognised in the statement of financial position.

C. A receivable for half the value of the claim should be recognised at this stage, as it is not certain that the money will be received and this is more prudent than recognising the full amount.

D. The details of the insurance claim should be disclosed in the notes to the financial statements.

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Question 6

Under IFRS 9, which of the following financial assets should be held at amortised cost:

1. A fixed interest rate loan
2. An investment in a convertible loan note
3. A zero coupon bond

A. All of the above

B. 1 and 3

C. 1 only

D. 1 and 2

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Module 6: What you will learn - Group accounting

This module covers eight IFRSs that concern the preparation of consolidated financial statements and covers a few other issues relating to investments within groups:

- IFRS 10 looks at the preparation of consolidated financial statements
- IAS 27 (revised 2011) considers accounting for investments in separate entity financial statements
- IFRS 3 looks at the treatment of goodwill in the context of business combinations
- IFRS 11 defines joint arrangements (including joint ventures)
- IAS 28 (revised 2011) deals with accounting for both associates and joint ventures
- IFRS 12 covers disclosure of interests in other entities
- IAS 21 and IAS 29 deal with items related to foreign currency and what to do when subsidiaries operate in hyperinflationary environments

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IFRS 10 Consolidated Financial Statements

"IFRS 10 defines a subsidiary and identifies principles of consolidation."

Definition of a subsidiary

A subsidiary is defined as an entity controlled by another entity. An investor controls an investee if it has ALL the following:

- Power over the investee;
- Exposure, or rights, to variable returns from its involvement with the investee; and
- The ability to use its power over the investee to affect the amount of the investor's returns.

(IFRS 10 paragraph 7)

Note that an entity could have power over the investee without holding a majority of the voting rights. Returns could be either positive or negative and could include dividends, change in the value of the investment, management or service fees etc.

Non-controlling interests (NCI)

Non-controlling interests are the equity in a subsidiary not attributable, directly or indirectly, to a parent. For example, if a parent owns 60% of a subsidiary, then the non-controlling interest percentage is 40%.

(IFRS 10 Appendix A)

Principles of consolidation

A parent prepares consolidated financial statements applying uniform accounting policies throughout .

(IFRS 10 paragraph 19)

A parent should start to consolidate from the date control is obtained and cease when control is lost. There is just one exemption available to this under IFRS 5. Consolidation is not required where temporary control is acquired because the subsidiary is held exclusively with a view to its subsequent disposal in the near future.

(IFRS 10 paragraph 20)

A partial disposal of an interest in a subsidiary in which the parent retains control, does not result in a gain or loss but an increase or decrease in equity. Purchase of some or all of the non-controlling interest is treated as a treasury share-type transaction and accounted for in equity.

(IFRS 10 paragraph 23)

Once an investment ceases to fall within the definition of a subsidiary, the parent company should derecognise the assets and liabilities of the subsidiary, derecognise the carrying amount of any non controlling interest and recognise the consideration received. Any investment retained in the subsidiary should be recognised at fair value, and treated as an associate under IAS 28, as a joint arrangement under IFRS 11 or as an investment under IFRS 9 as appropriate

(IFRS 10 paragraph B98).

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IFRS 10 Consolidated Financial statements

A parent is exempted from the preparation of consolidated accounts if it is itself a wholly or partially owned subsidiary and the ultimate or any intermediate parent company produces consolidated financial statements that comply with IFRS

(IFRS 10 paragraph 4)

Any difference between the reporting date of the parent and the reporting date of a subsidiary should not exceed three months.

(IFRS 10 paragraph B93)

Mechanics of consolidation

To consolidate the financial statements, items of assets, liabilities, income, expenses and cash flows are combined. The parent's investment in the subsidiary is also eliminated against the subsidiary's equity, goodwill is recognised and intragroup transactions are eliminated.

(IFRS 10 paragraph B86)

For further information and a summary of these standards please click on the following hyperlink to Deloitte's IAS Plus website where a summary of the standards can be accessed:

http://www.iasplus.com/standard/ifrs10.htm

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Exercise - IFRS 10 Question 1

Please review the following exercise:

How should one value a subsidiary that is about to be sold, when there is already a binding sales contract?

You should refer to the text of the standard when answering exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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Exercise - IFRS 10 Question 2

Please review the following exercise:

Can non controlling interests be presented within shareholders' funds?

You should refer to the text of the standard when answering exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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IAS 27 Separate Financial statements

"IAS 27 prescribes the accounting treatment of investments in individual financial statements of the investor."

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For further information and a summary of these standards please click on the following hyperlink to Deloitte's IAS Plus website where a summary of the standards can be accessed:

http://www.iasplus.com/standard/ias27_2011.htm

In the separate financial statements of the investor, investments in subsidiaries, associates and joint ventures are accounted for either:

- At cost, or
- In accordance with IFRS 9, or
- Using equity accounting

(IAS 27 paragraph 10)

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IFRS 3 Business Combinations

"IFRS 3 requires that the acquisition method is applied to business combinations. It specifies the measurement of acquired assets and liabilities including goodwill."

A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses (appendix A).

Acquisition method
All business combinations within the scope of IFRS 3 must be accounted for using the acquisition method.

(IFRS 3 paragraph 4)

This requires:

1. Identification of the acquirer
2. Determination of the acquisition date
3. Recognition and measurement of the identifiable assets acquired and liabilities assumed and any non-controlling interest in the acquiree
4. Recognition and measurement of goodwill or a gain from a bargain purchase (negative goodwill).

(IFRS 3 paragraph 5)

Goodwill

Goodwill is measured as:

	$
Consideration transferred	X
Non-controlling interest	X
Fair value of identifiable net assets of acquiree	(X)
Goodwill / bargain purchase	X/(X)

(IFRS 3 paragraph 32)

Consideration is measured at fair value. This includes contingent consideration. It does not include acquisition costs, which must be recognised in profit or loss.

(IFRS 3 paragraphs 37, 39, 53)

The non-controlling interest may be measured at either:

- Fair value on the acquisition date, or
- As a proportion of the fair value of net assets on the acquisition date

This choice is available on a transaction-by-transaction basis.

(IFRS 3 paragraph 19)

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IFRS 3 Business Combinations

The identifiable assets acquired and the liabilities assumed should be measured at their fair values. In general the identifiable assets acquired and liabilities assumed must meet the definition of assets and liabilities per the Conceptual Framework

(IFRS 3 paragraph 11, 18)

There are limited exceptions to the general recognition and measurement principles above, which lead to some items being recognised when normally they wouldn't be, or being recognised at an amount other than acquisition date fair value:

- **intangible assets** of the acquiree are recognised if they are identifiable. The other IAS 38 criteria need not be met, resulting in the recognition of intangibles on consolidation that are not otherwise recognised
- **Contingent liabilities** are recognised even if it is not probable that there will be an outflow of economic resources (contrary to the guidance given in IAS 37)
- The relevant standard is applied to measure and recognise deferred tax (IAS 12), employee benefits (IAS 19), share-based payments (IFRS 2) and assets held for sale (IFRS 5)

(IFRS 3 paragraphs B31, 23, 24, 26, 30, 31, 56)

Full goodwill and partial goodwill

As the non-controlling interest (NCI) can be measured in one of two ways, it follows that the resulting goodwill is one of two possible values:

- Where the NCI is measured at fair value the resulting goodwill is 'full goodwill' ie it is the goodwill of the acquiree attributable to the parent and the NCI
- Where the NCI is measured as a proportion of net assets, the resulting goodwill is 'partial goodwill' ie it is the goodwill of the acquiree attributable to the parent only

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IFRS 3 Business Combinations

Accounting for goodwill or a bargain purchase

Goodwill is not amortised but must be tested for impairment annually in accordance with IAS 36 Impairment of Assets.

"Negative goodwill" (a bargain purchase) must be recognised immediately in the statement of profit or loss as a gain. Before concluding that negative goodwill has arisen, however, IFRS 3 requires that the acquirer re-assess the situation to ensure the accuracy of the negative goodwill.

(IFRS 3 paragraph 34)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ifrs03.htm

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Exercise - IFRS 3 Question 1

Please review the following exercise:

Jam Co acquired 80% of the shares of Marmalade Co on 1 July 20X5.

Extracts from the statement of profit and loss for both companies for the year ended 31 December 20X5 were as follows:

	Jam Co $'000	Marmalade Co $'000
Profit after tax	8,400	4,200

Calculate the profit after tax that will appear in the consolidated statement of profit and loss for the Jam group for the year ended 31 December 20X5?

A: $12.60 million
B: $11.76 million
C: $10.50 million
D: $10.08 million

You should refer to the text of the standard when answering exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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Exercise - IFRS 3 Question 2

Please review the following exercise:

When should negative goodwill (referred to in IFRS 3 as a bargain purchase) be recognised as income?

You should refer to the text of the standard when answering exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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Exercise - IFRS 3 Question 3

Please review the following exercise:

Missile Co acquired a subsidiary on 1 January 20X3 for $2,145 million. The fair value of the net assets of the subsidiary acquired were $2,170 million. Missile Co acquired 70% of the shares of the subsidiary. The non controlling interest was fair valued at $683 million. Calculate goodwill based on the partial and full goodwill methods under IFRS 3.

