МІНІСТЕРСТВО ОСВІТИ І НАУКИ УКРАЇНИ
МИКОЛАЇВСЬКИЙ НАЦІОНАЛЬНИЙ АГРАРНИЙ УНІВЕРСИТЕТ

Навчально-науковий інститут бізнесу, інноваційного розвитку та міжнародної діяльності

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Кафедра обліку і оподаткування

ОБЛІК І ФІНАНСОВА ЗВІТНІСТЬ ЗА МІЖНАРОДНИМИ СТАНДАРТАМИ (ІНОЗЕМНОЮ МОВОЮ) (ЧАСТИНА І):

КУРС ЛЕКЦІЙ

для здобувачів другого (магістерського) рівня вищої освіти

ОПП «Облік і оподаткування» спеціальності 071 «Облік і оподаткування»

денної форми здобуття вищої освіти

Миколаїв
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О-16

Друкується за рішенням науково-методичної комісії обліково-фінансового факультету Миколаївського національного аграрного університету від 16 червня 2023 р. протокол № 11.

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Курс лекцій призначений для підготовки здобувачів другого (магістерського) рівня вищої освіти спеціальності 071 «Облік і оподаткування».

Містить основні положення з дисципліни «Облік і фінансова звітність за міжнародними стандартами (іноземною мовою)». Розкриваються концептуальні засади на рівні міжнародних стандартів, а також розглядаються основні аспекти визнання, оцінки та відображення за вимогами міжнародних стандартів фінансової звітності необоротних і оборотних активів, власного капіталу та зобов'язань. Курс лекцій допоможе сформувати у здобувачів вищої освіти певну лексичну базу, виробити уміння та навички спілкуватися англійською мовою з фаху.

Може бути корисним також для спеціалістів з бухгалтерського обліку, викладачів та здобувачів вищої освіти, які бажають поглибити знання англійської мови за професійним спрямуванням.

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CONTENTS

INTRODUCTION

International Financial Reporting Standards (IFRS) is a set of accounting standards developed by an independent, not-for-profit organization called the International Accounting Standards Board (IASB). The goal of IFRS is to provide a global framework for how public companies prepare and disclose their financial statements. IFRS provides general guidance for the preparation of financial statements, rather than setting rules for industry-specific reporting.

One major benefit of international standards is that they consider input from professionals and legal authorities around the world. This can create a set of ethical guidelines that do not favor one culture over another, as can be the case when a foreign company adheres to its own domestic ethical values.

International standards for accounting systems and the format of financial statements simplifies international investment decisions. Investors can compare the financial statements of companies following IFRS, regardless of the company's country of origin. Without standards, making comparisons becomes less reliable, as the information presented in financial statements is calculated using different methods. The adoption of international standards has allowed stock-trading exchanges to merge across continents and opened up a range of new investment opportunities to people all over the world.

Having an international standard is especially important for large companies that have subsidiaries in different countries. Adopting a single set of world-wide standards will simplify accounting procedures by allowing a company to use one reporting language throughout. A single standard will also provide investors and auditors with a cohesive view of finances.

Companies increasingly seek strategic partners, customers or suppliers in foreign countries. International accounting standards give companies a common financial language and understanding, making it easier for them to do business together. International standards also create an entirely new industry, international accounting consultation, creating new opportunities for entrepreneurs in any country.

MODULE 1. GENERAL PRINCIPLES OF ACCOUNTING ACCORDING TO IFRS

THEME 1. THE DEVELOPMENT AND IMPLEMENTATION OF IFRS

1.1. History of origin and development of IFRS

1.2. The role and the benefits of IFRS

1.3. The IFRS Foundation, its mission and structure

Key words: international financial reporting standards, international accounting standards, international accounting standards committee, international accounting standards board, IFRS foundation

1.1. History of origin and development of IFRS

Many of the largest companies in the world often do more of their business in foreign lands than in their home country. Companies now access not only their home capital markets for financing but others as well.

As this globalization takes place, companies are recognizing the need to have one set of financial reporting standards. For globalization to be efficient, what is reported for a transaction in Paris should be reported the same way in, New York, or London.

A revolution is therefore occurring in financial reporting. In the past, many countries used their own set of standards or followed standards set by larger countries, such as those in Europe or in the United States. However, that situation is changing rapidly.

A single set of rules, called International Financial Reporting Standards (IFRS), is now being used by over 150 countries.

IFRS began as an attempt to harmonize accounting across the European Union but the value of harmonization quickly made the concept attractive around the world.

They are sometimes still called by the original name of **International Accounting Standards** (IAS).

IAS were issued between 1973 and 2001 by the Board of the International Accounting Standards Committee (IASC).

The International Accounting Standards Committee (IASC) was founded in June 1973 in London.

It was responsible for developing the **International Accounting Standards** and promoting the use and application of these standards.

The IASC was founded as a result of an agreement between accountancy bodies in the following countries: Australia, Canada, France, Germany Japan, Mexico, the Netherlands, the United Kingdom and Ireland, the USA.

The IASC had about 140 member bodies from 104 countries.

The International Accounting Standards Committee (IASC) was renamed as The International Accounting Standards Board (IASB) in April 2001.

During its first meeting the new Board adopted existing IAS and Standing Interpretations Committee standards (SICs).

The IASB has continued to develop standards calling the new standards **International Financial Reporting Standards** (**IFRS**).

Consequently the standards issued thereafter are known as IFRS. Therefore all the standards issued after 2001 are IFRS. The previous IAS are still valid but are being gradually superseded by new IFRS.

International Financial Reporting Standards (IFRSs) are Standards and Interpretations adopted by the International Accounting Standards Board (IASB). They comprise:

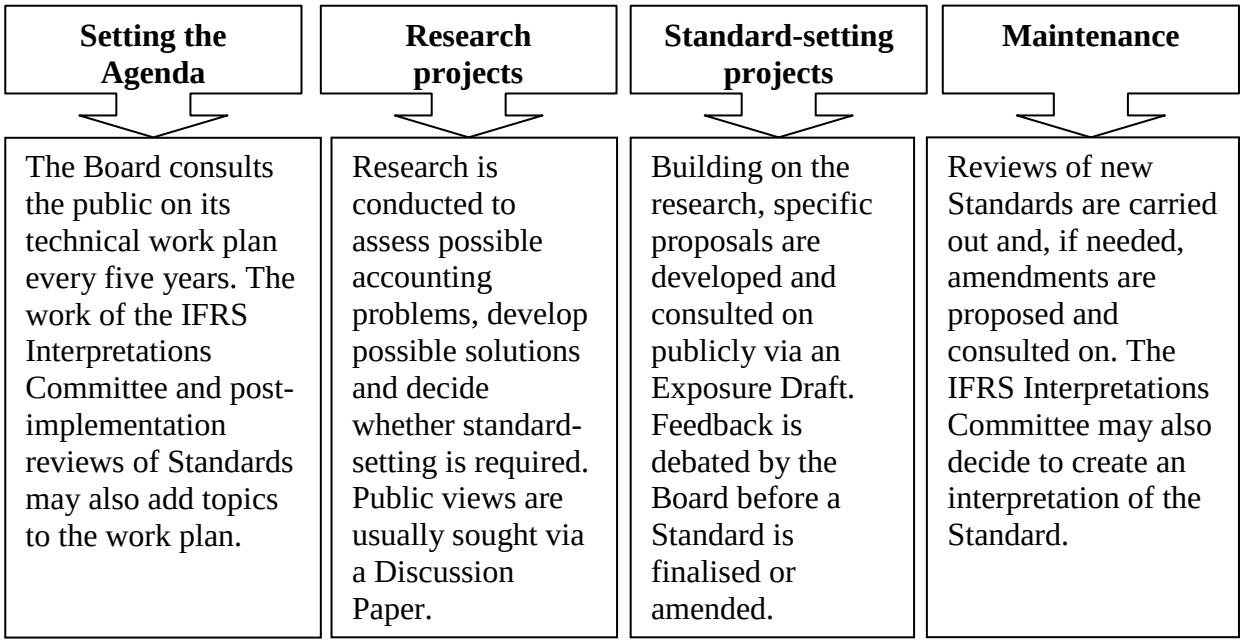
(a) International Financial Reporting Standards;

(b) International Accounting Standards; and

(c) Interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

Interpretations of IFRS Interpretations Committee are known as IFRIC while the Interpretations of the Standing Interpretations Committee (SIC) were known as SIC.

The process for developing the Standards is highly transparent; every stage involves public consultation. The public can also access all Board papers and observe all Board meetings via the website or by attending the meetings.



Steps in the standard-setting process

The IFRS Foundation supports the implementation and application of the Standards, often working in collaboration with other organisations with responsibilities in this area. Activities include education support for newly-issued Standards, conferences and other education materials.

1.2. The role and the benefits of IFRS

International Financial Reporting Standards (**IFRS**) are designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries. They are a consequence of growing international shareholding and trade and are particularly important for companies that have dealings in several countries. They are progressively replacing the many different national accounting standards. The rules to be followed by accountants to maintain books of accounts which is comparable, understandable, reliable and relevant as per the users internal or external.

Currently, profiles are completed for 150 jurisdictions.

Afghanistan	Albania	Angola	Anguilla	Antigua and Barbuda	Argentina
Armenia	Australia	Austria	Azerbaijan	Bahamas	Bahrain
Bangladesh	Barbados	Belarus	Belgium	Belize	Bermuda
Bhutan	Bolivia	Bosnia and Herzegovina	Botswana	Brazil	Brunei Darussalam
Bulgaria	Cambodia	Canada	Cayman Islands	Chile	China
Colombia	Costa Rica	Croatia	Cyprus	Czech Republic	Denmark
Dominica	Dominican Republic	Ecuador	Egypt	El Salvador	Estonia
European Union	Fiji	Finland	France	Gambia	Georgia
Germany	Ghana	Greece	Grenada	Guatemala	Guinea-Bissau
Guyana	Honduras	Hong Kong SAR	Hungary	Iceland	India
Indonesia	Iran	Iraq	Ireland	Israel	Italy
Jamaica	Japan	Jordan	Kazakhstan	Kenya	Kosovo
Kuwait	Latvia	Lesotho	Liberia	Liechtenstein	Lithuania
Luxembourg	Macao	Macedonia	Madagascar	Malawi	Malaysia
Maldives	Malta	Mauritius	Mexico	Moldova	Mongolia
Montenegro	Montserrat	Myanmar	Namibia	Nepal	Netherlands
New Zealand	Nicaragua	Niger	Nigeria	Norway	Oman
Pakistan	Palestine	Panama	Paraguay	Peru	Philippines
Poland	Portugal	Qatar	Romania	Russia	Rwanda
Saudi Arabia	Serbia	Sierra Leone	Singapore	Slovakia	Slovenia
South Africa	South Korea	Spain	Sri Lanka	St Kitts and Nevis	St Lucia
St Vincent and the Grenadines	Suriname	Swaziland	Sweden	Switzerland	Syria
Chinese Taipei	Tanzania	Thailand	Timor-Leste	Trinidad and Tobago	Turkey
Uganda	Ukraine	United Arab Emirates	United Kingdom	United States	Uruguay
Uzbekistan	Venezuela	Vietnam	Yemen	Zambia	Zimbabwe

Global application of IFRS will make the comparison of financial statements easier for foreign investors which is advantageous for companies to attract investors.

It is generally expected that IFRS adoption worldwide will be beneficial to investors and other users of financial statements, by reducing the costs of comparing alternative investments and increasing the quality of information.

Companies are also expected to benefit, as investors will be more willing to provide financing.

Companies that have high levels of international activities are among the group that would benefit from a switch to IFRS.

Companies that are involved in foreign activities and investing benefit from the switch due to the increased comparability of a set accounting standard.

It offers accounting professionals more opportunities in any part of the world if same accounting practices prevail throughout the world.

Today, everything in the world comes closer than ever before. Things are harmonizing and people learn to think and act global.

And indeed, you can see that in every step you make—you can shop the same items anywhere in the world, you can get the same food in McDonalds anywhere in the world, you can even fly anywhere in the world in less than 24 hours.

Accounting and financial reporting are no exception. This is where IFRS has its own spot—it will serve as unified set of principles for financial reporting anywhere in the world.

1.3. The IFRS Foundation, its mission and structure

The IFRS Foundation is an independent, privately organised, not-for-profit organisation, operating to serve the public interest. The governance and due process are designed to keep the standard-setting independent from special interests while ensuring accountability to our stakeholders around the world.

Its main objectives include the development and promotion of the

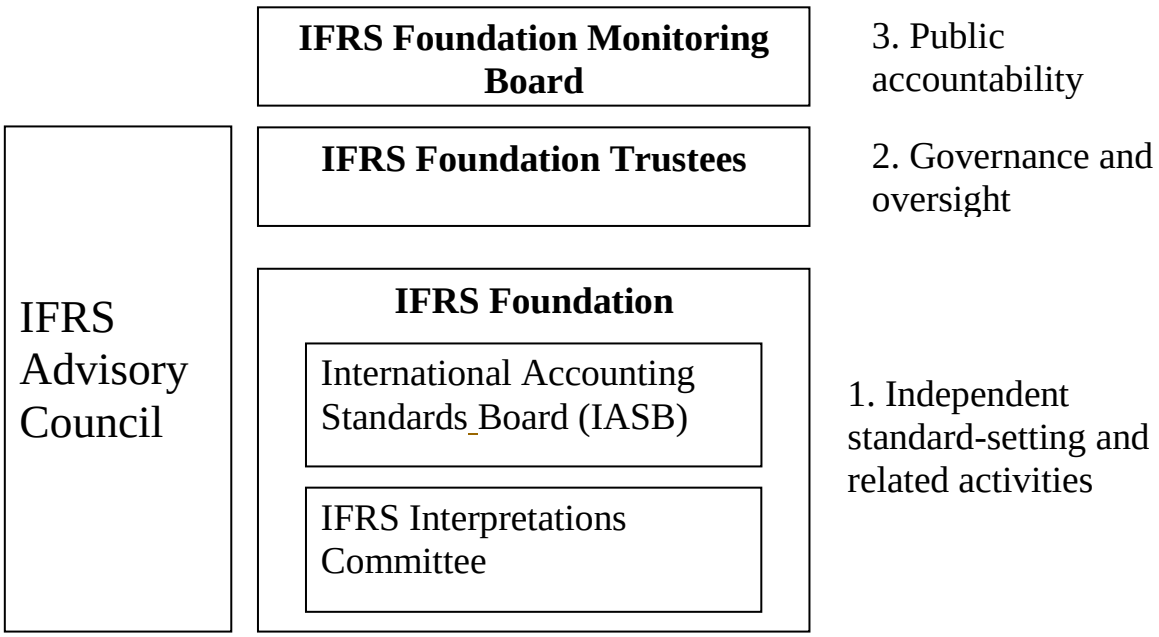
International Financial Reporting Standards (IFRSs) through the International Accounting Standards Board (IASB), which it oversees.

The mission of IFRS Foundation is to bring transparency, accountability and efficiency to financial markets around the world by developing IFRS. IFRS Foundation's work serves the public interest by fostering trust, growth and long-term financial stability in the global economy.