You should refer to the text of the standard when answering exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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Case study - IFRS 3

This case study once again reviews Newberg Co and the details that were presented to you in Module 5. Newberg Co is German. Its statements of profit or loss for 20X1 and 20X2 are shown right. On the following page you can see some accounting policies and notes.

Consolidated statements of income (in billions $)	20X1	20X2
Sales	32	38
Cost of goods sold	(10)	(12)
	------	------
Gross profit	22	26
Marketing and distribution	(8)	(10)
Research and development	(5)	(6)
Administrative	(2)	(2)
Other expenses	(1)	(1)
	------	------
Operating profit	6	7
Non-operating income	3	3
	------	------
Results before special charges and taxes	9	10
Special charges		
Acquired in-process research and development	-	(9)
Restructuring	-	(6)
Taxes		
On result before special charges	(2)	(2)
Benefit from special charges	-	3
	------	------
Net income (loss)	7 ------	(4) ------

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Case study - IFRS 3

Extracts from significant accounting policies and notes

Basis of preparation of financial statements. The consolidated financial statements of the Newberg Group are prepared in accordance with International Financial Reporting Standards.

Consolidation policy. The consolidated financial statements of the Group include the parent and the companies which it controls (subsidiaries). Control is evidenced by power over the investee, exposure, or rights, to variable returns from the investee and ability to use that power to affect the amount of return to the investor. Control is normally evidenced when the Group owns, either directly or indirectly, more than 50% of the voting rights of a company's share capital.

Changes in group organisation. On 24 June 20X2, a subsidiary of Newberg Co entered into an agreement with the shareholders of Orange Co to purchase all of the issued and outstanding common shares. Completion of the transaction was not possible until certain regulatory clearances had been obtained. In view of the overall materiality of the transaction and the advanced state of the integration planning, the consolidated financial statements of the Group give effect to the acquisition of Orange Co from 31 December 20X2.

Obtaining clearance from the regulatory authorities caused a delay in completing the transaction. These final clearances were received on 24 February 20X3 and the purchase of the shares was completed on 10 March 20X3.

The combination was accounted for under the acquisition method of accounting. Accordingly, the cost of the acquisition, including expenses incidental thereto, was allocated to identifiable assets and liabilities and to in-process research and development based on their estimated fair values. The portion of the acquisition cost allocated to in-process research and development was charged in full against income. This approach is consistent with the Group's accounting policy for research and development costs. After consideration of these items, the excess of the acquisition cost over the fair values was recorded as goodwill.

When you have studied the notes and table please go to the next page to see a question relating to the case study.

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Case study - IFRS 3 Question 1

Please review the following case study:

At what date did Newberg Co start consolidating Orange Co?

You should refer to the text of the standard when answering exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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Case study - IFRS 3 Question 2

Please review the following case study:

Is Newberg Co's treatment of purchased R&D in line with IFRSs?

You should refer to the text of the standard when answering exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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IAS 28 Investments in Associates and Joint Ventures

"IAS 28 defines an associate and prescribes the equity accounting method for associates and joint ventures."

Definition of associate
The standard defines an associate as an entity over which the investor has significant influence. This could include the power to participate in policy-making process, representation on the Board of directors, or interchange of management personnel or provision of essential technical information. This is presumed to exist where the investor owns 20% or more of the voting power in the investee.
(IAS 28 paragraph 5)

Equity method
Associates and joint ventures are to be included in consolidated financial statements using the equity method.
(IAS 28 paragraph 11)

The equity method requires that an investment is initially recorded at cost and is subsequently adjusted to reflect the investor's share of the net retained post acquisition profit or loss of the associate.
(IAS 28 paragraph 10)

The investment in an associate or joint venture is tested for impairment when there are indications of impairment.
(IAS 28 paragraph 41A)

In the statement of profit or loss and other comprehensive income, share of profit after tax and share of other comprehensive income of an associate or joint venture are recognised.

(IAS 28 paragraph 27)

Unrealised profits and losses should be eliminated to the extent of the investor's interest in the associate.
(IAS 28 paragraph 28)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ias28_2011.htm

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IFRS 11 Joint Arrangements

"IFRS 11 defines a joint arrangement, classifies joint arrangements as joint ventures and joint operations and prescribes the accounting treatment for each."

Definitions

A **joint arrangement** is an arrangement of which two or more parties have joint control.

Joint control is the contractually agreed sharing of control of an arrangement which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

Note that joint control requires:

- A contractual arrangement, and
- Unanimous consent

If either of these is absent, there is no joint control and IFRS 11 does not apply.

Example 1

A Co holds 50% of Joven Co and B Co and C Co both hold 25%. An agreement between them specifies that decisions about relevant activities require a majority of 75%.

Here A Co and B Co or A Co and C Co together could make decisions about relevant activities. As there is more than one combination of parties that can reach 75% there is no unanimous consent and therefore this is not joint control.

If the agreement stipulated the parties that must agree to reach 75% eg A Co and B Co, then those parties would have joint control of Joven Co.

Example 2

X Co holds 50% of Nejov Co, Y Co holds 30% and Z Co holds 20%. An agreement between them specifies that decisions about relevant activities require a majority of 75%.

Here only X Co and Y Co can joint to achieve 75%. Although the agreement does not stipulate which parties have joint control, it is implied.

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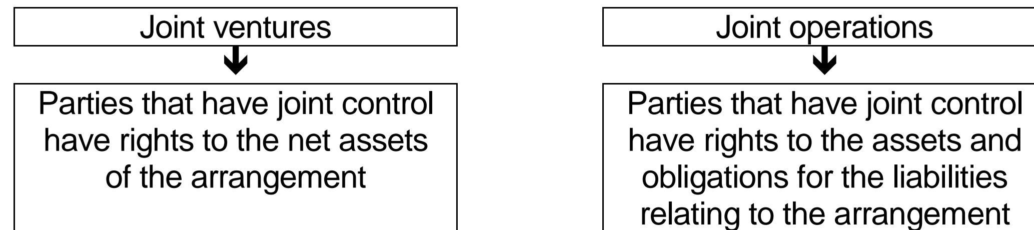
IFRS 11 Joint Arrangements

Forms of joint arrangement

Joint arrangements are either joint ventures or joint operations. Joint arrangements that are not structured through a separate entity are always joint operations.



Accounting treatment

- IFRS 11 requires interests in joint ventures to be equity accounted in accordance with IAS 28
- Joint operators recognise their share of assets, liabilities, revenues and expenses in accordance with applicable IFRSs

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ifrs11.htm

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IFRS 12 Disclosure of Interests in Other Entities

"IFRS 12 contains disclosure requirements in respect of subsidiaries, associates and joint ventures."

An entity should disclose information that helps the users of its financial statements to evaluate the nature of, and risks associated with, its interests in other entities. In order to achieve this objective the disclosure requirements introduced by IFRS 12 are extensive. However the entity must also make any additional disclosures necessary to meet the overall objective if those required by IFRS 12 and other standards are not sufficient.

(IFRS 12 paragraph 1)

An entity should disclose the significant judgements and assumptions it has made in determining whether it controls or has joint control or significant influence over an entity and also in determining the type of joint arrangement where applicable.

(IFRS 12 paragraph 7)

The standard outlines detailed disclosure provisions in relation to investments in each of subsidiaries, associates, joint arrangements, and unconsolidated structured entities.

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ifrs12.htm

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IAS 21 The Effects of Changes in Foreign Exchange Rates

"IAS 21 prescribes how to record foreign currency transactions in individual financial statements and how the financial statements of a foreign operation should be translated into a presentation currency for consolidation purposes."

Currency definitions

IAS 21 refers to two types of currency:

Functional currency. The currency of the primary economic environment in which the entity operates. The standard contains guidance on how to determine this currency. It is the currency that influences sales prices of goods and costs of inputs.

Presentation currency. The currency in which financial statements are presented. This may be any currency.

(IAS 21 paragraphs 8,9)

Foreign currency transactions

Transactions involving foreign currencies are recorded at the rate of exchange ruling on the date of the transaction. If exchange rates do not fluctuate significantly then an average rate may also be used.

At a subsequent reporting date:

- Non-monetary items (such as inventory and non-current assets) that are measured under the cost model should continue to be recorded at that exchange rate;
- Non-monetary items that are measured under the fair value model should be recorded at the exchange rate prevailing at the date of the latest revaluation to fair value;
- Monetary items (such as receivables and payables) resulting from past transactions should be translated at the closing rate and the resulting gains and losses recognised in profit or loss immediately

The settlement of a foreign monetary item (eg the payment of a supplier) is recorded at the prevailing exchange rate on the date of settlement. Any exchange gain or loss is recognised in profit or loss.

(IAS 21 paragraphs 21, 23, 28)

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IAS 21 The Effects of Changes in Foreign Exchange Rates

Foreign operations

A foreign operation is a subsidiary, associate, joint venture, or branch whose activities are based in a country other than that of the reporting entity.

The results of a foreign operation must be translated for the purposes of preparing consolidated financial statements. The method is as follows:

- Assets and liabilities are translated at the closing rate.
- Pre acquisition reserves are translated at the exchange rate on the date of acquisition
- Income and expenses are translated at the spot rate on the date of the transaction (or average rate as an approximation).
- Exchange differences are recognised in OCI and accumulated in a separate component of equity.
- Goodwill is also translated at the closing rate and any exchange difference recognised in OCI

On disposal of a foreign subsidiary, the cumulative exchange differences held in a separate component of equity are reclassified to profit or loss as part of the gain or loss on disposal.

(IAS 21 paragraphs 39, 40, 48)

Monetary items forming part of the net investment in a foreign operation

Where a reporting entity has, for example, made a loan to one of its foreign subsidiaries and settlement is not likely in the future, this forms part of the net investment in the foreign operation.

Exchange differences that arise on the retranslation of the loan in the reporting entity's separate accounts are recognised in profit or loss; in the consolidated accounts, they are however recognised in OCI and reclassified to profit or loss on the disposal of the foreign operation.

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ias21.htm

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IAS 29 Financial Reporting in Hyperinflationary Economies

IAS 29 prescribes the method to restate the financial statements of an entity operating in a hyperinflationary economy.

This standard should be applied by any entity that reports in the currency of a hyperinflationary economy.

Hyperinflation is not specifically defined, but an indication would be where there is a cumulative inflation rate of one hundred percent over three years. For most countries this would not apply at present. However, groups might have a subsidiary in such a country, which is why this standard has been included here in this module on group accounting.

Restatement

IAS 29 requires the financial statements of a hyperinflationary enterprise to be restated into current measuring units.

(IAS 29 paragraph 8)

If the entity is using historical cost financial statements, this suggests that the application of a general price index to non-monetary items is required. Even those entities using current cost accounting would need to re-express certain numbers using a measuring unit current at the reporting date.

A gain or loss on the net monetary position should be included in profit or loss and disclosed separately

(IAS 29 paragraph 9)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ias29.htm

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Frequently asked questions

1. When a European company adopts IFRSs for its consolidated statements, does this change its tax bills?
2. If a foreign subsidiary is using non-IFRS policies, what happens on consolidation?
3. What are reclassification adjustments (i.e. recycling)
4. Do the parties to a joint venture each need to own exactly the same proportion of shares?

1. Possibly; in the UK the tax authorities allow IFRSs to be used for tax purposes, however you should remember that tax authorities tax individual companies, not groups. Therefore an impact is only likely to be felt if group companies' separate financial statements are prepared in line with IFRSs.

2. The policies have to be corrected for consolidation, usually by consolidation adjustments rather than by changing the foreign statutory accounts.

3. Reclassification is the practice of reporting an amount in other comprehensive income in one period and then "recycling" or reporting it again through profit or loss in another period. An example of this is the recycling of exchange differences on the translation of a foreign subsidiary that are held in equity through profit or loss when it is sold.

4. No. For example, there is nothing to stop a 30/30/40 arrangement. The key point is that to have joint control, decisions regarding the entity must require the unanimous consent of all parties that together control the arrangement.

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Module 6 quick quiz

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Question 1

Netley Co purchased the whole of the share capital of Orell Co for $2,500,000 cash. Shareholders' funds of the two companies at the date of the purchase were as follows:

	Netley	Orell
	$	$
Share capital	5,000,000	2,000,000
Retained earnings	600,000	250,000

The fair value of Orell Co's tangible assets exceeded their carrying amount by $150,000. What balance should appear in the consolidated statement of financial position of Netley Co for goodwill at acquisition?

A. $400,000

B. $100,000

C. $250,000

D. $500,000

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Question 2

One third of the shares, and also voting rights, in Snow White Co are held by each of Sneezy Co, Sleepy Co and Dopey Co. Which of the following statements is true?

A. If an agreement has been drawn up specifying that decision making requires at least 60% of the voting rights, Sneezy Co would therefore have joint control.

B. If an agreement has been drawn up specifying that, as a minimum, decision making requires unanimous agreement by Sleepy Co and Dopey Co, Sneezy Co would have joint control due to the equal share in voting rights.

C. If an agreement has been drawn up specifying that decision making requires unanimous consent of Sneezy Co, Sleepy Co and Dopey Co, Sneezy Co would have joint control.

D. None of the above

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Question 3

Harwich Co holds 70,000 preference shares in Sall Co. These are non-voting but rank equally with the ordinary shares in a winding-up.

Felixstowe Co holds 20,000 voting ordinary shares in Sall Co.

The share capital of Sall Co is made up of the following:

	$
100,000 preference shares	100,000
30,000 ordinary shares	30,000
	130,000

Sall Co is a subsidiary undertaking of:

A. Both Harwich Co and Felixstowe Co

B. Harwich Co

C. Felixstowe Co

D. Neither Harwich Co nor Felixstowe Co

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Question 4

What is disclosed in the consolidated statement of financial position of an investor when the equity method is used to account for associates?

A. Receivables but not share of net assets of the associate.

B. Investment in associate at cost plus /minus the group's share of the associate's post acquisition retained profits or losses.

C. Share of net assets of the associate and receivables.

D. Cost of investment plus goodwill on acquisition less amounts written off but not receivables.

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Question 5

Inveresk Co has equity shareholdings in three other companies, as shown below, and has a seat on the board of each.

	Inveresk	Other shareholders
Raby Co	40%	No other holdings larger than 10%
Seal Co	30%	Another company holds 60% of Seal Co's equity
Toft Co	15%	Two other companies hold respectively 50% and 35% of Toft Co's equity, and each has a seat on its board. Inveresk Co exerts significant influence over Toft Co.

The associated undertakings of Inveresk Co, are:

A. Raby Co only

B. Raby Co and Seal Co

C. Raby Co and Toft Co

D. Raby Co, Seal Co and Toft Co

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Module 7: What you will learn - Disclosure standards

This module discusses the eight IASs that relate to disclosure and presentation:

- Statement of cash flows - IAS 7
- Operating segments - IFRS 8
- Related party disclosures - IAS 24
- Earnings per share - IAS 33
- Interim financial reporting - IAS 34
- First-time adoption of international financial reporting standards - IFRS 1
- Insurance contracts - IFRS 4

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Introduction

This module concerns a number of IFRSs that do not affect the recognition and measurement of items in the statement of financial position and statement of profit or loss and other comprehensive income.

However many of them do affect the presentation of numbers in the main financial statements. This is particularly obvious for the first standard (IAS 7) which concerns the major statement on cash flows. In most other accounting standards dealt with in the previous modules there are many disclosure requirements which on the whole have not been discussed so far in the course, but which you could examine by looking at the end of each accounting standard where there is a section on disclosures.

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IAS 7 Statement of Cash Flows

"A statement of cash flows is a primary statement required by IAS 1. IAS 7 provides the format of a statement of cash flows and guidance on classifying cash flows for presentation purposes."

The statement of cash flows explains the movement in cash and cash equivalents from the start to the end of a period. The total net cash flow should therefore reconcile to this amount.

Cash equivalents are somewhat vaguely defined as short-term highly liquid investments that are readily convertible to known amounts of cash, and carry an insignificant risk of changes in value.

(IAS 7 paragraph 6)

Classification of cash flows

Cash flows should be reported classified into three main headings

- Operating activities
- Investing activities
- Financing activities

Operating activities	• Receipts from sales • Receipts from royalties, fees, commissions etc • Payments to suppliers and employees • Tax payments or refunds
Investing activities	• Payments to acquire non-current assets • Proceeds of sale of non-current assets • Cash flows associated with loans made to other parties
Financing activities	• The proceeds of share issues • The proceeds of loan stock issues • Repayments of amounts borrowed • Finance lease payments

(IAS 7 paragraphs 14, 16, 1)**Interest and dividend payments and receipts must be disclosed separately.** Classification must be consistent but is not prescribed by IAS 7.

Interest and dividend payments and receipts must be disclosed separately. Classification must be consistent but is not prescribed by IAS 7.

- Interest payments may be classified as an operating or a financing cash flow. In the case of capitalised interest, they form part of the cost of an asset and so are investing cash flows. Interest and dividend receipts may be classified as operating or investing cash flows.
- Dividend payments may be classified as operating or financing cash flows.

(IAS 7 paragraphs 31-34)

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IAS 7 Statement of Cash Flows

Cash generated from operations

Cash flows from operating activities include cash generated by operations ie from conducting business. These include sales receipts, purchases and overheads.

These cash flows can be calculated either:

- Directly, by observing cash receipts and payments, or
- Indirectly, by adjusting profit for non-cash items and the effect of accrual accounting.

Regardless of the method used, the answer will be the same.

(IAS 7 paragraph 18).

The following is an example of the indirect method of calculating Cashflows from Operating Activities.**Example – the indirect method**

	$
Profit before tax	X
Add back finance costs	X
Add back depreciation	X
Decrease / (increase) in trade and other receivables	X/(X)
Decrease / (increase) in inventories	X/(X)
Increase / (decrease) in trade and other payables	X/(X)
Cash generated from operations	X

Additional points

Actual or average exchange rates should be used for cash flows from a foreign subsidiary.

(IAS 7 paragraph 25).