IFRS:

- bring **transparency** by enhancing the international comparability and quality of financial information, enabling investors and other market participants to make informed economic decisions.
- strengthen **accountability** by reducing the information gap between the providers of capital and the people to whom they have entrusted their money. IFRS Standards provide information needed to hold management to account. As a source of globally comparable information, IFRS Standards are also of vital importance to regulators around the world.
- contribute to economic **efficiency** by helping investors to identify opportunities and risks across the world, thus improving capital allocation. Use of a single, trusted accounting language lowers the cost of capital and reduces international reporting costs for businesses.

The IFRS Foundation has a three-tier governance structure, based on an independent standard-setting Board of experts (International Accounting Standards Board), governed and overseen by Trustees from around the world (IFRS Foundation Trustees) who in turn are accountable to a monitoring board of public authorities (IFRS Foundation Monitoring Board).



The **IFRS Advisory Council** provides advice and counsel to the Trustees and the Board, whilst the Board also consults extensively with a range of other standing advisory bodies and consultative groups.

The governance and oversight of the activities undertaken by the IFRS Foundation and its standard-setting body rests with its Trustees, who are also responsible for safeguarding the independence of the IASB and ensuring the financing of the organization.

At their January 2009 meeting the Trustees of the Foundation concluded the first part of the second Constitution Review, announcing the creation of a Monitoring Board and the expansion of the IASB to 16 members and giving more consideration to the geographical composition of the IASB.

The Trustees are publicly accountable to a Monitoring Board of public authorities.

The International Accounting Standards Board (IASB) is the independent standard-setting body of the IFRS Foundation.

Its members are responsible for the development and publication of IFRSs, and for approving **Interpretations of IFRSs** as developed by the **IFRS Interpretations Committee** (**the IFRIC**).

The International Accounting Standards Board (IASB) is an independent group of 16 experts with an appropriate mix of recent practical experience in

setting accounting standards, in preparing, auditing, or using financial reports, and in accounting education.

The IASB was founded on April 1, 2001 as the successor to the International Accounting Standards Committee (IASC).

The **IFRS Interpretations Committee** is the interpretative body of the IASB.

IFRS Interpretations Committee replaced the former Standing Interpretations Committee (SIC) in March 2002.

SIC was the committee which made interpretations on IAS.

The IFRS Interpretations Committee comprises 14 voting members drawn from a variety of countries and professional backgrounds.

Its brief is to provide timely guidance on issues that arise in practice.

They are appointed by the Trustees of the IFRS Foundation.

The mandate of the Interpretations Committee is to review on a timely basis widespread accounting issues that have arisen within the context of current IFRSs and to provide authoritative guidance **(IFRICs)** on those issues.

The Trustees promote the work of the International Accounting Standards Board (IASB)and the rigorous application of IFRSs but are not involved in any technical matters relating to the standards. This responsibility rests solely with the IASB.

Trustees are appointed for a renewable term of three years. Each Trustee is expected to have an understanding of, and be sensitive to, international issues relevant to the success of an international organisation responsible for the development of high quality global accounting standards for use in the world's capital markets and by other users.

Six of the Trustees must be selected from the Asia/Oceania region, six from Europe, six from North America, one from Africa, one from South America and two from the rest of the world.

The Monitoring Board was created in January 2009 with the aim of "providing a formal link between the Trustees and public authorities" in order to

enhance the public accountability of the IFRS Foundation.

The Monitoring Board's main responsibilities are to ensure that the Trustees continue to discharge their duties as defined by the IFRS Foundation Constitution, as well as approving the appointment or reappointment of Trustees. The Monitoring Board meets the Trustees at least once a year, or more often if appropriate.

The Monitoring Board consists of capital markets authorities responsible for setting the form and content of financial reporting. Through the Monitoring Board, securities regulators that allow or require the use of IFRS in their jurisdictions will be able to more effectively carry out their mandates regarding investor protection, market integrity, and capital formation.

The IFRS Advisory Council is the formal advisory body to the IASB and the Trustees of the IFRS Foundation. It is comprised of a wide range of representatives from user groups, preparers, financial analysts, academics, auditors, regulators, professional accounting bodies and investor groups that are affected by and interested in the IASB's work. Members of the Advisory Council are appointed by the Trustees. The Advisory Council normally meets three times a year for a period of two days.

THEME 2. THE FIRST APPLICATION OF IFRS

2.1. First-time adoption of IFRS

2.2. Chart of accounts

Key words: date of transition to IFRSs, first-time adopter, accounts, chart of accounts, balance sheet accounts, income statement accounts

2.1. First-time adoption of IFRS

IFRS 1 *First-time Adoption of International Financial Reporting Standards* sets out the procedures that an entity must follow when it adopts IFRSs for the first time as the basis for preparing its general purpose financial statements.

Date of transition to IFRSs - the beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements.

First IFRS financial statements - the first annual financial statements in which an entity adopts International Financial Reporting Standards (IFRSs), by an explicit and unreserved statement of compliance with IFRSs.

First-time adopter - an entity that presents its first IFRS financial statements.

2.2. Chart of accounts

To keep a company's financial data organized, accountants developed a system that sorts transactions into records called **accounts**.

Because every business transaction affects *at least two* accounts, our accounting system is known as a **double-entry** system.

Although the system is referred to as double-entry, a transaction may involve more than two accounts.

When a company's accounting system is set up, the accounts most likely to be affected by the company's transactions are identified and listed out. This list is referred to as the company's **chart of accounts**.

A chart of accounts is a listing of the names of the **accounts** that a company has identified and made available for recording transactions in its general ledger.

Within the chart of accounts you will find that the accounts are typically listed in the following order:

Balance sheet accounts	Assets Liabilities Owner's (Stockholders') Equity
Income statement accounts	Operating Revenues Operating Expenses Non-operating Revenues and Gains Non-operating Expenses and Losses

Depending on the size of a company and the complexity of its business operations, the chart of accounts may list as few as thirty accounts or as many as thousands. A company has the flexibility of tailoring its chart of accounts to best meet its needs.

Each account in the chart of accounts is typically assigned a name and a unique number by which it can be identified. (Software for some small businesses may not require account numbers.) Account numbers are often five or more digits in length with each digit representing a division of the company, the department, the type of account, etc.

MODULE 2. ACCOUNTING FOR ASSETS

THEME 3. PROPERTY, PLANT AND EQUIPMENT. INVESTMENT PROPERTY

3.1. Recognition of Property, Plant and Equipment

3.2. Measurement of PPE

3.3. Depreciation

3.4. Derecognition of PPE

3.5. Disclosure of PPE in the financial statements

3.6. Investment Property

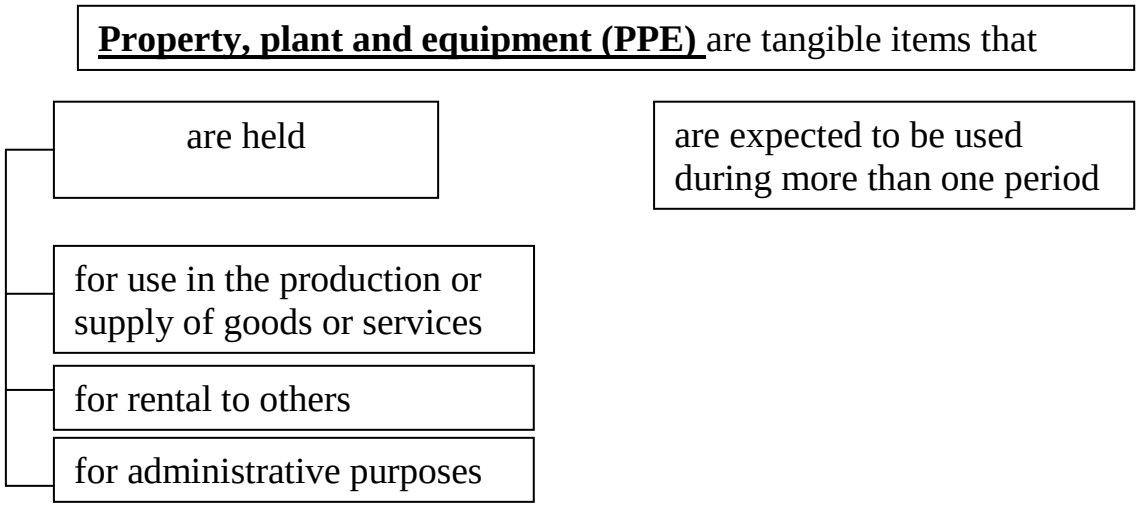
Key words: property, plant and equipment, initial measurement, subsequent measurement, depreciation, useful life, depreciation methods, investment property

3.1. Recognition of PPE

Property, plant and equipment are tangible items that:

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

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



A class of property, plant and equipment is a grouping of assets of a similar nature and use in an entity's operations. The following are examples of separate classes:

(a) land;

(b) land and buildings;

(c) machinery;

(d) ships;

(e) aircraft;

(f) motor vehicles;

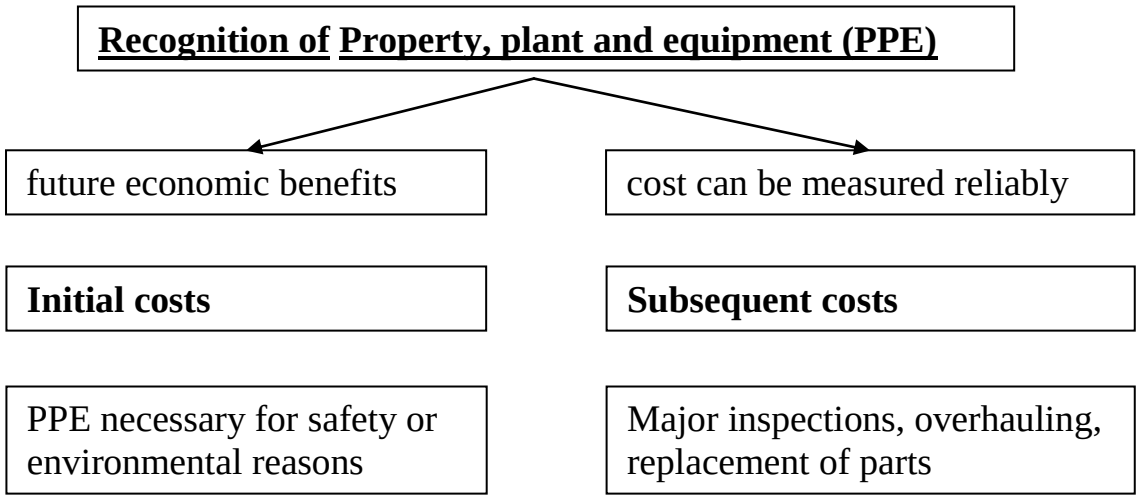
(g) furniture and fixtures; and

(h) office equipment.

IAS 16 states that the cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

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

This recognition principle shall be applied to all costs at the time they are incurred, both **incurred initially** to acquire or construct an item of property, plant and equipment and **incurred subsequently after recognition** to add to, replace part of or service it.



Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, eg IFRS 2

Share-based Payment.

Initial costs

Some items of property, plant and equipment might be necessary to acquire for safety or environmental reasons. Although they do not directly increase the future economic benefits, they might be inevitable to obtain future economic benefits from other assets and therefore, should be recognized as an asset. For example, water cleaning station might be necessary in order to proceed with some chemical processes within chemical manufacturer.

Subsequent costs

Day-to-day servicing of the item shall be recognized in profit or loss as incurred, because they just maintain (not enhance) item's capacity to bring future economic benefits.

However, some parts of the item of property, plant and equipment may require replacement at regular intervals, for example, aircraft interiors. In such a case, an entity derecognizes carrying amount of older part and recognizes the cost of new part into the carrying amount of the item. The same applies to major inspections for faults, overhauling and similar items.

3.2. Measurement of PPE

Initial Measurement

An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its **cost.**

The cost of an item of property, plant and equipment comprises:

1. its **purchase price** including import duties, non-refundable purchase taxes, after deducting trade discounts and rebates
2. any **costs directly attributable** to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Examples of these costs are: costs of site preparation, professional fees, initial delivery and handling, installation and assembly, etc.,
3. the initial estimate of **the costs of dismantling and removing the**

item and restoring the siteon which it is located.

The cost of an item of property, plant and equipment is the **cash price equivalent** at the recognition date.

If payment is **deferred** beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognized as **interest** over the period of credit (unless such interest is capitalized in accordance with IAS 23).

If an asset is acquired in exchange for another non-monetary asset, the cost will be measured at the fair value unless

(a) the exchange transaction lacks commercial substance or

(b) the fair value of neither the asset received nor the asset given up is reliably measurable.

If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

Initial Measurement of (PPE)

COST	=	***Purchase price***	+	***Directly attributable costs***	+	***Removal costs***

The cost of an item of property, plant and equipment is the ***cash price equivalent*** at the recognition date.

If an asset is acquired in exchange for another non-monetary asset, the cost will be measured at the **fair value**

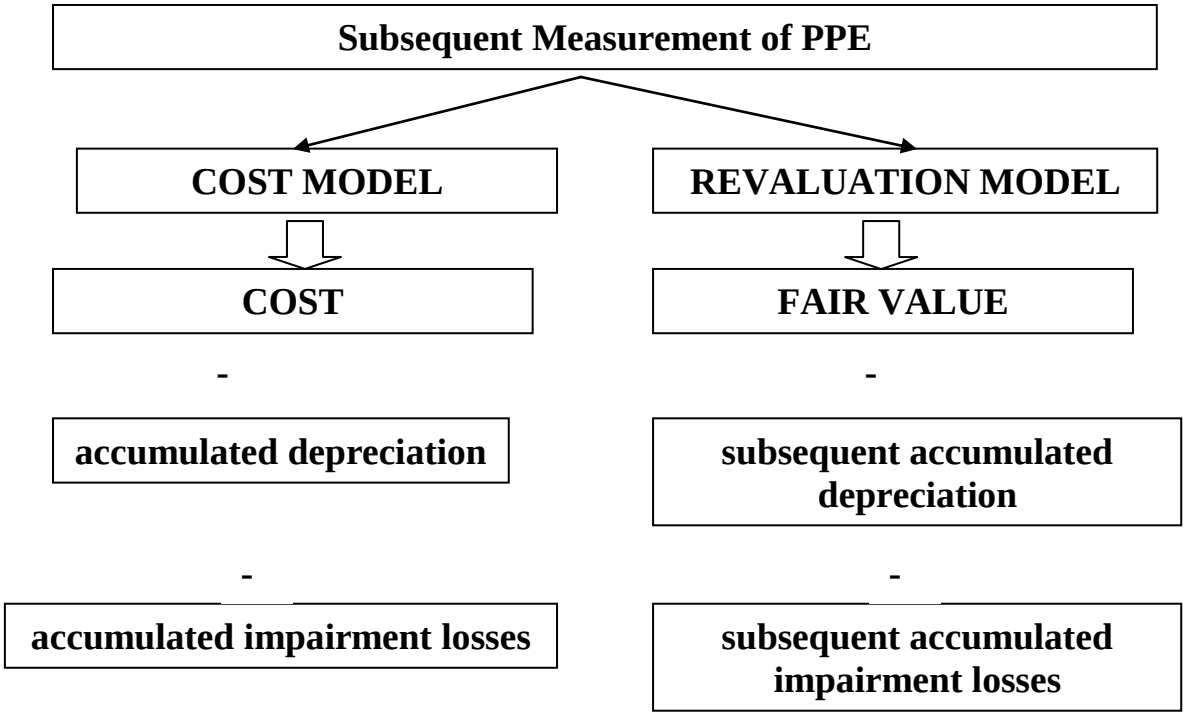
Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Subsequent Measurement

An entity may choose 2 accounting models for its property plant and equipment:

1. **Cost model** An entity shall carry an asset at its ***cost less any accumulated depreciation and any accumulated impairment losses***.