Non-cash transactions should not be included in the statement of cash flows, but should be disclosed in the notes

(IAS 7 paragraph 43).

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/en/standards/ias/ias7

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IFRS 8 Operating Segments

"IFRS 8 is mandatory for listed entities. It defines an operating segment, states criteria to apply to determine whether an operating segment is reportable and states required disclosures for reportable operating segments."

The disclosure of operating segment information means that an entity's business can be better understood; for example the different risks it faces and its returns from different parts of its operations.

Applicability

IFRS 8 is mandatory for companies whose debt or equity instruments are traded in a public market or companies in the process of issuing securities in a public market.

The standard is only applicable in the consolidated financial statements in those cases where parent and consolidated statements are in the same financial report.

(IFRS 8 paragraph 2)

Operating segments

An operating segment is a component of an entity:

- That engages in business activities from which it may earn revenues and incur expenses
- Whose operating results are regularly reviewed by the chief operating decision maker (CODM) of an entity in order to make decisions
- For which discrete financial information is available

IFRS 8 clarifies that the CODM may be a function rather than an individual. It may for example be the Board of Directors.

(IFRS 8 paragraphs 5, 7)

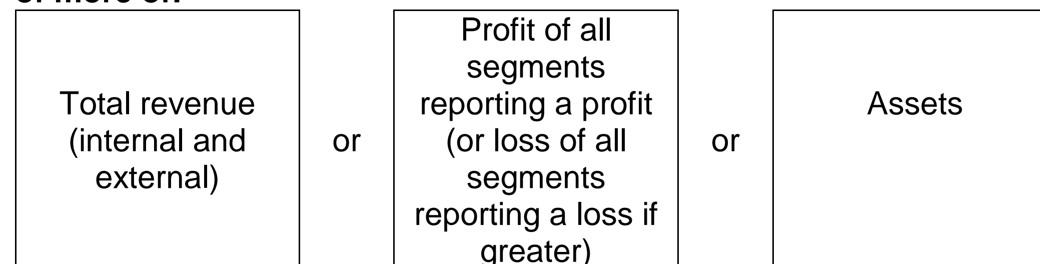
Aggregation

Operating segments with similar economic characteristics may be aggregated for the purpose of applying the standard.

(IFRS 8 paragraph 12)

Reportable operating segments

An operating segment is reportable if it has a segment total of 10% of more of:



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IFRS 8 Operating Segments

The total external revenue of all reportable operating segments must represent at least 75% of the entity's external revenue. If this is not the case, additional segments that do not meet the '10% test' must be designated as reportable.

(IFRS 8 paragraphs 13, 15)

Disclosure requirements are split into 4 types:

General information	• Factors used to identify reportable segments • Types of products and services from which each segment derives revenues

Information about profit or loss, assets and liabilities	• A measure of profit or loss for each reportable segment • Specific amounts included in this measure (eg internal and external revenues, interest and income tax) • A measure of total assets and liabilities for each segment only if these amounts are provided to the CODM • Specific amounts included in this measure (eg investments in associates and additions to non-current assets)

Reconciliations	Of each of the following items for reportable segments to entity reported figure: • Revenue • Profit or loss • Assets (if disclosed) • Liabilities (if disclosed) • Other material items

Entity wide disclosures	• External revenue by product and service • External revenue by geographical area (country of domicile/ other countries) • Non-current assets by geographical are (country of domicile / other countries)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/en/standards/ifrs/ifrs8

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Exercise - IFRS 8 Question

Please review the following exercise:

How is a reportable segment defined under IFRS 8?

You should refer to the text of the standard when answering exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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IAS 24 Related Party Disclosures

"IAS 24 defines related parties and prescribes the required disclosures. It provides information to allow investors to assess the stewardship of the directors."

Definitions are key to IAS 24; especially the definition of a related party. A party that is related to a reporting entity may be an individual or another reporting entity:

Individuals
(a) A person who has control or joint control over the reporting entity (b) A person who has significant influence over the reporting entity (c) A member of key management personnel of the reporting entity or its parent (d) A close member of family of any person mentioned in (a), (b) or (c).

Note that the definitions of key management personnel and close family members are not definitive:
key management personnel includes, but is not restricted to, directors;

- close family members include, but are not restricted to, spouses, domestic partners and dependants.

Therefore judgement must be applied when determining whether an individual is related to a reporting entity.

Reporting entities that are related
(a) Members of the same group (b) Associates or joint ventures and their parents (or companies within the same group as their parent) (c) Two joint ventures of the same third party (d) An associate and a joint venture of the same parent entity (e) A reporting entity and the post-employment benefit plan for its employees (f) An entity that is controlled or jointly controlled by an individual and an entity that is a related party of the same individual (g) An entity that is controlled or jointly controlled by an individual and another entity that the same individual has significant influence over or is key management personnel of (h) An entity and an entity that provides it with key management personnel services

Despite this extensive definition, IAS 24 is clear that substance prevails and therefore although a relationship may not meet the stated definition, it may be a related party relationship.

(IAS 24 paragraph 9, 10)

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IAS 24 Related Party Disclosures

Related party transactions are transfers of resources, services, obligations between related parties, regardless of whether a price is charged.

(IAS 24 paragraph 9)

Disclosure

The disclosure requirements of the standard relate to three areas:

Parent-subsidiary relationship	Name of parent and ultimate controlling party, regardless of whether transactions have taken place
Key management personnel	Totals of share-based payments, short-term, post-employment, other long term and termination benefits paid to key management personnel
Related party transactions	Amount of transactions in the period, amount outstanding at the period end, provisions for doubtful debts recognised and expense for irrecoverable debts for each type of related party

Note that related party transactions and outstanding balances with other entities in a group are to be disclosed in an entity's financial statements. However, no intragroup transactions and balances are disclosed in the consolidated financial statements as they are eliminated.

Also note that substantiation is required if an entity discloses that related party transactions were made on an arm's length basis.

(IAS 24 paragraphs 13, 17, 18, 19, 23)

Government related entities

The IAS 24 disclosure requirements do not apply to transactions between a reporting entity and:

- a government that has control, joint control or significant influence over the entity and
- another entity that is related to the reporting entity because the same government controls, jointly controls or significantly influences both.

(IAS 24 paragraph 25)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/standard/ias24.htm

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IAS 33 Earnings per Share

"IAS 33 is mandatory for entities with publicly traded securities. Other companies that choose to present EPS must also apply IAS 33."

Basic earnings per share (EPS)

Calculated as:

$$\frac{\text{Profit / (loss) attributable to ordinary shareholders}}{\text{Weighted average number of ordinary shares}}$$

(IAS 33 paragraph 10)

The profit attributable to ordinary shareholders is profit after tax:

- Attributable to the owners of the parent and
- After deducting preference share dividends that are not included within finance costs (ie irredeemable preference shares).

(IAS 33 paragraph 12)

The weighted average number of ordinary shares is calculated by:

- Pro-rating the number of shares outstanding where there have been share issues in the period
- Adjusting any shares in issue before a bonus issue by a bonus fraction
- Adjusting any shares in issue before a rights issue by a bonus fraction

(IAS 33 paragraphs 20, 28)

The bonus fraction for a bonus issue is:

$$\frac{\text{Number of shares in issue post bonus issue}}{\text{Number of shares in issue pre bonus issue}}$$

The bonus fraction for a rights issue is:

$$\frac{\text{Pre rights issue price of shares}}{\text{Theoretical ex-rights price (TERP)}}$$

The TERP is calculated as:

$$\frac{\text{Total market value of shares pre rights issue + proceeds of rights issue}}{\text{Number of shares post rights issue}}$$

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IAS 33 Earnings per Share

Example

A company reports a post tax profit of $300 million for the year ended 31 December 20X4. On 1 January 20X4 the company has 50 million shares in issue. On 1 March 20X4 there was a bonus issue of 1 new share for every 5 outstanding.

Weighted average number of shares is:

1.1.14-28.2.14 50,000,000 x 2/12m
8,333,333
1.3.14 rights issue 10,000,000
1.3.14-31.12.14 60,000,000 x 8/12m x 6/5
48,000,000

56,333,333

Therefore basic EPS is 300,000,000/56,333,333 = $5.33

Diluted earnings per share

Diluted earnings per share is calculated as:

Profit for basic EPS adjusted for effect of dilutive potential ordinary shares
Number of shares for basic EPS adjusted for dilutive potential ordinary shares

(IAS 33 paragraph 31)

Potential ordinary shares are dilutive when their conversion would decrease net profit per share.

(IAS 33 paragraph 41)

Potential ordinary shares include options, convertible instruments (eg loan stock or preference shares) and contingently issuable shares.

(IAS 33 paragraph 31)

Where there are a number of groups of potential ordinary shares in issue, the effects of these are added into the DEPS calculation one by one, starting with most dilutive. Diluted EPS is the lowest EPS calculated at any stage.

(IAS 33 paragraph 7)

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IAS 34 Interim Financial Reporting

"IAS 34 does not mandate the preparation of interim financial reports, but it does prescribe minimum content and recognition and measurement principles for those entities that do prepare them."

Publicly traded entities are encouraged to:Publicly traded entities are encouraged to:

- provide interim reports at least at the end of the first half of each financial year, and
- make these reports available not more than 60 days after the end of the interim period.

Content of an interim report
IAS 34 requires that an interim report contains, as a minimum, condensed versions of all four primary statements, selected explanatory notes and earnings per share.

An entity may alternatively choose to prepare full financial statements in accordance with IAS 1 as its interim report.

(IAS 34 paragraphs 8, 9, 11)

Comparative figures for previous interim periods and previous full years are required.

(IAS 34 paragraph 20)

Recognition and measurement
The same accounting policies are required in the interim reporting as for annual reporting, although changes in accounting policy might be made at the interim stage rather than waiting for a year end. The frequency with which interim reporting is carried out must not be allowed to affect the annual result.

(IAS 34 paragraph 28)

For interim reporting, the use of year end practices with respect to whether items should be anticipated or deferred is required. That is, interim reports should largely be seen as periods in their own right.

(IAS 34 paragraphs 37, 39)

Disclosure

Notes to the financial statements must include disclosure of significant events and transactions since the end of the last full period.

(IAS 34 paragraph 15)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

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Exercise - IAS 34 Question

Please review the following exercise:

When development expenditure has been recognised as an expense, it cannot subsequently be capitalised (see IAS 38). However, IAS 34 states that:

"An entity shall apply the same accounting policies in its interim financial statements as are applied in its annual financial statements…However, the frequency of an entity's reporting (annual, half-yearly, or quarterly) shall not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes shall be made on a year-to-date basis."

If a company prepares interim financial reports, when should the IAS 38 criteria for capitalising development expenditure be considered: (a) when the interim reports are prepared; or (b) at the financial year end?

You should refer to the text of the standard when answering exercises.

Consider your answer to the question, when you are ready click next to enter it into the course blog.

You may wish to discuss this with a colleague before finally submitting it.

You can then review the ideas of other students on this subject.

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IFRS 1 First-time Adoption of International Financial Reporting Standards

"IFRS 1 sets out the procedures that must be followed when a company applies IFRSs for the first time."

Opening statement of financial position

An IFRS statement of financial position should be prepared at the date of transition to IFRSs.

The date of transition is the beginning of the earliest period for which full comparative information is prepared. Therefore if IFRSs are first adopted in the financial statements for the year ended 31 December 20X5, the date of transition is 1 January 20X4.

The same accounting policies should apply in the opening IFRS statement of financial position and throughout all periods presented in the first IFRS financial statements. They should comply with IFRSs effective at the end of the first IFRS period (in the example above, on 31 December 20X5).

(IFRS 1 paragraphs 6, 7)

Recognition The reporting entity should eliminate previous GAAP assets and liabilities from the opening statement of financial position if they do not qualify for recognition under IFRSs.

For example, if the company's previous GAAP had allowed accrual of liabilities for "general reserves", restructurings, future operating losses, or major overhauls that do not meet the conditions for recognition as a provision under IAS 37**,** these should be eliminated in the opening IFRS statement of financial position.

The company should recognise all assets and liabilities that are required to be recognised by IFRS even if they were not recognised under previous GAAP. For example, IAS 37 requires recognition of provisions as liabilities including a company's obligations for restructurings, onerous contracts, decommissioning, etc.

(IFRS 1 paragraphs 10,11)

Measurement

The company should apply IFRS in measuring all recognised assets and liabilities. Any adjustments should be recognised directly in retained earnings or equity at the date of transition to IFRSs.

In preparing IFRS estimates retrospectively, the company must use the transactions and assumptions that had been used to determine previous GAAP estimates in periods before the date of transition to IFRS, provided that those transactions and assumptions are consistent with IFRS.

(IFRS 1 paragraphs 10, 14)

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IFRS 1 First-time Adoption of International Financial Reporting Standards

Presentation

The company should reclassify previous GAAP opening statement of financial position items into the appropriate IFRS classification. For example, IAS 10 does not permit classifying dividends declared or proposed after the reporting date as a liability at that date. If a company had done so in its opening statement of financial position, then the dividends would need to be reclassified as retained earnings.

Disclosure

A first-time adopter should make an explicit and unreserved statement that its general purpose financial statements comply with IFRSs for the first time.

(IFRS 1 paragraph 3)

Exceptions and exemptions

There are some important exceptions to the general restatement and measurement principles set out above.

The following items must not be adjusted retrospectively on adoption of IFRSs:

- Derecognition of financial instruments
- Hedge accounting
- Non-controlling interests
- Classification and measurement of financial Embedded derivatives
- Government loans

(IFRS 1 appendix B)

Other optional exemptions are available in respect of several areas of accounting, including business combinations, share-based payment transactions, leases, foreign exchange differences, borrowing costs and compound financial instruments.

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

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IFRS 4 Insurance Contracts

"IFRS 4 applies to all insurance contracts that an entity issues and to reinsurance contracts that it holds. The standard is a temporary solution whilst the IASB develops a new standard on the topic."

An insurance contract is a contract under which the insurer accepts significant insurance risk from the policyholder by agreeing to compensate the policyholder if a specified uncertain future event affects them.

A reinsurance contract is an insurance contract issued by one insurer to compensate another insurer for losses on contracts they have issued.

IFRS 4 prohibits an insurer or reinsurer from making a provision for claims not in existence at the reporting date. It also:

- prohibits the offsetting of insurance liabilities against reinsurance assets
- requires that insurers and reinsurers test for the adequacy of reported liabiltiies
- requires that insurers conduct an impairment test for reinsurance assets**.**

(IFRS 4 paragraph 14)

For further useful information please click on the following hyperlink to Deloitte's IAS Plus website:

http://www.iasplus.com/en/standards/ifrs/ifrs4

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Frequently asked questions

Why did the IASB issue IFRS 4 Insurance Contracts?

Many insurance companies had accounting policies that were in conflict with IFRSs. In order to ensure compliance with IFRS for the purpose of the 2005 deadline, the IASB had to issue a “stop-gap” standard, which allowed insurance companies to follow more or less their existing policies so that they could state compliance with IFRSs.

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Module 7 quick quiz

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Question 1

In accordance with IFRS 8 Operating segments which of the following must be disclosed for a reportable segment?

1. Revenue - external
2. Segment profit or loss
3. Total assets
4. Total liabilities

A. 1 and 3

B. 2 only

C. 1, 3 and 4

D. 2, 3 and 4

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Question 2

In accordance with IFRS 8 Operating Segments which of the following must be disclosed by geographical area?

1. Revenue - external
2. Segment result
3. Total assets
4. Non-current assets

A. All of the above

B. 1, 2 and 3

C. 1 and 4

D. 2, 3 and 4.

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Question 3

A segment should be treated as reportable under IFRS 8 if it is reported internal and external revenue is what percentage of the combined revenue (internal and external)?

A. 5% or more

B. 10% or more

C. 15% or more

D. 20% or more.

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Question 4

Which of the following is not a potential ordinary share when applying IAS 33 Earnings per Share?

A. Convertible debt

B. Redeemable preference shares

C. Share options

D. Shares which will be issued subject to certain conditions being met

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Question 5

A company, the shares in which currently sell at $75 each, plans to make a rights issue of one share at $60 for every four existing shares.

What is the theoretical ex-rights price of the shares after the issue?

A. $75.00

B. $72.00

C. 467.50

D. $63.00

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Question 6

On 1 January 20X8 a company has 10m ordinary shares in issue. On 1 April 20X8 it issues a further 2m shares in a share for share exchange deal.

What is the number of ordinary shares to be used in the basic EPS calculation for the year ended 31 December 20X8?

A. 10m

B. 10.5m

C. 11.5m

D. 12m

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Question 7

At 31 December 20X8 a company has 1200 share options in issue. The exercise price of these options is $5 per share. The average fair value of shares for the period was $6 per share.

What is the number of shares that will be added to the basic EPS share figure for the diluted EPS calculation?

A. 200

B. 240

C. 1000

D. 1200

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Question 8

At 31 December 20X8 a company has in issue convertible loan stock. The liability element has a carrying amount of $1,000,000 and the effective interest rate is 10%. Income tax is charged at the rate of 30%.

By what amount will the profit figure increase in the diluted EPS calculation as a result of including the convertible loan stock?

A. Nil

B. $70,000

C. $100,000

D. $130,000

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Question 9

Which of the following are related parties of Moor Co?

1. The purchasing director, Adam Webster
2. Lucy Webster, Adam's wife
3. Cake Design Co, a company in which Lucy Webster holds 100% of the shares
4. Boris Davies, who holds a controlling shareholding in Moor Co

A 1 and 4
B 1, 2 and 4
C 4 only
D All of them

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Question 10

How should a gain on the disposal of a non-current asset be shown in a company's statement of cash flows and the supporting notes?

A. As a reconciling item between operating profit and net cash flow from operating activities

B. As an operating cash flow

C. As an investing cash flow

D. It will not appear at all

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Question 11

Scaffold Co has increased its bad debts provision by $25,000.
How would this be reflected in Scaffold Co's statement of cash flows?