2. **Revaluation model** An entity shall carry an asset at a ***revalued amount***. Revalued amount is its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.



An **impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use.

An entity shall revalue its assets with sufficient regularity so that the carrying amount does not differ materially from its fair value at the end of the reporting period.

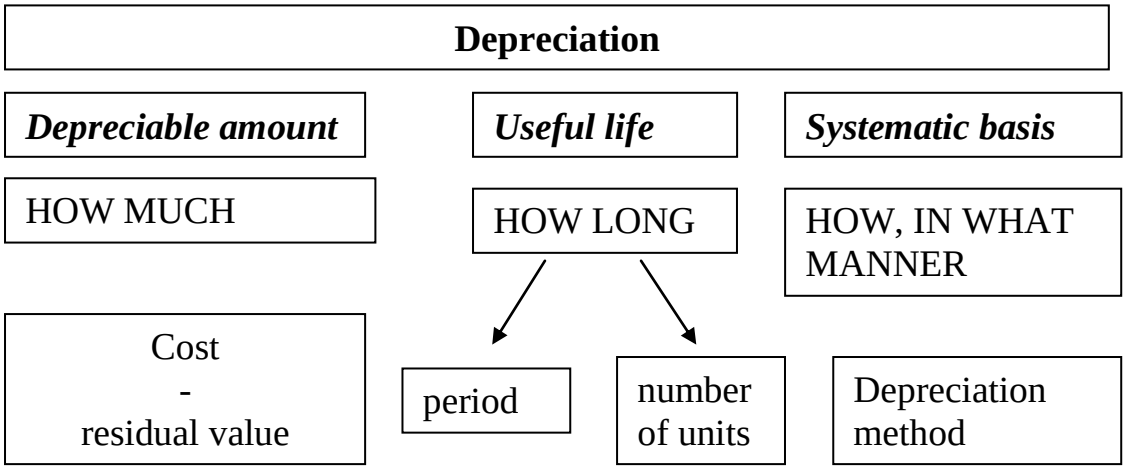
If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.

3.3. Depreciation

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

The items of PPE are usually depreciated in order to maintain matching

principle – as they are in operation for more than 1 year, they assist in producing the revenues in more than 1 year and therefore, their cost shall be spread among those years in order to match the revenue they help to produce.



When dealing with the depreciation please do have 3 basic things in mind:

- ***Depreciable amount*** is simply HOW MUCH you are going to depreciate. It is the cost of an asset, or other amount substituted for cost, less its residual value.

- ***Depreciation period*** is simply HOW LONG you are going to depreciate and it is basically asset's **useful life**.

Useful life is:

(a) the period over which an asset is expected to be available for use by an entity; or

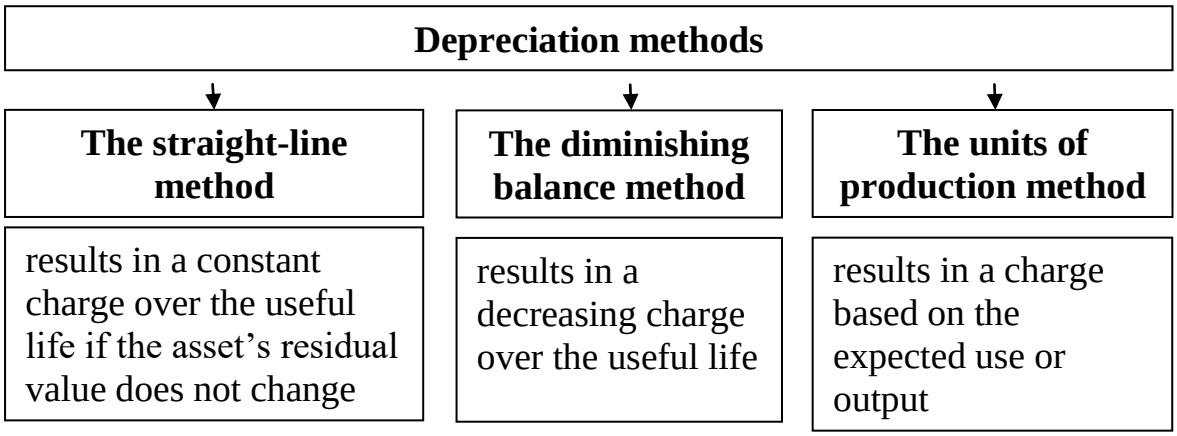
(b) the number of production or similar units expected to be obtained from the asset by an entity.

IFRS16 lists several factors that shall be considered when establishing item's useful life: expected usage of the item, expected physical wear and tear, technical or commercial obsolescence of the item, and legal or other limits on the use of the asset. Useful life and asset's residual value (input to depreciable amount) shall be reviewed ***at least at the end of each financial year.*** If there is a change in the expectations comparing to previous estimates, then change shall be accounted for as a change in an accounting estimate in line with IAS 8 (no restatement of previous periods).

- ***Depreciation method*** is simply HOW, IN WHAT MANNER you are going to depreciate.

The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life.



The entity selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits.

The depreciation charge for each period shall be recognised in profit or loss unless it is included in the carrying amount of another asset.

Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

For example, aircraft interior cost might be depreciated separately from the remaining airplane cost.

Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

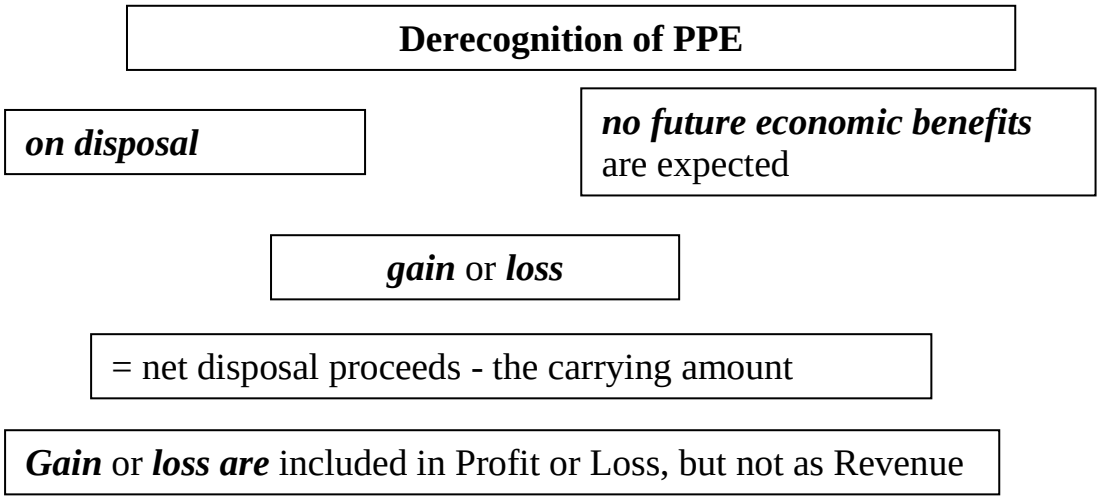
The **residual value** of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

3.4. Derecognition of PPE

The carrying amount of an item of property, plant and equipment shall be derecognised:

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.



The gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognised. Gains shall not be classified as revenue.

The gain or loss arising from the derecognition of an item of PPE shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

3.5. Disclosure of PPE in the financial statements

The financial statements shall disclose, for each class of PPE:

(a) the measurement bases used for determining the gross carrying amount;

(b) the depreciation methods used;

(c) the useful lives or the depreciation rates used;

(d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and

(e) a reconciliation of the carrying amount at the beginning and end of the period showing:

(i) additions;

(ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with IFRS 5 and other disposals;

(iii) acquisitions through business combinations;

(iv) increases or decreases resulting from revaluations under paragraphs 31, 39 and 40 and from impairment losses recognised or reversed in other comprehensive income in accordance with IAS 36;

(v) impairment losses recognised in profit or loss in accordance with IAS 36;

(vi) impairment losses reversed in profit or loss in accordance with IAS 36;

(vii) depreciation;

(viii) the net exchange differences arising on the translation of the financial statements from the functional currency into a different presentation currency, including the translation of a foreign operation into the presentation currency of the reporting entity; and

(ix) other changes.

The financial statements shall also disclose:

(a) the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;

(b) the amount of expenditures recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;

(c) the amount of contractual commitments for the acquisition of property, plant and equipment; and

(d) if it is not disclosed separately in the statement of comprehensive income, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss.

3.6. Investment Property

Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

(a) use in the production or supply of goods or services or for administrative purposes; or

(b) sale in the ordinary course of business.

An investment property shall be measured initially at its cost. Transaction costs shall be included in the initial measurement.

Transfers to, or from, investment property shall be made when, and only when, there is a change in use, evidenced by:

(a) commencement of owner-occupation, for a transfer from investment property to owner-occupied property;

(b) commencement of development with a view to sale, for a transfer from investment property to inventories;

(c) end of owner-occupation, for a transfer from owner-occupied property to investment property; or

(d) commencement of an operating lease to another party, for a transfer from inventories to investment property.

THEME 4. INTANGIBLE ASSETS

4.1. The definition, recognition and types of intangible assets

4.2. Sources and measurement of intangible assets

4.3. Depreciation and disposal of intangible assets

4.4. Disclosure of intangible assets in the financial statements

Key words: intangible assets, research and development, initial measurement, subsequent expenditure, amortisation, derecognition of intangible assets

4.1. The definition, recognition and types of intangible assets

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

Intangible assets are assets that lack physical existence and are not financial instruments.

Intangible assets are usually classified as non-current (long-term) assets because they produce benefits over several years. They are valuable because they provide rights and privileges to their owners.

An asset is a resource that is controlled by the entity as a result of past events (for example, purchase or self-creation) and from which future economic benefits (inflows of cash or other assets) are expected. Thus, the three critical attributes of an intangible asset are:

- identifiability
- control (power to obtain benefits from the asset)
- future economic benefits (such as revenues or reduced future costs)

An intangible asset meets the **identfiability criterion** when:

- it is separable, that is it can be separated or divided from the entity and sold, transferred, licensed or exchanged, either individually or together with a related contract, asset or liability: or
- arises from contractual or other legal rights, whether or not those rights are transferable or separable from the entity or from other rights and

obligations.

The criteria for **recognition** of an intangible asset are that:

- it meets the definition of an intangible asset;
- it is probable that future economic benefits attributable to the asset will flow to the entity; and
- the asset's cost can be reliably measured.

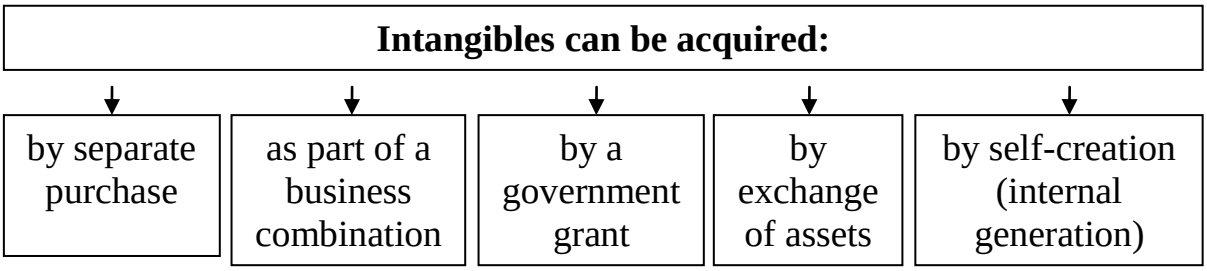
Control exists where an entity has the power to obtain the future economic benefits from an underlying resource and to restrict the access of others to those benefits.

Control is usually evidenced by legally enforceable contractual or other rights, such as legal title or a licence. In the absence of legal rights, it is more difficult to demonstrate control. The entity may be able to control the future economic benefits in some other way, for example control over the benefits of know-how may be attained through secrecy.

<u>Examples of possible intangible assets include:</u>

- ✓ computer software
- ✓ patents
- ✓ copyrights
- ✓ motion picture films
- ✓ customer lists
- ✓ mortgage servicing rights
- ✓ licenses
- ✓ import quotas
- ✓ franchises
- ✓ customer and supplier relationships
- ✓ marketing rights

4.2. Sources and measurement of intangible assets



Intangible assets acquired separately or as part of a business combination

The probability recognition criterion is always satisfied when intangible assets are acquired separately or as part of a business combination. This is because the price paid reflects expectations about the probability that the future economic benefits of the asset will flow to the entity.

IFRS 3, ‘Business combinations', contains an illustrative list of items acquired in a business combination that meet the definition of an intangible asset. The summarised list is as follows:

- Marketing-related intangible assets, including trademarks, internet domain names and newspaper mastheads.
- Customer-related intangible assets, including customer lists, order backlogs, customer contracts and non-contractual customer relationships.
- Artistic-related intangible assets, including copyrights for plays, books and musical works.
- Contract-based intangible assets, including licence agreements, management contracts and broadcasting rights.
- Technology-based intangible assets, including patented technology, databases and trade secrets such as secret formulas, processes or recipes.

Internally generated intangible assets

There will always be difficulties with identifying internally generated intangible assets and in distinguishing the expected future economic benefits that might be attributable to the internally generated intangible assets from those expected from the business as a whole.

Research and development

The process of generating an intangible asset is divided into a research phase and a development phase.

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the commencement of commercial production or use. Development is more closely related to the earnings process than research.

Non-qualifying expenditure

Costs that are indistinguishable from the costs of developing the business as a whole should be expensed as incurred and include start up, training, advertising and promotion costs, relocation and reorganisation costs.

Initial measurement

Intangible assets should be measured initially at cost.

Separately acquired intangible assets

The cost of a separately acquired intangible asset comprises the purchase price, including import duties and non-refundable purchase taxes after deducting trade discounts and rebates. Directly attributable costs of preparing the asset for its intended use are also included. The cost can usually be measured reliably, particularly when the purchase consideration is in the form of cash or other monetary assets.

Intangible assets acquired as part of a business combination

The cost of an intangible asset that is acquired as part of a business combination is represented by the asset's fair value at the acquisition date. *Internally-generated intangible assets*

The cost of internally-generated intangibles should include all directly attributable costs incurred in the creation of the asset from the date on which the asset first met the recognition criteria

Examples of directly attributable costs include the costs of materials and

services used or consumed in generating the asset, employment costs of those directly involved in creating the asset, depreciation of relevant property, plant and equipment, amortisation of patents and licences utilised in creating the asset legal fees and registration fees. The costs capitalised should also include borrowing costs where relevant.

Intangible assets acquired by way of government grant

An intangible asset may sometimes be acquired free of charge or for a nominal amount, by way of government grant. Intangible assets such as these may be recognised either at fair value or nominal value.

Exchange of intangible assets

An intangible asset acquired in exchange for a non-monetary asset or for a combination of monetary and non-monetary assets should be measured at fair value, unless the exchange transaction lacks commercial substance or the fair value of neither the asset given up nor the asset received can be reliably measured. If the intangible asset is not measured at fair value, it is measured at the carrying amount of the asset given up.

Subsequent expenditure

The nature of many intangible assets is that there are often no additions to the asset or replacements to parts of it. Therefore, most subsequent expenditure is likely to be incurred to maintain the asset and will not usually meet the criteria for recognition as an asset. Moreover, it is often difficult to attribute subsequent expenditure to a particular intangible asset rather than to the business as a whole. For this reason, most subsequent expenditure will not qualify as an asset and will be expensed as incurred. Subsequent expenditure on intangible assets is only capitalised in rare circumstances.

Subsequent expenditure on acquired research and development is expensed as incurred until the project meets the criteria for recognition. Once the criteria are met all subsequent expenditure is capitalised

Measurement subsequent to initial recognition

Subsequent to initial recognition, an entity may choose to adopt the cost or

revaluation model as its accounting policy if the asset is traded in an active market.

Under the cost model the intangible asset is carried at cost less any accumulated amortisation and impairment losses.

Under the revaluation model the intangible asset is carried at a revalued amount. This amount is the asset's fair value (the active market price) at the date of valuation less subsequent accumulated amortisation and impairment losses.

4.3. Amortization and disposal of intangible assets

Useful life for an intangible asset is the period over which the asset is expected to be available for use by an entity or the number of production or similar units expected to be obtained from the asset by an entity.

Intangible assets are classified **based on useful life**.

- **Indefinite life:** no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.
- **Finite life:** a limited period of benefit to the entity.

Amortisation – intangibles with finite lives

Where an intangible asset has a finite useful life its depreciable amount should be amortised on a systematic basis over that life.

The amortisation method should reflect the pattern of consumption of the economic benefits expected from the asset or, if the pattern cannot be reliably determined, the entity should apply the straight-line method of amortisation. Amortisation is recorded in the income statement, unless it is permitted or required to be included in the carrying amount of another asset.

A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include straight-line method, the diminishing balance method and the unit of production method.

The residual value of an intangible asset with a finite useful life should be assumed to be zero, unless there is either a commitment by a third party to purchase the asset at the end of its useful life or there is an active and continuing

market for the intangible asset and the residual value of the asset can be determined by reference to that market.

Derecognition of intangible assets

Where an intangible asset is disposed of or where no future economic benefits are expected from its use or disposal it should be derecognised.

Gains and losses arising on derecognition should be calculated as the difference between the asset's net disposal proceeds and its carrying amount and should be recognised in the income statement.

4.4. Disclosure of intangible assets in the financial statements

For each class of intangible asset, disclose:

✓ useful life or amortisation rate

✓ amortisation method

✓ gross carrying amount

✓ accumulated amortisation and impairment losses

✓ line items in the income statement in which amortisation is included

✓ reconciliation of the carrying amount at the beginning and the end of the period showing:

✓ additions (business combinations separately)

✓ assets held for sale

✓ retirements and other disposals

✓ revaluations

✓ impairments

✓ reversals of impairments

✓ amortisation

✓ foreign exchange differences

✓ other changes

✓ basis for determining that an intangible has an indefinite life

✓ description and carrying amount of individually material intangible assets

✓ certain special disclosures about intangible assets acquired by way of

government grants

- ✓ information about intangible assets whose title is restricted
- ✓ contractual commitments to acquire intangible assets

Additional disclosures are required about:

- intangible assets carried at revalued amounts
- the amount of research and development expenditure recognised as an expense in the current period.

THEME 5. INVENTORIES

5.1. Definitions and measurement of inventories

5.2. Inventory Costing Methods

5.3. Perpetual and Periodic Inventory Systems

5.4. Recognition as an expense

5.4. Disclosure of inventories in the financial statements

Key words: inventories, net realisable value, specific identification method, FIFO method, weighted-average cost method, perpetual inventory system, periodic inventory system

5.1. Definitions and measurement of inventories

Inventories are assets:

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

The term inventory refers to the stock of goods which the business holds in a variety of forms:

- Raw materials for use in a subsequent manufacturing process.
- Work in progress, partly manufactured goods.
- Finished goods, completed goods ready for sale to customers.
- Finished goods which the business has bought for resale to customers.

A manufacturer may hold three categories of inventory:

- raw materials
- work in progress
- finished goods

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

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.

Inventories shall be measured at the lower of (1) and (2)

(1) Cost

(2) Net realisable value.

The **cost of inventories** shall comprise

all costs of purchase,

costs of conversion

and other costs incurred in bringing the inventories to their present location and condition.

The **costs of purchase** of inventories comprise

the purchase price,

import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities),

and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services.

Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

The **costs of conversion** of inventories include costs directly related to the units of production, such as direct labour.

They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods.

Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration.

Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

Other costs are included in the cost of inventories only to the extent that

they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include non-production overheads or the costs of designing products for specific customers in the cost of inventories.

Net realisable value is:

(1) net amount expected to realise

(2) from selling inventories

(3) during ordinary course of business

Net realisable value is entity-specific.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. This is simply the expected revenue from the sale of inventory after deducting any further costs that are necessary in order to sell the inventory.

Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:

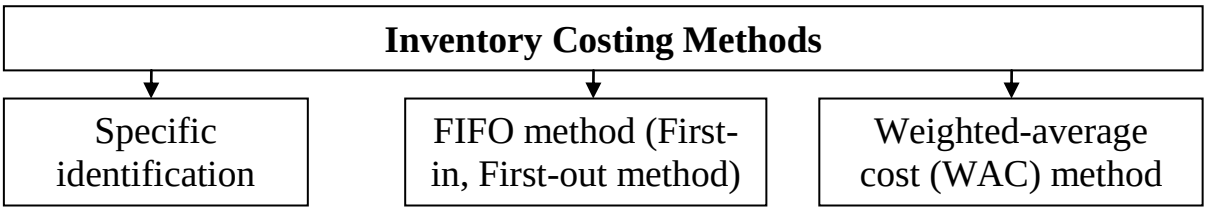
(a) abnormal amounts of wasted materials, labour or other production costs;

(b) storage costs, unless those costs are necessary in the production process before a further production stage;

(c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and

(d) selling costs.

5.2. Inventory Costing Methods



The cost of inventories of items that are not ordinarily interchangeable and

goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs.

In all other cases the cost of inventories should be measured using either the

- FIFO method (First-in, First-out method)
- Weighted-average cost (WAC) method

An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified.

The **First-In, First-Out (FIFO) method** assumes that goods are used in the order in which they are purchased.

In other words, it assumes that **the first goods purchased are the first used** (in a manufacturing concern) **or sold** (in a merchandising concern). The inventory remaining must therefore represent the most recent purchases.

In all cases where FIFO is used, the inventory and cost of goods sold would be the same at the end of the month whether a perpetual or periodic system is used.

This is true because the same costs will always be first in and, therefore, first out.

This is true whether cost of goods sold is computed as goods are sold throughout the accounting period (the perpetual system) or as a residual at the end of the accounting period (the periodic system).

One objective of FIFO is to approximate the physical flow of goods.

When the physical flow of goods is actually first-in, first-out, the FIFO method closely approximates specific identification. At the same time, it does not permit manipulation of income because the enterprise is not free to pick a certain cost item to be charged to expense.

Another advantage of the FIFO method is that the ending inventory is close to current cost. Because the first goods in are the first goods out, the ending inventory amount will be composed of the most recent purchases.

This is particularly true where the inventory turnover is rapid. This approach generally provides a reasonable approximation of replacement cost on the balance

sheet when price changes have not occurred since the most recent purchases.

The basic disadvantage of the FIFO method is that current costs are not matched against current revenues on the income statement. The oldest costs are charged against the more current revenue, which can lead to distortions in gross profit and net income.

FIFO assumes that the first items put on the shelf are the first items sold, so your oldest goods are sold first. This system is generally used by companies whose inventory is perishable or subject to quick obsolescence. If prices go up, FIFO will give you a lower cost of goods sold because you are using your older, cheaper goods first. Your bottom line will look better to your investors, if you have any, but your tax liability will be higher because you have higher profit. A positive about the FIFO method is that it represents recent purchases and, as such, more accurately reflects replacement costs.

The use of the **average cost methods** is usually justified on the basis of practical rather than conceptual reasons. These methods are simple to apply and objective. They are not as subject to income manipulation as some of the other inventory pricing methods.

In addition, proponents of the average cost methods argue that it is often impossible to measure a specific physical flow of inventory and therefore it is better to cost items on an average-price basis. This argument is particularly persuasive when the inventory involved is relatively homogeneous in nature.

IAS 2 allows two different methods to be used for valuing inventory:

1. First in, first out (FIFO). This assumes that the first items to be bought will be the first to be used, although this may not be the physical distribution of the goods. Thus, remaining inventory valuation will always be the value of the most recently purchased items.

2. Average cost (AVCO). Under this method a new average value (usually the weighted average using the number of items bought) is calculated each time a new delivery of inventory is acquired.

IAS does not allow for inventory to be valued using the Last in, first out

(LIFO) method.

Similarly, inventories which are similar in nature and use to the company will use the same valuation method. Only where inventories are different in nature or use can a different valuation method be used.

Once a suitable method of valuation has been adopted by a company then it should continue to use that method unless there are good reasons why a change should be made. This is in line with the **CONSISTENCY** concept.

Valuing Raw Materials

A comparison is made between the cost of the raw materials (applying either FIFO or AVCO) and their realisable value.

Valuing Work in Progress and Finished Goods

IAS 2 requires that the valuation of these two items includes not only their raw or direct material content, but also includes an element for direct labour, direct expenses and production overheads.

The cost of these two items therefore consists of:

- direct materials
- direct labour
- direct expenses
- production overheads, these are costs to bring the product to its present location and condition
- Other overheads which may be applicable to bring the product to its present location and condition

The cost of these two items excludes:

- abnormal waste in the production process
- storage costs
- selling costs
- administration costs not related to production.

5.3. Perpetual and Periodic Inventory Systems

Perpetual inventory system and periodic inventory systems are the two systems of keeping records of inventory.

Perpetual inventory system updates inventory accounts after each purchase or sale.

Inventory subsidiary ledger is updated after each transaction

Inventory quantities are updated continuously.

Periodic inventory system records inventory purchase or sale in "Purchases" account.

"Purchases" account is updated continuously, however, "Inventory" account is updated on a periodic basis, at the end of each accounting period (e.g., monthly, quarterly)

Inventory subsidiary ledger is not updated after each purchase or sale of inventory.

Inventory quantities are not updated continuously.

Inventory quantities are updated on a periodic basis.

5.4. Recognition as an expense

When inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories shall be recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, shall be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

5.5. Disclosure of inventories in the financial statements

The financial statements shall disclose:

(a) the accounting policies adopted in measuring inventories, including the

cost formula used;

(b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity;

(c) the carrying amount of inventories carried at fair value less costs to sell;

(d) the amount of inventories recognised as an expense during the period;

(e) the amount of any write-down of inventories recognised as an expense in the period in accordance with paragraph 34;

(f) the amount of any reversal of any write-down that is recognised as a reduction in the amount of inventories recognised as expense in the period in accordance with paragraph 34;

(g) the circumstances or events that led to the reversal of a write-down of inventories in accordance with paragraph 34; and

(h) the carrying amount of inventories pledged as security for liabilities.

THEME 6. BIOLOGICAL ASSETS

6.1. The definition and types of biological assets

6.2. Recognition and measurement

6.3. Disclosure of biological assets in the financial statements

Key words: agricultural activity, biological asset, biological transformation, agricultural produce, fair value, costs to sell

6.1. The definition and types of biological assets

Agricultural activity is the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.

Examples of agricultural activity include:

• Raising livestock, fish or poultry

• Stud farms (for example, breeding horses or cattle)

• Forestry

• Cultivating vineyards, orchards or plantations

• Floriculture

A **biological asset** is a living animal or plant.

Biological assets include the following:

• Sheep, pigs, beef cattle, poultry and fish;

• Dairy cows;

• Trees in a forest;

• Plants for harvest (for example, wheat and vegetables);

• Trees, plants and bushes from which agricultural produce is harvested (for example, fruit trees, vines and tea bushes).

Bearer plant - a living plant that:

1. is used in the production or supply of agricultural produce
2. is expected to bear produce for more than one period, and
3. has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.

A **group of biological assets** is an aggregation of similar living animals or plants.

Biological transformation comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset.

Biological transformation is a natural change in a biological asset.

It includes growth of living animals or plants, reduction in output due to age or disease and the production of new biological assets through a managed reproductive programme.

Agricultural produce is the harvested product of the entity's biological assets.

Harvest is the detachment of produce from a biological asset or the cessation of a biological asset's life processes.

The table below provides examples of biological assets, agricultural produce, and products that are the result of processing after harvest:

Biological assets	Agricultural produce	Products that are the result of processing after harvest
Sheep	Wool	Yarn, carpet
Trees in a plantation forest	Felled trees	Logs, lumber
Plants	Cotton	Thread, clothing
	Harvested cane	Sugar
Dairy cattle	Milk	Cheese
Pigs	Carcass	Sausages, cured hams
Bushes	Leaf	Tea, cured tobacco
Vines	Grapes	Wine
Fruit trees	Picked fruit	Processed fruit

An **active market** is a market where all the following conditions exist:

(a) the items traded within the market are homogeneous;

(b) willing buyers and sellers can normally be found at any time; and

(c) prices are available to the public.

6.2. Recognition and measurement of biological assets

An entity shall recognise a biological asset or agricultural produce when, and only when:

(a) the entity controls the asset as a result of past events;

(b) it is probable that future economic benefits associated with the asset will flow to the entity; and

(c) the fair value or cost of the asset can be measured reliably.

In agricultural activity, control may be evidenced by, for example, legal ownership of cattle and the branding or otherwise marking of the cattle on acquisition, birth, or weaning. The future benefits are normally assessed by measuring the significant physical attributes.

A biological asset shall be measured on initial recognition and at the end of each reporting period at its fair value less costs to sell, except limited circumstances (for the case described in paragraph 30 where the fair value cannot be measured reliably).

There are two occasions where the standard permits departure from current fair value:

at the early stage of an asset's life;

and when fair value cannot be measured reliably on initial recognition.

Agricultural produce harvested from an entity's biological assets shall be measured at its fair value less costs to sell at the point of harvest. Such measurement is the cost at that date when applying IAS 2 *Inventories* or another applicable Standard.

Carrying amount is the amount at which an asset is recognised in the statement of financial position.

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.

The fair value of an asset is based on its present location and condition. As a result, for example, the fair value of cattle at a farm is the price for the cattle in the

relevant market less the transport and other costs of getting the cattle to that market.

The fair value hierarchy may be summarised as follows:

• Price for the asset in an active market.

• Recent transaction price for the asset if there is no active market.

• Market prices for similar assets, adjusted for the points of difference.

• Sector benchmarks.

• Present value of the future cash flows expected to be generated from the asset.

Contract prices are not necessarily relevant in determining fair value, because fair value reflects the current market in which a willing buyer and seller would enter into a transaction.

At the date a contract is signed between willing parties, the contract price would be the best estimate of the future market price and would therefore be a relevant price to use in a cash flow model. At a later date, historical contract prices may bear no relevance to the current fair value of the biological asset itself. Therefore, the fair value of a biological asset or its agricultural produce is not influenced by the existence of a contract unless the contract prices represent current market prices.