A

Reconciliation of operating profit to net cash inflow from operating activities: increase in receivables	Increase in cash
Decrease	**No change**

B

Reconciliation of operating profit to net cash inflow from operating activities: increase in receivables	Increase in cash
Decrease	**Decrease**

C

Reconciliation of operating profit to net cash inflow from operating activities: increase in receivables	Increase in cash
No change	**No change**

D

Reconciliation of operating profit to net cash inflow from operating activities: increase in receivables	Increase in cash
No change	**Decrease**

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Question 12

A company incurs expenditure on development during the year, which is capitalised.

How would this expenditure be shown in a statement of cash flows?

A. As an operating cash flow

B. As an investing cash flow

C. As an item in the reconciliation of operating profit and net cash inflow from operating activities

D. It will not appear at all.

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Module 8: What you will learn - principal differences between IFRS and UK GAAP/US GAAP

This module will deal with the following items:

- Principal differences between IFRS and UK GAAP
- Principal differences between IFRS and US GAAP

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Principal differences between IFRS and UK GAAP

Financial Reporting Standard 102 *The Financial Reporting Standard Applicable in the UK and the Republic of Ireland* (FRS 102) replaced the individual standards of UK GAAP on 1 January 2015 (more details regarding the introduction of FRS 102 are provided in Module 9).

The aim was to reduce the quantity and complexity of rules that existed under UK GAAP; as FRS 102 explains:

“This FRS [FRS 102] aims to provide entities with succinct financial reporting requirements. The requirements in this FRS are based on the …IASB’s International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs) issued in 2009. The IFRS for SMEs is intended to apply to the general purpose financial statements of, and other financial reporting by, entities that in many countries are referred to by a variety of terms including ‘small and medium-sized’, ‘private’ and ‘non-publicly accountable” (FRS 102, page 3)

Note: FRS 102 simplifies the IFRS principles for recognising and measuring assets, liabilities, income and expenses. Often, only basic accounting treatments are required, the number of accounting options offered (in comparison to IFRS) is reduced and fewer disclosures are required.

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Principal differences between IFRS and UK GAAP

The following table highlights the main differences between IFRS and FRS 102.

Topic	Main differences between IFRS and FRS 102
Financial statements presentation	IAS 1 formats for the financial statements differ from the UK Companies Act formats used in FRS 102.
Cash flow statements	No noticeable differences between FRS 102 and IAS 7.
Financial Instruments	FRS 102 requires that basic financial instruments are measured at amortised cost. The definition of ‘basic’ includes a wide range of debt instruments for which amortised cost measurement adequately captures the risk associated with the instrument. More complex financial instruments (and those designated as such) are measured at fair value through profit or loss. IFRS 9 requires initial recognition at fair value and applies more complex rules for subsequent measurement, resulting in a broader range of financial instruments being measured at fair value.
Government grants	FRS 102 allows either the accruals or performance method of recognising the grant in the statement of profit or loss. IAS 20 only permits the accruals method.
Capitalisation of borrowing costs	FRS 102 allows capitalisation or expensing of borrowing costs whereas IAS 23 requires their capitalisation.
Retirement benefits	No noticeable differences between FRS 102 and IAS 19.
Foreign currency	No noticeable differences between FRS 102 and IAS 21.
Share based payment transactions	Option pricing models are not always applied under FRS 102 whereas the IFRS 2 treatment differs.
Deferred tax	FRS 102 has a 'timing differences plus' approach whereas IAS 12 uses an approach based on “temporary differences”.

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Principal differences between IFRS and UK GAAP

Topic	Main differences between IFRS and FRS 102
Intangible assets other than goodwill	FRS 102 does not permit assets to have indefinite lives and they are all subject to amortisation. IAS 38 does permit intangible assets to have indefinite useful lives but these must be subject to an annual impairment review.
Property, plant and equipment	No noticeable differences between FRS 102 and IAS 16.
Investment property	Under FRS 102, the fair value of an investment property is used if measureable; otherwise cost is used. IAS 40 offers a choice between both these methods.
Impairment of non-financial assets	Impairment of goodwill can be reversed under FRS 102, but under IAS 36 it is permanent.
Leases	No noticeable differences between FRS 102 and IAS 17
Inventories	No noticeable differences between FRS 102 and IAS 2
Provisions and contingencies	No noticeable differences between FRS 102 and IAS 37
Events after the reporting period	No noticeable differences between FRS 102 and IAS 10
Consolidation	There is no remeasurement of pre-existing or retained stakes under FRS 102.
Business combinations (including goodwill)	Goodwill is not amortised under IFRS but it is under FRS 102. Transaction costs are included in the acquisition cost under FRS 102 whereas under IFRS they are expensed. Contingent consideration is also treated differently depending on the probability of its payment.
Discontinued operations & assets held for sale	FRS 102 does not deal with assets held for sale.
Investment in associates	No noticeable differences between FRS 102 and IAS 28.

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Principal differences between IFRS and UK GAAP

Topic	Main differences between IFRS and FRS 102
Investments in joint ventures	No noticeable differences between FRS 102 and IAS 11.
Related party transactions	No noticeable differences between FRS 102 and IAS 24.
Specialised activities (agriculture)	There is a choice of measurement at cost or fair value available under FRS 102 whereas IAS 40 requires measurement at fair value.
Service concession arrangements	FRS 102 addresses accounting by grantors whereas IFRS includes a model for operators.

FRS 102 does not address all of the topics covered by IFRS; for example, the following topics are omitted from FRS 102:

- Earnings per share
- Segmental reporting
- Interim financial reporting
- Classification of non-current assets held for sale

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Principal differences between IFRS and US GAAP

General approach

- US GAAP comprises more “rules-based” standards with specific application guidance
- IFRSs are considered to be more “principles-based”

IAS 1 Presentation of Financial Statements

- Unlike IFRS, US GAAP financial statements are usually prepared on a going concern basis unless liquidation is imminent
- Specific line items and one year comparative financial information required by IAS 1
- No comparative information required for private companies under US GAAP (though in practice a single year is often presented). However public companies are subject to SEC rules and regulations, which require statements of financial position for the two most recent years and all other statements to cover three years
- SEC registrants are required to present expenses based on function. Under IFRS expenses may be presented by nature or function

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Principal differences between IFRS and US GAAP

Extraordinary items

- Extraordinary items are prohibited by IAS 1
- Extraordinary items are permitted, but are restricted to items that are both infrequent in occurrence and unusual in nature (thus rare in practice). Negative goodwill is an extraordinary item under US GAAP

IAS 2 Inventories

- IAS 2 requires that inventories are measured at the lower of cost and net realisable value
- US GAAP requires that inventories are measured at the lower of cost and market value, being current replacement cost
- The LIFO (last in first out) assumption is prohibited by IAS 2 but permitted (and commonly used) by US GAAP
- IAS 2 allows previously recognised impairment losses to be reversed up to the amount of the original impairment loss. US GAAP does not allow the reversal of write downs of inventory to market value unless it relates to changes in exchange rates

IAS 7 Statement of Cash Flows

Classification of items in the cash flow statement:

- Interest received and/or paid may be classified as an operating, investing or financing activity under IAS 7
- Must be classified as an operating activity by US GAAP
- IAS 7 allows dividends paid to be classified as operating or financing activities
- They must be classified as financing activities under US GAAP

Bank overdrafts:

- Included in cash under IAS 7 if they form an integral part of an entity's cash management
- Excluded from cash by US GAAP, and instead treated as short-term financing

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Principal differences between IFRS and US GAAP

IAS 12 Income Taxes

Classification of deferred tax assets and liabilities:

- Always non-current under IAS 12
- Under US GAAP classification is split between current and non-current components based on the classification of underlying asset or liability, or on the expected reversal of items not related to an asset or liability

Impact of temporary differences related to inter-company profits:

- Deferred tax effect is recognised at the buyer's tax rate by IAS 12
- Deferred tax effect is recognised at the seller's tax rate, as if the transaction had not occurred under US GAAP

Initial recognition exemption:

- Deferred tax not recognised for taxable temporary differences that arise from the initial recognition of certain assets and liabilities under IAS 12
- No similar exemption under US GAAP

Measurement:

- Use enacted or "substantively enacted" tax rate under IAS 12
- Use enacted tax rate under US GAAP

Recognition of deferred tax assets:

- Amounts are recognised only to the extent it is probable that they will be realised under IFRS
- Recognised in full under US GAAP but valuation allowance reduces asset to the amount that is more likely than not to be realised

IAS 16 Property, Plant and Equipment:

- IAS 16 offers choice between revaluation and historical cost model. Under US GAAP revaluation is not permitted
- US GAAP permits component depreciation but it is not commonly used. Under IFRS component depreciation must be used if components of an asset have differing patterns of benefit
- Residual values and useful lives must be reviewed annually per IAS 16; under US GAAP they are reviewed when events or changes in circumstances indicate they are no longer appropriate

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Principal differences between IFRS and US GAAP

IAS 17 Leases

Classification:

- Under US GAAP there are quantitative thresholds to apply in determining classification (e.g. whether the present value of minimum lease payments equals or exceeds 90% of the fair value of the lease item). There are no such thresholds under IFRS
- Leases may therefore be classified differently under IFRS than under US GAAP

Recognition of a gain on a sale and leaseback transaction where the leaseback is an operating lease:

- Under IFRS the gain is recognised immediately (subject to adjustment if the sale price differs from fair value).
- Under US GAAP the gain is amortised over the lease term provided the seller does not relinquish more than a minor part of the right to use an asset.