In some cases, a contract for the sale of a biological asset or agricultural produce may be an onerous contract, as defined in IAS 37, ‘Provisons, contingent liabilities and contingent assets’, and would be measured in accordance with that standard. The existence of an onerous contract does not affect the fair value of the biological asset.

Costs to sell are the incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes.

Costs to sell are the incremental costs incurred in selling the asset.

They include commissions paid to brokers and dealers, transfer taxes and duties and fees paid to regulatory agencies or commodity exchanges.

Costs to sell do not include the cost of transporting the asset to market (as

this is included in its fair value) or income taxes and finance costs.

Income under IAS 41 can be classified into:

• Initial gain or loss on biological assets.

• Changes in fair value less costs to sell of biological assets.

• Initial gain or loss on agricultural produce.

Initial losses on biological assets typically arise when a biological asset is purchased.

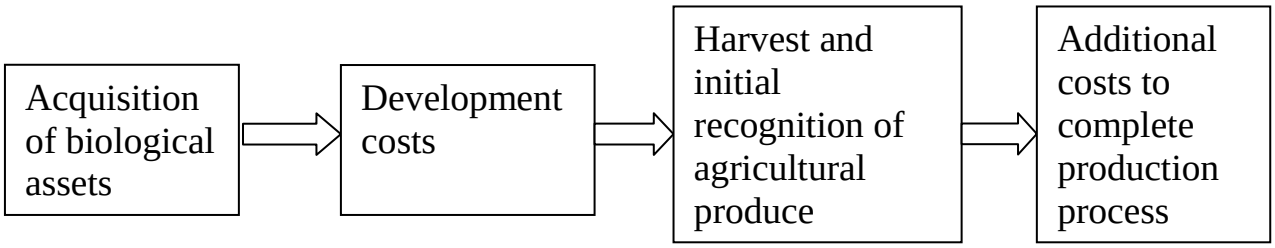
The cost of the biological asset is often higher than the fair value less costs to sell, as the latter represents an exit price, and transaction expenses therefore create a loss. Initial gains on biological assets arise when new biological assets are generated – for example, when a calf or a piglet is born.

Changes in fair value less costs to sell of biological assets represent the difference in value from period to period, normally on an aggregated basis. It is therefore sometimes difficult to distinguish from the initial gain due to procreation. The value typically increases due to growth, procreation and higher prices, but may decrease due to degeneration, sickness and lower prices.

Initial gains or losses on agricultural produce represents the difference between the change in carrying value of the biological assets due to harvest and the fair value less costs to sell of the harvested agricultural produce. It reflects the last stage of the value creation of the biological process, and the harvested produce is transferred to inventory.

There may be further costs involved in preparing the inventory for market.

The different stages in the accounting life of a biological asset are shown in the simple diagram below.



IAS 41 requires all gains and losses arising under the standard to be disclosed on an aggregated basis. It should be noted that the standard does not

require or encourage disaggregating the gain or loss. Further, disaggregating gains and losses arising from initial recognition and changes during the year may be impracticable.

A gain or loss arising on initial recognition of a biological asset at fair value less costs to sell and from a change in fair value less costs to sell of a biological asset shall be included in profit or loss for the period in which it arises.

A loss may arise on initial recognition of a biological asset, because costs to sell are deducted in determining fair value less costs to sell of a biological asset. A gain may arise on initial recognition of a biological asset, such as when a calf is born.

A gain or loss arising on initial recognition of agricultural produce at fair value less costs to sell shall be included in profit or loss for the period in which it arises.

There is a presumption that fair value can be measured reliably for a biological asset. However, that presumption can be rebutted only on initial recognition for a biological asset for which market-determined prices or values are not available and for which alternative estimates of fair value are determined to be clearly unreliable. In such a case, that biological asset shall be measured at its cost less any accumulated depreciation and any accumulated impairment losses. Once the fair value of such a biological asset becomes reliably measurable, an entity shall measure it at its fair value less costs to sell. Once a non-current biological asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale) in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, it is presumed that fair value can be measured reliably.

6.3. Disclosure of biological assets in the financial statements

Disclosure requirements in IAS 41 include:

- aggregate gain or loss from the initial recognition of biological assets and agricultural produce and the change in fair value less costs to sell during the

period

- description of an entity's biological assets, by broad group
- description of the nature of an entity's activities with each group of biological assets and non-financial measures or estimates of physical quantities of output during the period and assets on hand at the end of the period
- information about biological assets whose title is restricted or that are pledged as security
- commitments for development or acquisition of biological assets
- financial risk management strategies
- reconciliation of changes in the carrying amount of biological assets, showing separately changes in value, purchases, sales, harvesting, business combinations, and foreign exchange differences

Disclosure of a quantified description of each group of biological assets, distinguishing between consumable and bearer assets or between mature and immature assets, is encouraged but not required.

If fair value cannot be measured reliably, additional required disclosures include:

- description of the assets
- an explanation of why fair value cannot be reliably measured
- if possible, a range within which fair value is highly likely to lie
- depreciation method
- useful lives or depreciation rates
- gross carrying amount and the accumulated depreciation, beginning and ending.

If the fair value of biological assets previously measured at cost subsequently becomes available, certain additional disclosures are required.

Disclosures relating to government grants include the nature and extent of grants, unfulfilled conditions, and significant decreases expected in the level of grants.

THEME 7. CASH AND CASH EQUIVALENTS

7.1. The definition and recognition of cash and cash equivalents

7.2. Accounting for the movement of cash and cash equivalents

7.3. Disclosure of cash and cash equivalents in the financial statements

Key words: cash, cash flows, operating activities, investing activities, financing activities, statement of cash flows

7.1. The definition and recognition of cash and cash equivalents

Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

The term **cash and cash equivalents** includes: currency, coins, checks received but not yet deposited, checking accounts, petty cash, savings accounts, money market accounts, and short-term, highly liquid investments with a maturity of three months or less at the time of purchase.

The items included as cash and cash equivalents must also be unrestricted.

7.2. Accounting for the movement of cash and cash equivalents

Cash flows are inflows and outflows of cash and cash equivalents.

Business activities can be divided into three (3) groups:

- Operating activities
- Investing activities
- Financing activities

Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.

Operating activities are day-to-day business activities of a company which determine the company's net income (loss).

Operating activities are business activities associated with the primary purpose of a business**.**

Examples of operating activities are listed in the table below:

Business	**Operating Activities**
Manufacturing	Manufacturing and selling goods
Retail	Buying and re-selling goods
Service	Selling and providing services

Operating activities involve transactions that create revenues and expenses and thus are used to determine net income (loss).

In other words, operating activities are principal revenue producing activities.

The results of operating activities are reported in the operating income section of the **income statement** and in the operating cash flows section of the **statement of cash flows**.

Balance sheet also reflects some of the results of operations (e.g., working capital, long-term assets, and liabilities).

For example, the statement of cash flows classifies cash receipts and payments as operating, investing, and financing activities. Typical cash receipts and payments within the operating activities category are provided below:

Operating cash receipts (inflows):

- Revenue from the sale of goods and services
- Interest income (i.e., return on loans)
- Dividends income (i.e., return on equity securities)
- Royalties, fees, commissions, and other revenue

Operating cash payments (outflows):

- Payments to employees for services
- Payments to suppliers for inventory
- Payments to lenders for interest
- Payments to government for taxes
- Payments to others for operating expenses (e.g., insurance premiums)

Important to note, **some cash flows related to financing and investing activities** (e.g., interest, dividend)**are reported as operating activities** on the

statement of cash flows **when these items involve income determination** (i.e., are reported in the income statement). For example, even though loan proceeds and repayment involve financing activities, interest expense is reported as an operating activity because interest expense is reported in the income statement.

Operating cash flows and a company's net income (loss) are seldom equal due to the depreciation and amortization expense, changes in current assets and current liability accounts, etc.

It is important to evaluate operating cash flows when analyzing an entity's going concern because a**company often depends on its operating cash flows to meet its cash flow needs**.

Negative operating cash flows, combined with cash inflows from investing (e.g., selling assets) and financing activities (e.g., borrowing), may indicate a serious financial problem. On the other hand, **positive operating cash flows** combined with negative investing cash flows indicate goods financial performance and growth. An excess in operating cash flows can be used for financial purposes (e.g., pay dividends, repurchase stock, repay debt) and growth (e.g., buy assets).

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Investing activities are identified with changes in a corporation's long-term assets.

Examples of investing activities include the *acquisition* (purchase) of long-term investments, equipment used in the business, a building used in the business, and so on.

Investing activities also include the *sale* of long-term investments and the sale of long-term assets that had been used in the business.

In general **investing activities involve purchasing and disposing assets necessary for business operations**. Different businesses need to acquire different types of assets such as land, property, plant, equipment, patents, copyrights, cash, accounts receivable, etc.

Investing activities is one of the ways to acquire assets.

Cash flows from investing activities are usually reported in the second section of the statement of cash flows. Typical investing cash flows are presented below.

Cash inflows from investing activities:

- Selling fixed assets
- Selling intangible assets
- Selling investments
- Collecting principal on loans made to other entities*

(*) Collecting interest payments on loans made to other entities is reported as an operating activity because interest revenue involves income determination.

Cash outflows from investing activities:

- Payments to purchase fixed assets
- Payments to purchase intangible assets
- Payments to purchase investments (i.e., equity securities of other entities)
- Making loans to other entities

Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

Financing activities are business activities that involve issuing and paying off debt, issuing preferred and common stock, paying cash dividends, and acquiring treasury stock

In other words, in general **financing activities involve obtaining funds to start and operate a business**. Such activities reflect the relationship between the company and its **lenders** (e.g. bank) and **owners** (e.g., shareholders).

For instance, issuing bonds and repaying the debt is a financing activity that involves creditors while paying cash dividends is a financing activity that involves owners.

Cash flows from financing activities are usually reported in the third section of the statement of cash flows. Typical financing cash flows are presented below.

Cash inflows from financing activities:

- Issuing notes payable
- Issuing bonds
- Issuing preferred and common stock

Cash outflows from financing activities:

- Repaying debt (i.e., principal)*
- Paying cash dividends**
- Buying treasury stock

(*) Interest expense payments on debt are reported as an operating activity because interest expense involves income determination.

(**) Paying cash dividends is not an operating activity because cash dividends do not represent an expense. Cash dividends reduce retained earnings and thus represent a financing activity.

Noncash investing and financing activities

There are investing and financing activities that do not affect cash flows. For example, retiring long-term debt by issuing common stock is a noncash financing activity. Other example of noncash investing and financing activities include: acquiring land by issuing common stock, purchasing a building by issuing a note payable, acquiring equipment in exchange for land, etc.

Because noncash investing and financing activities *indirectly* affect cash flows, they are **reported in a separate section of the statement of cash flows**.

Important noncash investing and financing activities provide valuable information about overall investing and financing activities of an entity and must be reported either:

- **At the bottom of the statement of cash flows**, or
- **In the notes to the financial statements**.

Usually noncash investing and financing activities are reported in a separate section at the bottom of the statement of cash flows. This section lists important noncash investing and financing activities and offsets these transactions against each other.

In other words, **noncash financing/investing "outflows" offset financing/investing cash "inflows",** and vice versa. As the result, cash is not affected.

Examples:

- Financing cash "outflow" from retiring debt is offset by financing cash "inflow" from issuing stock.
- Investing cash "outflow" from acquiring land is offset by financing cash "inflow" from issuing stock.
- Investing cash "outflow" from acquiring equipment is offset by investing cash "inflow" from selling land.

The above-listed examples are summarized in the table below.

"Outflow"	"Inflow"
Retiring debt by issuing common stock	
Retiring debt: financing cash "outflow"	Issuing common stock: financing cash "inflow"
Acquiring land by issuing common stock	
Acquiring land: investing cash "outflow"	Issuing common stock: financing cash "inflow"
Acquiring equipment in exchange for land	
Acquiring equipment: investing cash "outflow"	Selling land: investing cash "inflow"

7.3. Disclosure of cash and cash equivalents in the financial statements

The amount of cash and cash equivalents will be reported on the balance sheet as the first item in the listing of current assets.

The change in the amount of cash and cash equivalents during an accounting period is explained by the statement of cash flows.

A change in this balance sheet category	...is reported in this section of the cash flow statement
Current Assets (other than Cash)	Operating Activities
Current Liabilities	Operating Activities
Long-term Assets	Investing Activities
Long-term Liabilities	Financing Activities
Stockholders' Equity	Financing Activities

The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities.

The purpose of the *cash flow statement* or *statement of cash flows* is to provide information about a company's gross receipts and gross payments for a specified period of time.

The gross receipts and gross payments will be reported in the cash flow statement according to one of the following classifications: operating activities, investing activities, and financing activities. The net change from these three classifications should equal the change in a company's *cash and cash equivalents* during the reporting period. For instance, the cash flow statement for the calendar year 2013 will report the causes of the change in a company's *cash and cash equivalents* between its balance sheets of December 31, 2012 and December 31, 2013.

In addition to the cash amounts being reported as operating, investing, and financing activities, the cash flow statement must disclose other information, including the amount of interest paid, the amount of income taxes paid, and any significant investing and financing activities which did not require the use of cash.

The statement of cash flows is to be distributed along with a company's income statement and balance sheet.

Format of the Statement of Cash Flows

The statement of cash flows has four distinct sections:

1. Cash involving **operating activities**
2. Cash involving **investing activities**
3. Cash involving **financing activities**
4. Supplemental information.

Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss. Examples of cash flows from operating activities are:

(a) cash receipts from the sale of goods and the rendering of services;

(b) cash receipts from royalties, fees, commissions and other revenue;

(c) cash payments to suppliers for goods and services;

(d) cash payments to and on behalf of employees;

(e) cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits;

(f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and

(g) cash receipts and payments from contracts held for dealing or trading purposes.

1. Cash Provided From or Used By Operating Activities

This section of the cash flow statement reports the company's net income and then converts it from the accrual basis to the cash basis by using the changes in the balances of current asset and current liability accounts, such as:

Accounts Receivable	Notes Payable (generally due within one year)
Inventory	Accounts Payable
Supplies	Wages Payable
Prepaid Insurance	Payroll Taxes Payable
Other Current Assets	Interest Payable
	Income Taxes Payable
	Unearned Revenues
	Other Current Liabilities

In addition to using the changes in current assets and current liabilities, the operating activities section has adjustments for depreciation expense and for the gains and losses on the sale of long-term assets.

Investing activities

The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are:

(a) cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalised development costs and self-constructed property, plant and equipment;

(b) cash receipts from sales of property, plant and equipment, intangibles

and other long-term assets;

(c) cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);

(d) cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

(e) cash advances and loans made to other parties (other than advances and loans made by a financial institution);

(f) cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);

(g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and

(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge of an identifiable position the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

2. Cash Provided From or Used By Investing Activities

This section of the cash flow statement reports *changes* in the balances of *long-term asset* accounts, such as:

- Long-term Investments
- Land
- Buildings
- Equipment
- Furniture & Fixtures
- Vehicles

In short, investing activities involve the purchase and/or sale of long-term

investments and PPE.