IAS 19 Employee Benefits:

- Under IFRS, actuarial gains and losses must be recognised immediately in other comprehensive income; this is not permitted under US GAAP
- IAS 19 requires that a defined benefit asset is restricted by the ‘asset ceiling’. US GAAP has no such restriction

IAS 20 Government Grants

There is no specific US GAAP guidance on accounting for grants awarded by a government and its bodies.

IFRS 10 Consolidated Financial Statements
IAS 27 Separate Financial Statements

Basis for consolidation is different:

- Power to control is key under IFRS 10 (defined as exposure or rights to variable returns from involvement with the investee and ability to affect those returns through power over the investee)
- US GAAP approach depends on the type of entity. For voting interests, entities generally look to majority voting rights. For variable interest entities (VIE), look to a risks and rewards model coupled with consideration of which enterprise can direct the activities of the VIE

Different accounting policies of parent and subsidiaries:

- Must conform to policies under IFRS
- No specific requirement to conform to policies under US GAAP Consolidated financial statements generally prepared by using uniform accounting policies for all entities in a group but some exceptions where a subsidiary conforms to specialised industry accounting principles

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Principal differences between IFRS and US GAAP

Non-controlling interests:

- Under US GAAP, non-controlling interests are measured at full fair value
- Under IFRS, there is a choice. The non-controlling interest is either measured as a proportion of the fair value of the identifiable net assets or at full fair value. The use of the full fair value option results in full goodwill being recognised in the consolidated statement of financial position

IAS 32 Financial Instruments: Presentation

Classification of convertible debt instruments:

- Split the instrument into its liability and equity components and measure the liability at fair value with the equity component representing the residual under IFRS
- Classify the entire instrument as a liability under US GAAP

IAS 33 Earnings Per Share

- Basic and diluted income from continuing operations per share and net profit or loss per share is disclosed under IFRS
- Basic and diluted income from continuing operations, discontinued operations, extraordinary items, cumulative effect of a change in accounting policy, and net profit or loss per share is disclosed under US GAAP

IAS 36 Impairment of Assets

Determining impairment:

- Impairment testing performed if indicators exist under IAS 36
- Under US GAAP the carrying amount of the asset is compared to the sum of future undiscounted cash flows generated through use and eventual disposition. If it is determined that the asset is not recoverable, impairment testing must be performed

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Principal differences between IFRS and US GAAP

Measurement of impairment loss:

- Based on the difference between carrying amount and recoverable amount (the higher of the asset's value-in-use and fair value less costs to sell) under IFRS
- Based on the difference between carrying amount and fair value under US GAAP

Allocation of goodwill:

- Goodwill is allocated to a Cash generating unit (CGU) or group of CGUs under IFRS
- Goodwill is allocated to a reporting unit (an operating segment or one level below an operating segment) under US GAAP

Impairment reversal:

- Under IFRS subsequent reversal of an impairment loss is required for all assets, other than goodwill, if certain criteria are met
- Under US GAAP impairment reversal is prohibited for all assets to be held and used

IAS 37 Provisions, Contingent Liabilities and Contingent Assets

Recognition criteria:

- Both IAS 37 and US GAAP require that a provision is recognised only where a loss is 'probable'. IAS 37 defines this as 'more likely than not' (which refers to a probability of over 50%), whereas US GAAP defines it as 'likely', which is widely interpreted as a probability of more than 70%

Measurement of provisions:

- IAS 37 allows a provision to be discounted to reflect the time value of money
- US GAAP allows discounting only in limited cases and specific requirements apply that differ from IFRS
- IAS 37 measures a provision at the best estimate of the obligation. This is typically an expected value where a large population of items is being measured. Where a single obligation is measured, best estimate should consider the most likely outcome, which may be adjusted for higher and lower possible outcomes
- US GAAP requires that a provision is measured at the most likely outcome; where there is no single most likely outcome, the minimum amount in the range of outcomes forms the measurement

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Principal differences between IFRS and US GAAP

IAS 38 Intangible Assets

Development costs are:

- Capitalised if certain criteria are met under IFRS, but

Expensed (except for certain website development costs and certain costs associated with developing internal use software) under US GAAP

Revaluation of intangible assets is:

- Permitted only if the intangible asset trades in an active market under IFRS (fairly uncommon)
- Revaluation prohibited under US GAAP

IAS 40 Investment Property

Measurement basis for investment property:

- Under IFRS there is an option to use either the historical cost model or the fair value model (with value changes through profit or loss)
- Investment property is not separately defined under US GAAP and so is accounted for as property, plant and equipment (measured using the historical cost basis) unless it meets the criteria to be held for sale

IAS 41 Agriculture

Measurement basis of agricultural crops, livestock, orchards, forests is:

- At fair value less costs to sell with changes recognised in profit or loss under IFRS
- Generally at historical cost under US GAAP. However, fair value less costs to sell is used for harvested crops and livestock held for sale under US GAAP

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Principal differences between IFRS and US GAAP

IFRS 1 First Time Adoption of IFRS

First time adoption:

- General principle is retrospective application of IFRSs in force at the time of adoption
- No specific standard under US GAAP

IFRS 2 Share Based Payments

- Under IFRS the fair value of a transaction should be based on the value of the goods or services received and only on the fair value of the equity instruments if the fair value of the goods and services cannot be reliably determined
- Under US GAAP either the fair value of (1) the goods or services received, or (2) the equity instruments is used to value the transaction, whichever is more reliable
- If employee may opt for equity repurchase, liability classification is required under IFRS, but is not required under US GAAP if employee bears risks and rewards of equity ownership for at least six months from the date the equity is issued or vests

IFRS 3 Business Combinations

- Treatment of contingent colnsideration, contingent liabilities and intangible assets different in acquisition accounting under US GAAP

IFRS 4 insurance Contracts

- IFRS 4 addresses recognition and measurement in only a limited way. It is an interim standard pending completion of a comprehensive project
- Several comprehensive pronouncements and other comprehensive industry accounting guides have been published under US GAAP

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Principal differences between IFRS and US GAAP

IFRS 11 Joint Arrangements

- IFRS define a joint arrangement as an arrangement over which two or more parties have joint control. Joint arrangements may be ‘joint operations’ or ‘joint ventures’. A joint venture exists where the venturers have rights to the net assets of the arrangement
- US GAAP does not define ‘joint arrangement’ or ‘joint operation’. The definition of a joint venture refers to a jointly controlled activity conducted with the use of a legal entity
- In line with IFRS, US GAAP requires that joint ventures are generally accounted for using the equity method

IFRS 15 Revenue from Contracts with Customers

Only minor differences exist relating to:

- Collectability thresholds;
- Interim disclosure requirements;
- Early application and effective dates;
- Impairment loss reversal; and
- Non-public entity requirements

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Frequently asked questions

1. Have the differences between the UK, US and IFRS requirements been growing or shrinking recently?
2. What is the difference between “incompatible” and “inconsistent”?

To reveal our answers click below:

1. On a number of recent standard-setting issues, there has been a concerted US/IFRS or UK/IFRS effort. For example, IAS 33 (earnings per share) was written jointly with the FASB; and IAS 37 (provisions) was written jointly with the UK’s Accounting Standards Board. Also IAS 12 (income tax) is based closely on the US rules. The UK influenced the IASB on IAS 36 (impairment) and IAS 38 (intangibles). More recently, IFRS 15 was developed with FASB, which issued a converged US standard at the same time. The new UK GAAP standard, FRS 102, is based on the IFRS for SMEs, so meaning that differences between UK GAAP and IFRS have reduced in recent years.

2. “Incompatible” means that it is impossible to obey both instructions at the same time. “Inconsistent” means that the rules allow different choices.

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Quick Quiz

Module 8 quick quiz

Click next to continue

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Question 1

When preparing financial statements in accordance with FRS 102 rather than IFRS, which of the following statements is true?

A. Negative goodwill is released to the statement of profit and loss over 20 years

B. Goodwill is amortised in the statement of profit and loss

C. Goodwill can be revalued upwards after acquisition

D. Goodwill should be measured at fair value

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Question 2

When considering the differences between US and UK GAAP which of the following statements is true?

1. IFRS does not allow the use of extraordinary items; US GAAP does and includes the recognition of negative goodwill under this heading
2. The LIFO method of inventory valuation is not permitted under UK or US GAAP
3. In the IFRS statement of cash flows, interest received or paid may be classified under any of the 3 main headings; US GAAP specifies interest as an operating cash flow

A. 1 only

B. 2 and 3

C. 1 and 3

D. All of the above.

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Question 3

When preparing consolidated financial statements, which of the following statements are true:

1. US GAAP requires that a non controlling interest in a subsidiary is measured at full fair value
2. IFRS permits a non controlling interest in a subsidiary to be measured at full fair value or as a proportion of the fair value of the identifiable net assets of the acquiree.
3. US GAAP requires that joint ventures are generally accounted for using the equity method

A. 3 only

B. 1 and 3

C. None of the above

D. All of the above

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Module 9: What you will learn - Forthcoming proposals for change

This last module will look at the following items:

- Convergence of IFRS with US GAAP
- Convergence of IFRS with UK GAAP
- IASB workplan

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The FASB and the future for US financial reporting

"In September 2009 the G20 leaders stated "We call on our international accounting bodies to redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process, and complete their convergence project by June 2011."