Financing activities

The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the entity. Examples of cash flows arising from financing activities are:

(a) cash proceeds from issuing shares or other equity instruments;

(b) cash payments to owners to acquire or redeem the entity's shares;

(c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short or long-term borrowings;

(d) cash repayments of amounts borrowed; and

(e) cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

3. Cash Provided From or Used By Financing Activities

This section of the cash flow statement reports *changes* in balances of the *long-term liability* and *stockholders' equity* accounts, such as:

- Notes Payable (generally due after one year)
- Bonds Payable
- Deferred Income Taxes
- Preferred Stock
- Paid-in Capital in Excess of Par-Preferred Stock
- Common Stock
- Paid-in Capital in Excess of Par-Common Stock
- Paid-in Capital from Treasury Stock
- Retained Earnings
- Treasury Stock

In short, financing activities involve the issuance and/or the repurchase of a company's own bonds or stock. Dividend payments are also reported in this section.

4. Supplemental Information

This section of the cash flow statement discloses the amount of interest and income taxes paid. Also reported are significant exchanges not involving cash. For example, the exchange of company stock for company bonds would be reported in this section.

the general assumptions:

- When an asset (other than cash) increases, the Cash account *decreases*.
- When an asset (other than cash) decreases, the Cash account *increases*.
- When a liability increases, the Cash account *increases*.
- When a liability decreases, the Cash account *decreases*.
- When owner's equity increases, the Cash account *increases*.
- When owner's equity decreases, the Cash account *decreases*.

For a change in assets (other than cash)—the change in the Cash account is in the *opposite* direction.

For a change in liabilities and owner's equity—the change in the Cash account is in the *same* direction.

An entity shall report cash flows from operating activities using either:

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

An entity shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis.

Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:

(a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity; and

(b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

Cash flows arising from transactions in a foreign currency shall be recorded in an entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

The cash flows of a foreign subsidiary shall be translated at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.

MODULE 3. ACCOUNTING FOR FINANCIAL INSTRUMENTS, REVENUE AND LIABILITIES

THEME 8. FINANCIAL INSTRUMENTS

8.1. Definitions and main features of financial instruments

8.2. Derecognition of financial instruments

8.3. Classification of financial instruments

8.4. Measurement of financial instruments

8.5. Impairment of financial assets

8.6. Embedded derivatives

8.7. Hedge accounting

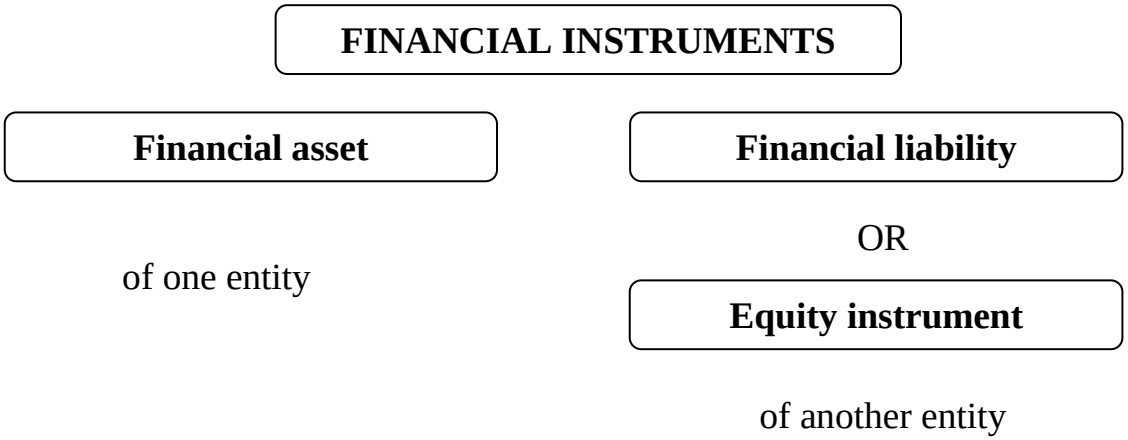
Key words: financial instrument, financial asset, financial liability, equity instrument

8.1. Definitions and main features of financial instruments

The definitions of financial instruments are prescribed in ***IAS 32 Financial Instruments: Presentation***.

A financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Unlike other assets or liabilities, financial instruments arise from the ***CONTRACT.***



Here, the equity instrument is the investment in another entity, so ***entity's***

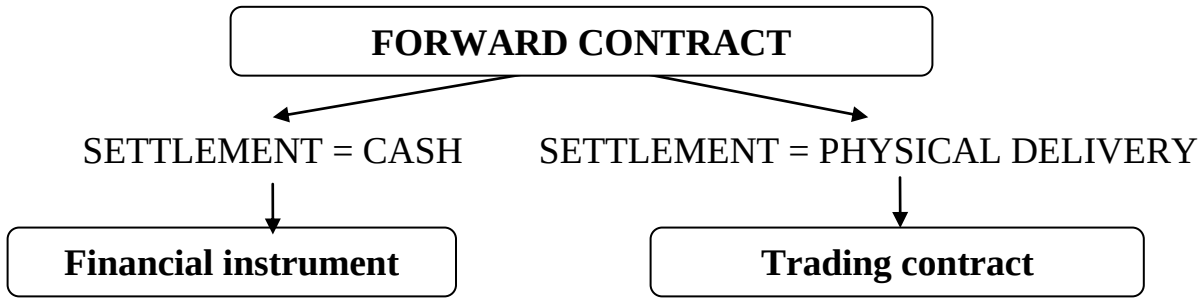
own shares are excluded, as well as the interests in the reporting entity's joint venture or subsidiary.

Therefore, the financial instrument is a bridging tool between the assets or rights on one side, and liabilities or equity instruments of another entity on the other side.

Financial assets are:

- Cash,
- Equity instruments of another entity (e.g. shares),
- Contractual right
  - to receive cash or another financial asset of another entity (e.g. trade receivable);
  - to exchange financial assets or financial liabilities with another entities under potentially favorable conditions (e.g. foreign currency forward contract with positive outcome – derivative asset)
- Contract settled with ***variable amount of own equity instruments***. If this would be settled with fixed amount of own equity instruments, then it would have been an equity instrument, not a financial asset.

The contractual rights to receive an asset other than cash or a financial asset of another entity is NOT a financial instrument.



Financial liability is:

- A contractual obligation
  - to deliver cash or another financial asset to another entity (e.g. loan taken, ,trade payable), or
  - to exchange financial assets or financial liabilities other than the

entity's own equity under potentially unfavorable conditions.

- Contract settled with ***variable amount*** of own equity instruments (very simplified). If this would be settled with fixed amount of own equity instruments, then it would have been an equity instrument, not a financial liability.

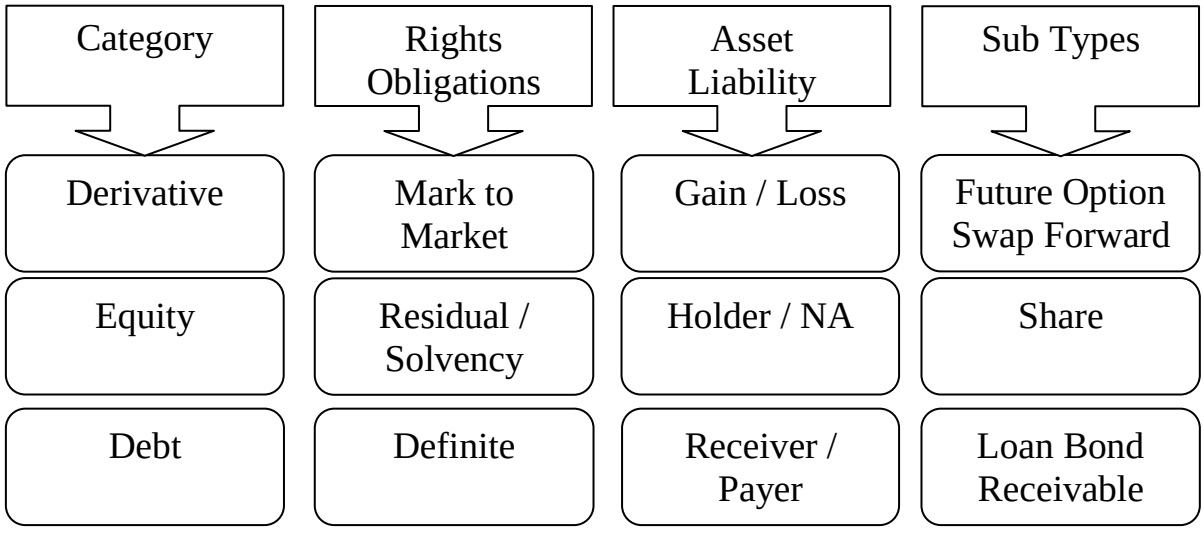
According to the characteristics of risks and rewards associated with the financial instruments, there are **three types**:

1. Derivatives,
2. Equities (e.g. shares) and
3. Debt instruments (including receivables).

In addition to the three basic instruments, there are hybrid or compound financial instruments with more complicated features.

The following matrix depicts **the main features** of the financial instruments in three dimensions:

1. How to define the Rights and Obligations,
2. Who recognizes Assets or Liabilities for each category of the financial instruments, and
3. Various subtypes available for the category.



Derivatives

Derivatives are the contracts with negligible or zero initial net value and subsequent fair value changes depending on the ***mark to market*** value of the underlying assets.

Derivatives can be either asset or liability depending on whether there is a mark to market gain or loss from the contract.

In addition, the future settlement of derivatives is normally in cash or other types of financial assets, instead of physical delivery.

Forward, futures, swaps and options are four basic types of the derivatives. Moreover, there are advanced or exotic derivatives.

Equity instruments

Equity represents both the residual rights of the holders and the issuers' limited obligation to stakeholders after total assets deducting total liabilities during solvency.

However, the residual rights and limited obligations are applicable ***only during the issuers' solvency***, which means the issuer of ordinary shares has no obligation to pay the holder in daily operations.

As per previous discussion, only the equity holder needs to book it under the IFRS 9 as the financial assets, while the equity on the issuer's side is out of scope of IFRS 9.

Debt instruments

Debt instruments are the contractual rights and obligations with ***defined terms for amount and timing to pay***.

It must be reminded that the receiver of the debt contract, or the rights owner should book the debt as assets; while the payer of debt contract should book the debt as liabilities.

Unlike the equity where the payment by the issuer is only be expected during the solvency, the debt must be paid when due as prescribed by the debt contracts. Normally the debts are in the form of deposits, loan, bonds, payables and receivables.

According to IFRS 9, the debts should be further split into SPPI (Solely Payments of Principal & Interest) and Non-SPPI, where the interest of the former is mainly based on time value, credit risk and liquidity risk.

8.2. Derecognition of financial instruments

IFRS 9 establishes principles for the financial reporting of financial assets and financial liabilities.

IFRS 9 ***does NOT define*** financial instruments (the definitions of financial instruments in IAS 32 Financial Instruments: Presentation).

IFRS 9 ***does NOT deal with own (issued) equity instruments*** like own shares, issued warrants, written options for equity, etc.

IFRS 9 DOES deal with the equity instruments of someone else, because they are financial assets.

IFRS 9 does NOT deal with investments in subsidiaries, associates and joint ventures (IFRS 10, IAS 28 and related).

An entity shall **recognise** a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes **party to the contractual provisions** of the instrument (IFRS 9 par. 3.1.1).

Unlike in other IFRS standards that put emphasis on the future economic benefits, IFRS 9 is more about the contract.

IFRS 9 treats the derecognition of financial assets differently from the derecognition of financial liabilities.

Derecognition of financial assets

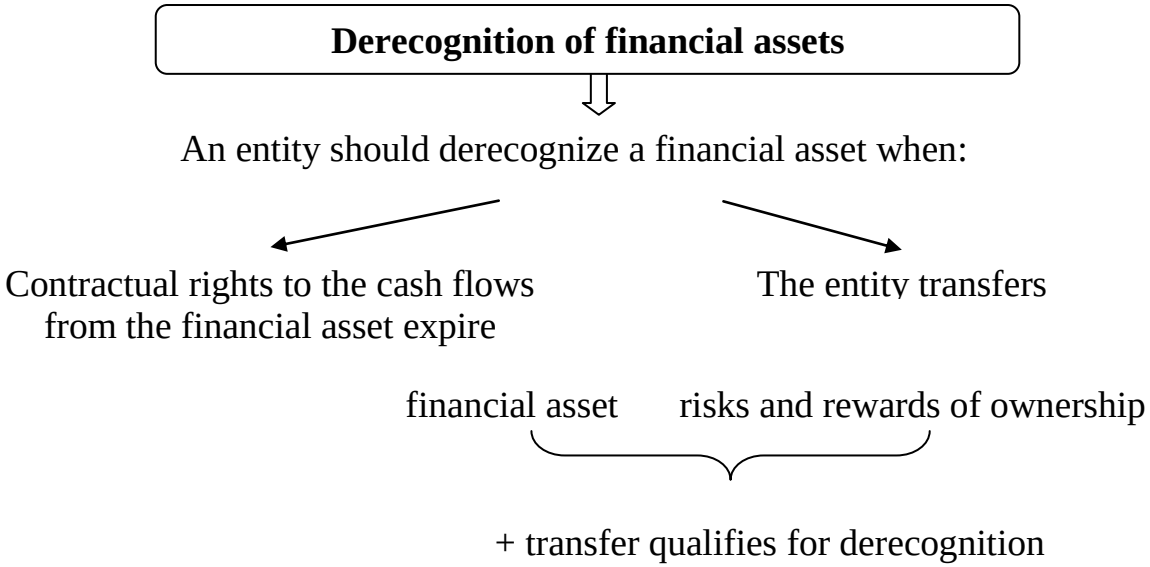
The basic premise for the derecognition model in IFRS 9 is to determine whether the asset under consideration for derecognition is: (IFRS 9, par. 3.2.2)

- an asset in its entirety or
- specifically identified cash flows from an asset (or a group of similar financial assets) or
- a fully proportionate (pro rata) share of the cash flows from an asset (or a group of similar financial assets). or
- a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (or a group of similar financial assets)

Once the asset under consideration for derecognition has been determined, an assessment is made as to whether the asset has been transferred, and if so,

whether the transfer of that asset is subsequently eligible for derecognition (IFRS 9 par. 3.2.3):

- The contractual rights to the cash flows from the financial asset expire; or
- An entity transfers the financial asset and the transfer qualifies for the derecognition.



An asset is transferred if either the entity has transferred the contractual rights to receive the cash flows, or the entity has retained the contractual rights to receive the cash flows from the asset, but has assumed a contractual obligation to pass those cash flows on under an arrangement that meets the following three conditions: (IFRS 9, par 3.2.4-3.2.5)

- the entity has no obligation to pay amounts to the eventual recipient unless it collects equivalent amounts on the original asset
- the entity is prohibited from selling or pledging the original asset (other than as security to the eventual recipient),
- the entity has an obligation to remit those cash flows without material delay.

Once an entity has determined that the asset has been transferred, it then determines whether or not it has transferred substantially all of the risks and rewards of ownership of the asset. If substantially all the risks and rewards have

been transferred, the asset is derecognised. If substantially all the risks and rewards have been retained, derecognition of the asset is precluded. (IFRS 9, par 3.2.6)

These various derecognition steps are summarised in the decision tree in paragraph B3.2.1.

Derecognition of a financial liability

An entity shall derecognize a financial liability ***when it is extinguished***. It happens when the obligation specified in the contract is discharged, cancelled or expires.

8.3. Classification of financial instruments

IFRS 9 **classifies financial assets** based on two characteristics:

1. ***Business model test***

What is the objective of holding financial assets? Collecting the contractual cash flows? Selling?

2. ***Contractual cash flows' characteristics test***

Are the cash flows from the financial assets on the specified dates solely payments of principal and interest on the principal outstanding? Or, is there something else?

Based on these two tests, the financial assets can be classified in the following categories:

1. ***At amortized cost***

A financial asset falls into this category if BOTH of the following conditions are met:

- Business model test is met, i.e. you hold the financial assets only to collect contractual cash flows (not to sell them), and
- Contractual cash flows' characteristics test is met, i.e. the cash flows from the asset are only the payments of principal and interest.

Examples: debt securities, receivables, loans.

2. ***At fair value through other comprehensive income (FVOCI)***

Here, there are 2 subcategories:

- 2a. If a financial asset meets contractual cash flows characteristics test (i.e. debt assets only) and the business model is to collect contractual cash flows AND SELL financial assets, then such an asset mandatorily falls into this category (unless FVTPL option is chosen)
- 2b. It is possible to voluntarily choose to measure some equity instruments at FVOCI. This is an irrevocable election at initial recognition.

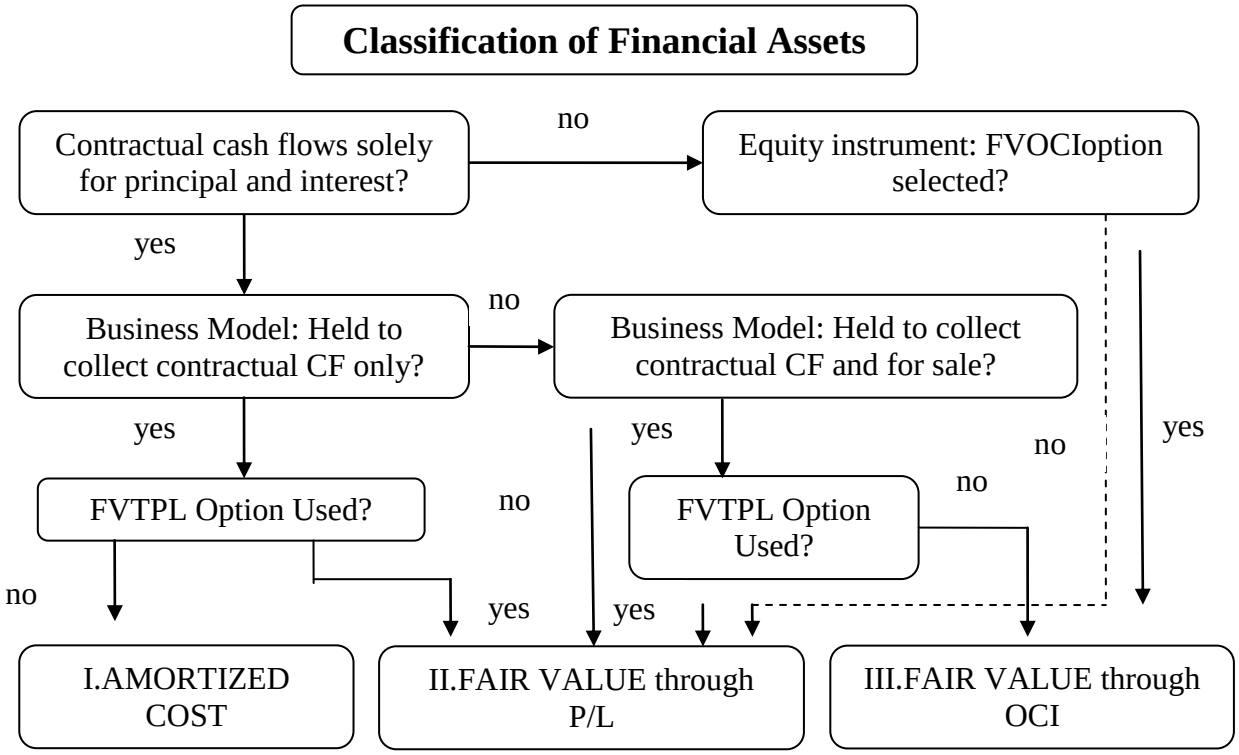
3. ***At fair value through profit or loss (FVTPL)***

All other financial assets fall in this category.

Derivative financial assets are automatically classified at FVTPL.

Moreover, regardless above 2 categories, it is possible to decide to designate the financial asset at fair value through profit or loss at its initial recognition.

The following scheme explains it:



IFRS 9 **classifies financial liabilities** as follows:

1. ***Financial liabilities at fair value through profit or loss***: these financial liabilities are subsequently measured at fair value and here, all derivatives belong.

2. ***Other financial liabilities measured at amortized cost*** using the

effective interest method.

IFRS 9 mentions separately some other types of financial liabilities measured in a different way, such as financial guarantee contracts and commitments to provide a loan at a below market interest rate, but here, we will deal with 2 main categories.

8.4. Measurement of financial instruments

Initial measurement

Financial asset or financial liability shall be initially measured at:

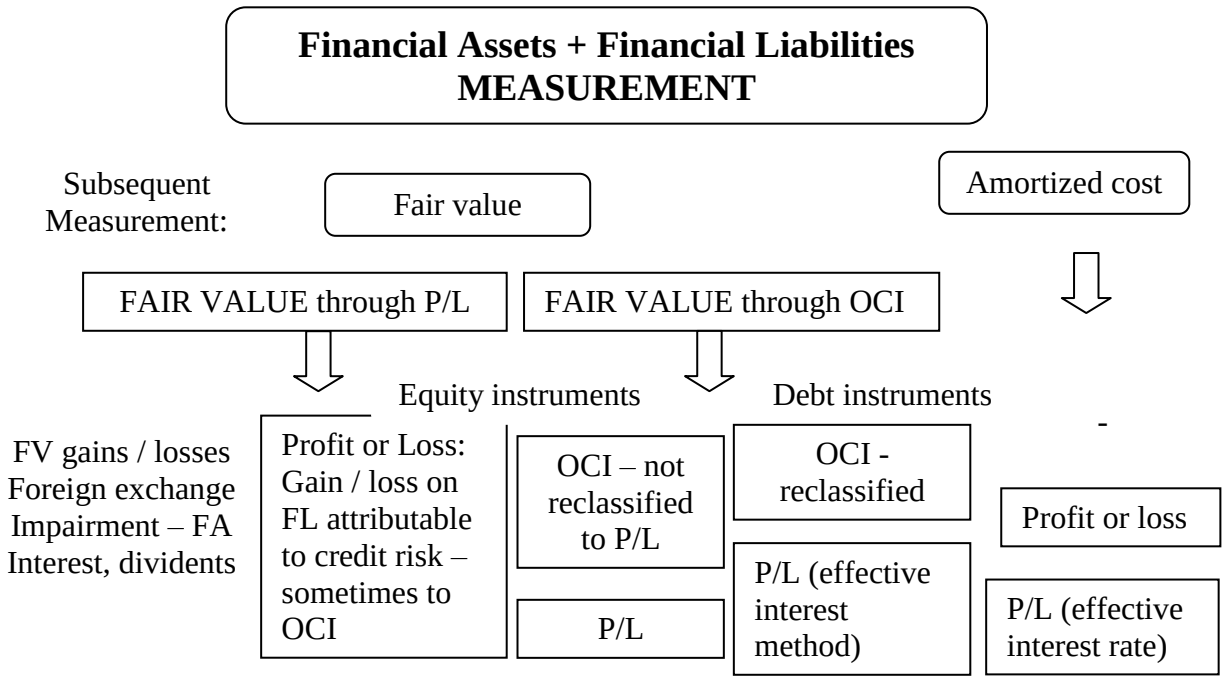
- ***Fair value***: all financial instruments at fair value through profit or loss;
- ***Fair value plus transaction cost***: all other financial instruments (at amortized cost or fair value through other comprehensive income).

Subsequent measurement

Subsequent measurement ***depends on the category of a financial instrument***:

- Financial assets shall be subsequently measured either at fair value or at amortized cost;
- Financial liabilities are measured at amortized cost unless the fair value option is applied.

With regard to recognizing gains and losses from subsequent measurement, here's the scheme:



8.5. Impairment of financial assets

Using the IFRS 9 terminology, "bad debt provision" = impairment of financial assets, or a loss allowance.

It does NOT affect all financial assets. For example, shares and other equity instruments are excluded, because their potential impairment is taken into account when re-measuring these investments to their fair value.

IFRS 9 requires entities to estimate and account for ***expected credit losses for all relevant financial assets*** (mostly debt securities, receivables including lease receivables, contract assets under IFRS 15, loans), starting from when they first acquire a financial instrument.

When measuring expected credit losses, entities will be required to use all relevant information that is available to them (without undue cost or effort).

IFRS 9 offers two approaches:

1. ***General model*** for measuring a loss allowance:

This model recognizes loss allowance depending on the stage in which the financial asset is. There are 3 stages:

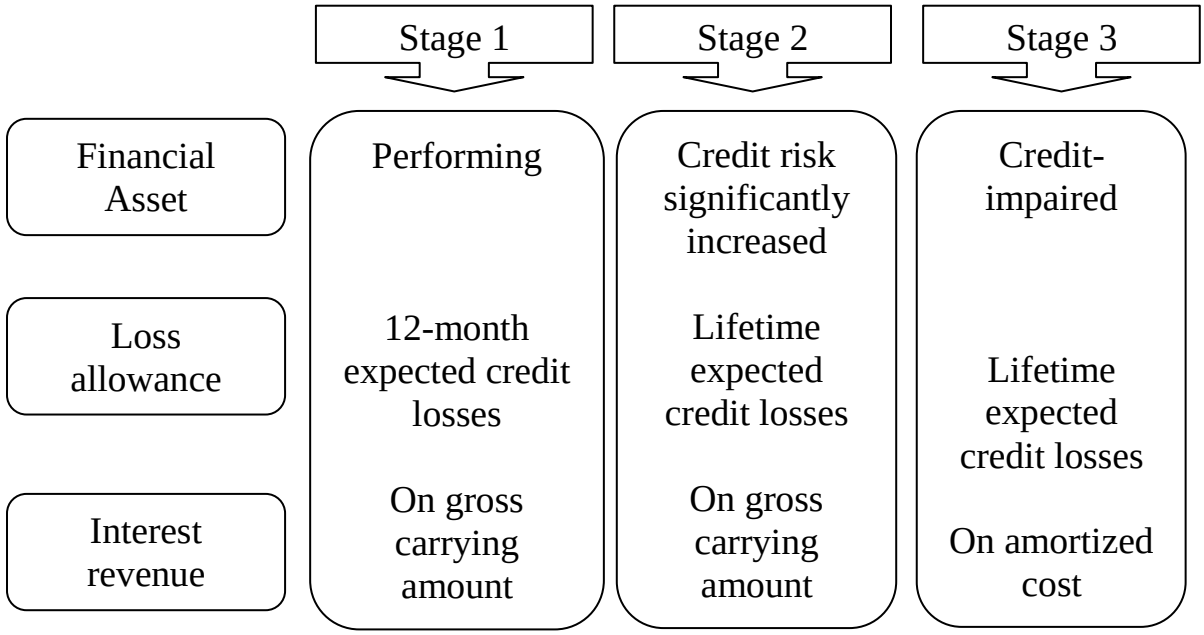
- ***Stage 1 – Performing assets:*** Loss allowance is recognized in the amount of 12-month expected credit loss;
- ***Stage 2 – Financial assets with significantly increased credit risk:***

Loss allowance is recognized in the amount of lifetime expected credit loss, and

- ***Stage 3 – Credit-impaired financial assets:*** Loss allowance is recognized in the amount of lifetime expected credit loss and interest revenue is recognized based on amortized cost.

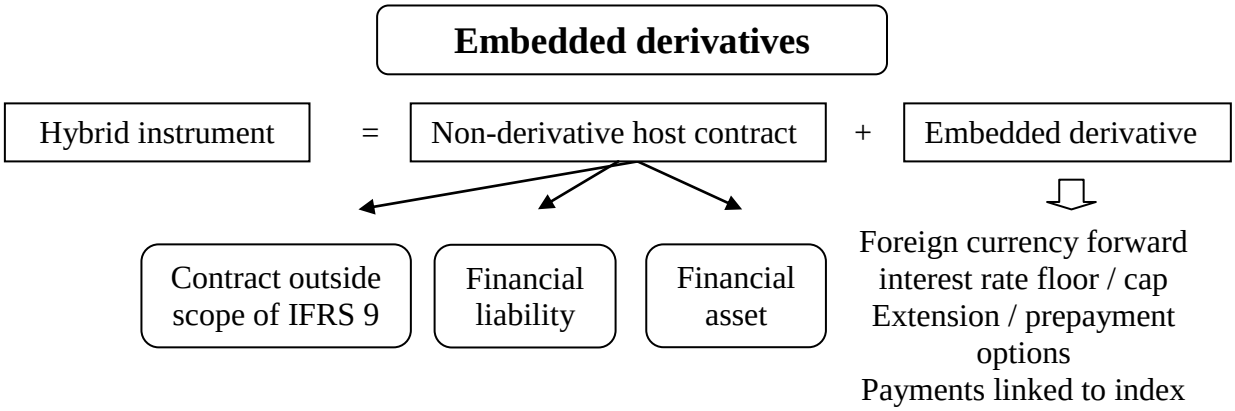
2. ***Simplified model:***

There is no need to determine the stage of a financial asset, because a loss allowance is recognized always at a lifetime expected credit loss.



8.6. Embedded derivatives

An embedded derivative is simply a component of a hybrid instrument that also includes a non-derivative host contract.



Accounting of embedded derivatives ***depends on WHAT the host contract***

is:

- If host = financial asset within the scope of IFRS 9, then the whole hybrid contract shall be measured as one and not separated.
- If host = financial liability within the scope of IFRS 9 OR a contract outside the scope of IFRS 9 (e.g. service contract, lease contract…), it should be separated when the conditions are met.

Separation means that the embedded derivative is accounted separately in line with IFRS 9 and the host contract in line with other appropriate standard.

If an entity is not able to do this, then the whole contract must be accounted for as a financial instrument at fair value through profit or loss.

8.7. Hedge accounting

Hedge accounting is designating one or more hedging instruments so that their change in fair value is an offset to the change in fair value or cash flows of a hedged item.

Hedge accounting is ***NOT mandatory***!

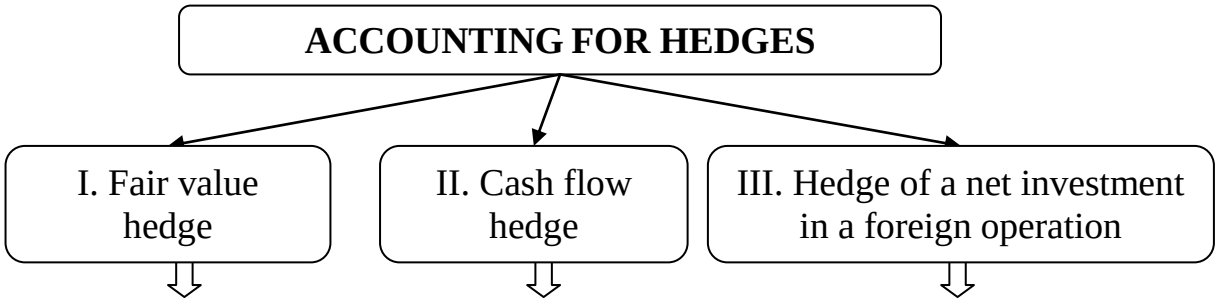
To apply hedge accounting, 3 criteria must be met (IFRS 9, par. 6.4.1):

1. the hedging relationship consists only of eligible hedging instruments and eligible hedged items.
2. at the inception of the hedging relationship there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge.
3. the hedging relationship meets all of the hedge effectiveness requirements.