After their joint meeting in September 2002, the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued the Norwalk Agreement in which they each acknowledged their commitment to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that meeting, the FASB and the IASB pledged "to use their best efforts to make their existing financial reporting standards fully compatible as soon as is practicable and to co-ordinate their future work programmes to ensure that once achieved, compatibility is maintained."

In 2006 FASB and the IASB produced a joint memorandum of understanding (MoU) outlining the projects that would be addressed as a priority as part of a joint work programme to achieve convergence. This work was identified as a priority by the G20 leaders in September 2009.

Under the original agreement the aim was to achieve full convergence i.e. a set of common standards, by June 2011. Following concerns raised regarding the volume of draft standards due for issue in a short time , the IASB and FASB announced jointly in 2010 that the scope of the project would be reduced. By June 2011 a converged solution would be found for all of the areas identified by the original MoU, plus for other issues not in the MoU where a solution was urgently required.

This project was largely completed on time, although the joint standards on revenue recognition was not finalised until 2014 and a joint project to develop a new standard for leasing is ongoing.

A long-awaited SEC report released in July 2012 contained no recommendation on IFRS adoption for US public companies, although at this time it was suggested that the next logical step would be a recommendation on IFRS.

In 2015, the SEC's chief accountant said that he was unlikely to recommend that the SEC make IFRS mandatory or even suggest that US companies have the choice of reporting under IFRS. He did however confirm continued support for the objective of a single set of high-quality accounting standards.

Therefore, despite several years of co-operation between FASB and the IASB, it currently seems unlikely that US companies will adopt IFRS.

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The FRC and the future for UK financial reporting

The current financial reporting model in the UK is that listed companies (in accordance with EU regulations) prepare accounts under IFRS, whilst other companies choose to apply either UK GAAP or IFRS.

The UK Financial Reporting Council (FRC) is committed to eliminating differences between UK accounting standards and IFRS. In August 2009, it announced a draft policy for implementation of the IFRS for SMEs in place of the existing UK GAAP. In response to public consultation the FRC modified its approach and in late 2012/early 2013 the **FRS for Small Entities (FRSSE) was updated** and three new standards were published:

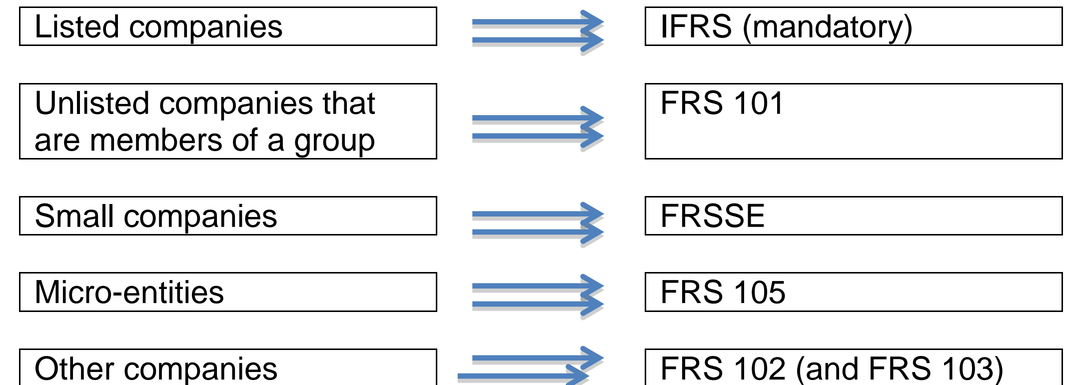
- **FRS 100 Application of Financial Reporting Requirements**
- **FRS 101 Reduced Disclosure Framework**
- **FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland**

These new standards took effect for accounting periods beginning on or after 1 January 2015.The FRC issued three further standards which form part of new UK GAAP in 2014/2015:

- **FRS 103 Insurance Contracts**
- **FRS 104 Interim Financial Reporting**
- **FRS 105 The FRS applicable to the Micro-entities Regime**

FRS 103 and 104 are effective for accounting periods beginning on or after 1 January 2015 and FRS 105 for accounting periods beginning on or after 1 January 2016.

FRS 100 outlines the new financial reporting framework and sets out which of the new standard(s) should be applied by which companies. Although all companies may apply IFRS, it is anticipated that most companies will apply standards as follows:



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New UK GAAP

FRS 101 Reduced Disclosure Framework may be applied to the separate financial statements of entities that are included in publicly available consolidated financial statements. The standard cannot be applied to consolidated financial statements. FRS 101 requires that EU-adopted IFRS are applied however with:

- Certain amendments to the requirements of IFRS in order to comply with the Companies Act, and
- Exemptions from a number of disclosures required by IFRS

FRS 102 The Financial Reporting Standard is based upon the IFRS for SMEs but with some significant modifications. These modifications ensure compliance with UK company law and also allow inclusion of certain accounting treatments permitted by full IFRSs but not by the IFRS for SMEs. FRS 102 is split into 35 sections and uses IFRS terminology such as receivables and inventory instead of old UK terminology such as debtors and stock. FRS 102 was amended in 2014 to bring the standard closer to IFRS 9 in relation to financial instruments. (See Module 8 for a more detailed comparison)

FRS 103 Insurance Contracts provides the specific accounting requirements for entities that have insurance contracts and are applying FRS 102.

FRS 104 Interim Financial Reporting is based on IAS 34 and provides guidance for those entities that choose to prepare interim reports. It is intended for use by entities that apply FRS 102, but may also be used by entities that apply FRS 101.

FRS 105 The FRS applicable to the Micro-entities regime is for use by companies defined as micro-entities under UK law. It is based on FRS 102, but with certain changes to reflect the smaller size and more simple nature of micro-entities. For example, the standard includes no guidance on deferred tax or equity-settled share-based payments, and removes all accounting policy choices, requiring all assets to be measured based on historical cost.

IASB work plan at 3 September 2015

Major projects:

Upcoming standards
Leases
Insurance Contracts

Published Exposure Draft
Conceptual Framework

Upcoming Exposure Drafts
Disclosure Initiative – Changes in Accounting Policies and Estimates
Disclosure Initiative – Materiality Practice Statement

Published Discussion Papers
Dynamic Risk Management – a Portfolio Revaluation Approach to Macro Hedging
Rate-Regulated Activities

Upcoming Discussion Papers
Disclosure Initiative – Principles of Disclosure

Other projects:
Annual Improvements 2014-2016
Clarifications Arising from the Post-Implementation Review (Proposed amendments to IFRS 8)
Clarifications of Classification and Measurement of Share-Based Payment Transactions (Proposed amendments to IFRS 2)
Clarifications to IFRS 15 *Revenue from Transactions with Customers:* Issues Emerging from TRG Discussions
Classification of Liabilities (Proposed amendment to IAS 1)
Disclosure Initiative – Amendments to IAS 7
Effective Date of Amendments to IFRS 10 and IAS 28
Fair Value Measurement: Unit of Account
Recognition of Deferred Tax Assets for Unrealised Losses (Proposed amendments to IAS 12)
Remeasurement of a Plan Amendment, Curtailment or Settlement/ Availability of a Refund of a Surplus from a Defined Benefit Plan (Proposed amendments to IAS 19 and IFRIC 14)
Transfers of Investment Property (Proposed amendments to IAS 40)

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Course conclusion

In pursuing its goal of creating a global set of accounting standards, the IASB has come a long way. Many of the largest economies in the world now apply IFRS, with others planning to adopt, or currently in the process of adopting, these standards.

It currently seems unlikely that the USA will adopt international standards. However, in the future if it were to adopt IFRS, that would really complete the international accounting jigsaw. The world will watch and wait to see whether the current thinking of the SEC is reversed.

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Quick Quiz

Module 9 quick quiz

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Question 1

Which of the following statements is true?

A US public companies may apply IFRS

B UK public companies may apply IFRS

C US public companies will all be required to apply IFRS in the future on a date to be determined by the SEC

D UK private companies may apply IFRS

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Question 2

Under what circumstances is a UK entity eligible to use FRS 101 Reduced Disclosure Framework?

A If the entity is an unlisted member of a group and is preparing publicly available consolidated financial statements for that group.

B If the entity is a listed member of a group for which consolidated financial statements are publicly available and is preparing its separate financial statements.

C If the entity is an unlisted member of a group for which consolidated financial statements are publicly available and is preparing its separate financial statements.

D If the entity is listed and preparing publicly available consolidated financial statements for that group.

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Question 3

Which UK entities should apply FRS 103?

A Entities that have insurance contracts and apply FRS 101

B Entities that have insurance contracts and apply FRS 102

C Entities that prepare interim reports and apply FRS 101

D Entities that prepare interim reports and apply FRS 102

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