IFRS 9 sets the rules for 3 types of hedges:

1. Cash flow hedge,
2. Fair value hedge, and
3. Hedge of the net investment in the foreign operation.

The overview of the accounting for these hedges is shown in the following scheme:



Hedging instrument:
=>Change in FV to P/L (OCI)

Hedged item:
=>Adjust carrying amount through P/L (OCI)

Hedging instrument:
=>Effective portion to OCI
Hedged item:
=>Remaining part to P/L
=>Reclassify "cash flow hedge reserve" in eqity

As cash flow hedge

THEME 9. REVENUE FROM CONTRACTS WITH CUSTOMERS

9.1. Definitions and general principles

9.2. The five-step model for recognising revenue from contracts with customers

9.3. Contract costs

9.4. Presentation in financial statements and disclosure

Key words: contract, customer, income, performance obligation, revenue, transaction price

9.1. Definitions and general principles

The objective of IFRS 15 is to establish the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer.

IFRS 15 Revenue from Contracts with Customers applies to all contracts with customers except for:

- leases within the scope of IAS 17 Leases;

- financial instruments and other contractual rights or obligations within the scope of IFRS Financial Instruments, IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements, IAS 27Separate Financial Statements and IAS 28 Investments in Associates and Joint Ventures;

- insurance contracts within the scope of IFRS 4 Insurance Contracts;

- non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers.

Key definitions:

Contract - an agreement between two or more parties that creates enforceable rights and obligations.

Customer - a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration.

Income - increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.

Performance obligation - a promise in a contract with a customer to transfer to the customer either:

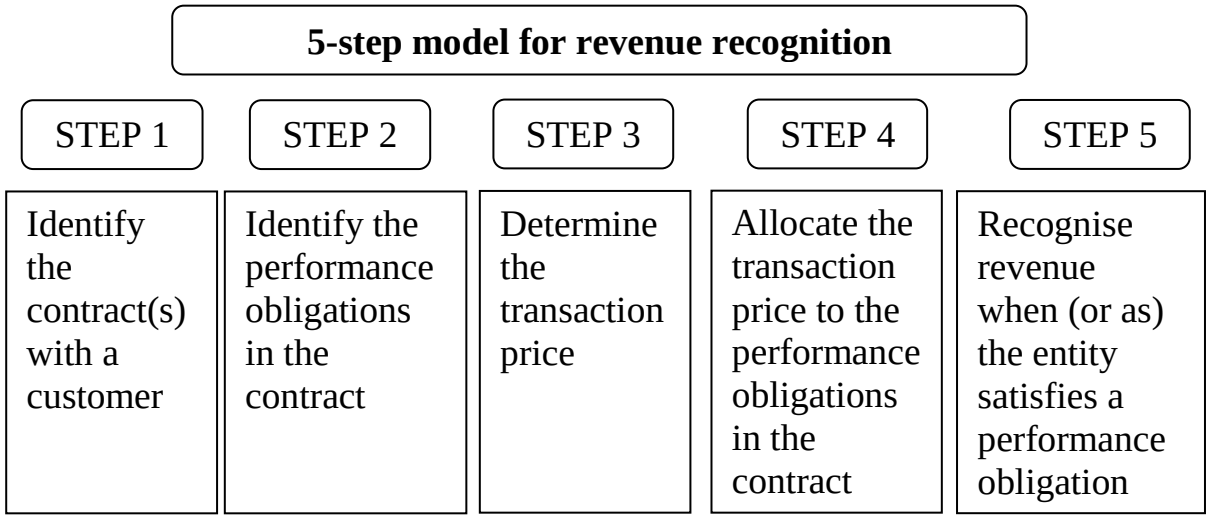
- a good or service (or a bundle of goods or services) that is distinct; or
- a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

Revenue - income arising in the course of an entity's ordinary activities.

Transaction price - the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.

9.2. The five-step model for recognising revenue from contracts with customers

The core principle of IFRS 15 is that an entity will recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This core principle is delivered in a five-step model framework.



Application of this guidance will depend on the facts and circumstances present in a contract with a customer and will require the exercise of judgment.

Step 1: Identify the contract with the customer

A contract with a customer will be within the scope of IFRS 15 if all the following conditions are met:

- the contract has been approved by the parties to the contract;
- each party's rights in relation to the goods or services to be transferred can be identified;
- the payment terms for the goods or services to be transferred can be identified;
- the contract has commercial substance; and
- it is probable that the consideration to which the entity is entitled to in exchange for the goods or services will be collected.

If a contract with a customer does not yet meet all of the above criteria, the entity will continue to re-assess the contract going forward to determine whether it subsequently meets the above criteria. From that point, the entity will apply IFRS 15 to the contract.

The standard provides detailed guidance on how to account for approved contract modifications. If certain conditions are met, a contract modification will be accounted for as a separate contract with the customer. If not, it will be accounted for by modifying the accounting for the current contract with the customer. Whether the latter type of modification is accounted for prospectively or retrospectively depends on whether the remaining goods or services to be delivered after the modification are distinct from those delivered prior to the modification.

Step 2: Identify the performance obligations in the contract

At the inception of the contract, the entity should assess the goods or services that have been promised to the customer, and identify as a performance obligation:

- a good or service (or bundle of goods or services) that is distinct; or
- a series of distinct goods or services that are substantially the same and

that have the same pattern of transfer to the customer.

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

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

A good or service is distinct if both of the following criteria are met:

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

Factors for consideration as to whether a promise to transfer goods or services to the customer is not separately identifiable include, but are not limited to:

- the entity does provide a significant service of integrating the goods or services with other goods or services promised in the contract;
- the goods or services significantly modify or customise other goods or services promised in the contract;
- the goods or services are highly interrelated or highly interdependent.

Step 3: Determine the transaction price

The transaction price is the amount to which an entity expects to be entitled in exchange for the transfer of goods and services. When making this determination, an entity will consider past customary business practices.

Where a contract contains elements of variable consideration, the entity will estimate the amount of variable consideration to which it will be entitled under the contract. Variable consideration can arise, for example, as a result of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses,

penalties or other similar items. Variable consideration is also present if an entity's right to consideration is contingent on the occurrence of a future event.

The standard deals with the uncertainty relating to variable consideration by limiting the amount of variable consideration that can be recognised. Specifically, variable consideration is only included in the transaction price if, and to the extent that, it is highly probable that its inclusion will not result in a significant revenue reversal in the future when the uncertainty has been subsequently resolved.

However, a different, more restrictive approach is applied in respect of sales or usage-based royalty revenue arising from licences of intellectual property. Such revenue is recognised only when the underlying sales or usage occur.

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. If a standalone selling price is not directly observable, the entity will need to estimate it. IFRS 15 suggests various methods that might be used, including:

- Adjusted market assessment approach
- Expected cost plus a margin approach
- Residual approach (only permissible in limited circumstances).

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 such a discount to some but not all of the performance obligations.

Where consideration is paid in advance or in arrears, the entity will need to consider whether the contract includes a significant financing arrangement and, if so, adjust for the time value of money. A practical expedient is available where the interval between transfer of the promised goods or services and payment by the customer is expected to be less than 12 months.

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 point in time.

Control of an asset is defined as the ability to direct the use of and obtain substantially all of the remaining benefits from the asset. This includes the ability to prevent others from directing the use of and obtaining the benefits from the asset. The benefits related to the asset are the potential cash flows that may be obtained directly or indirectly. These include, but are not limited to:

- using the asset to produce goods or provide services;
- using the asset to enhance the value of other assets;
- using the asset to settle liabilities or to reduce expenses;
- selling or exchanging the asset;
- pledging the asset to secure a loan; and
- holding the asset.

An entity recognises revenue over time if one of the following criteria is met:

- the customer simultaneously receives and consumes all of the benefits provided by the entity as the entity performs;
- the entity's performance creates or enhances an asset that the customer controls as the asset is created; or
- 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.

If an entity does not satisfy its performance obligation over time, it satisfies it at a point in time. Revenue will therefore be recognised when control is passed at a certain point in time. Factors that may indicate the point in time at which control passes include, but are not limited to:

- the entity has a present right to payment for the asset;
- the customer has legal title to the asset;
- the entity has transferred physical possession of the asset;
- the customer has the significant risks and rewards related to the ownership

of the asset; and

- the customer has accepted the asset.

9.3. Contract costs

The incremental costs of obtaining a contract must be recognised as an asset if the entity expects to recover those costs. However, those incremental costs are limited to the costs that the entity would not have incurred if the contract had not been successfully obtained (e.g. 'success fees' paid to agents). A practical expedient is available, allowing the incremental costs of obtaining a contract to be expensed if the associated amortisation period would be 12 months or less.

Costs incurred to fulfil a contract are recognised as an asset if and only if all of the following criteria are met:

- the costs relate directly to a contract (or a specific anticipated contract);
- the costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future; and
- the costs are expected to be recovered.

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

The asset recognised in respect of the costs to obtain or fulfil a contract is amortised on a systematic basis that is consistent with the pattern of transfer of the goods or services to which the asset relates.

9.4. Presentation in financial statements and disclosure

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

A contract liability is presented in the statement of financial position where a customer has paid an amount of consideration prior to the entity performing by

transferring the related good or service to the customer.

Where the entity has performed by transferring a good or service to the customer and the customer has not yet paid the related consideration, **a contract asset or a receivable** is presented in the statement of financial position, depending on the nature of the entity's right to consideration.

A contract asset is recognised when the entity's right to consideration is conditional on something other than the passage of time, for example future performance of the entity.

A receivable is recognised when the entity's right to consideration is unconditional except for the passage of time.

Contract assets and receivables shall be accounted for in accordance with IFRS 9. Any impairment relating to contracts with customers should be measured, presented and disclosed in accordance with IFRS 9. Any difference between the initial recognition of a receivable and the corresponding amount of revenue recognised should also be presented as an expense, for example, an impairment loss.

The **disclosure** objective stated in IFRS 15 is for an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Therefore, an entity should disclose qualitative and quantitative information about all of the following:

- its contracts with customers;
- the significant judgments, and changes in the judgments, made in applying the guidance to those contracts; and
- any assets recognised from the costs to obtain or fulfil a contract with a customer.

Entities will need to consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the requirements. An entity should aggregate or disaggregate disclosures to ensure that useful information is not obscured.

THEME 10. LIABILITIES AND EMPLOYEE BENEFITS

10.1. Liabilities

10.2. Employee benefits

Key words: liability, current liability, non-current liability, employee benefits, short-term employee benefits, post-employment benefits, other long-term benefits, termination benefits

10.1. Liabilities

A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits. In simple words, liability is an obligation of the entity to transfer cash or other resources to another party.

Liability could for instance be a bank loan, which obligates the entity to pay loan installments over the duration of the loan to the bank along with the associated interest cost. Alternatively, an entity's liability could be a trade payable arising from the purchase of goods from a supplier on credit.

Liabilities may be classified into *Current* and *Non-Current*. The distinction is made on the basis of time period within which the liability is expected to be settled by the entity.

Current Liability is one which the entity expects to pay off within one year from the reporting date.

Non-Current Liability is one which the entity expects to settle after one year from the reporting date.

Following are examples the common types of liabilities along with their usual classifications.

Liability	**Classification**
Long Term Bank Loan	Non-current
Bank Overdraft	current
Short Term Bank Loan	current
Trade Payables	current
Debenture	Non-current
Tax Payble	Current

The following recognition criteria to be met before a liability could be shown on the face of a financial statement:

1. The outflow of resources embodying economic benefits (such as cash) from the entity is probable.

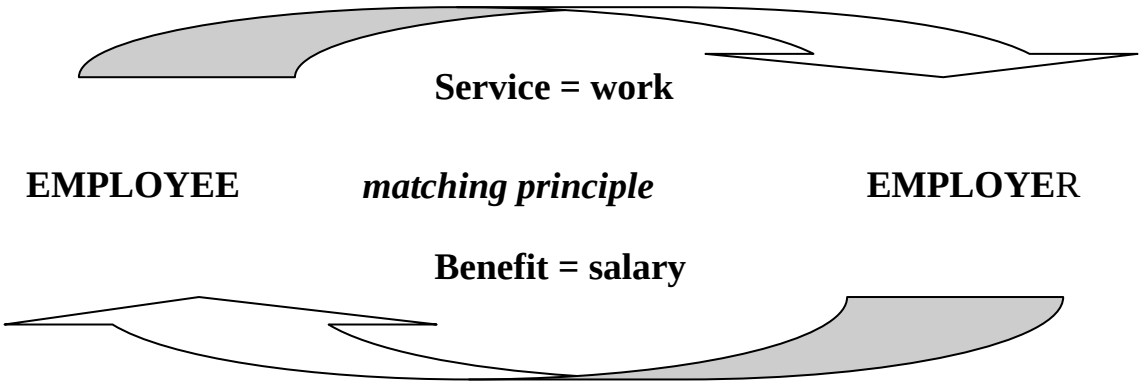
2. The cost / value of the obligation can be measured reliably.

10.2. Employee benefits

The main objective of IAS 19 is to prescribe the accounting and disclosure for employee benefits. IAS 19 requires and entity to recognize:

- ***a liability*** when an employee has provided service in exchange for employee benefits to be paid in the future; and
- ***an expense*** when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

That's the clear demonstration of ***matching principle*** — to recognize an expense in the period when matching revenue is recognized.



Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees.

Multi-employer plans are defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:

(a) pool the assets contributed by various entities that are not under common control; and

(b) use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to

the identity of the entity that employs the employees concerned.

Vested employee benefits are employee benefits that are not conditional on future employment.

The *present value of a defined benefit obligation* is the present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.

Current service cost is the increase in the present value of a defined benefit obligation resulting from employee service in the current period.

Interest cost is the increase during a period in the present value of a defined benefit obligation which arises because the benefits are one period closer to settlement.

Plan assets comprise:

(a) assets held by a long-term employee benefit fund; and

(b) qualifying insurance policies.

Assets held by a long-term employee benefit fund are assets (other than non-transferable financial instruments issued by the reporting entity) that:

(a) are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and

(b) are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:

(i) the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or

(ii) the assets are returned to the reporting entity to reimburse it for employee benefits already paid.

A qualifying insurance policy is an insurance policy* issued by an insurer that is not a related party (as defined in IAS 24 *Related Party Disclosures*) of the reporting entity, if the proceeds of the policy:

(a) can be used only to pay or fund employee benefits under a defined benefit plan; and

(b) are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:

(i) the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or

(ii) the proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.

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.

The *return on plan assets* is interest, dividends and other revenue derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less any costs of administering the plan (other than those included in the actuarial assumptions used to measure the defined benefit obligation) and less any tax payable by the plan itself.

Actuarial gains and losses comprise:

(a) experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and

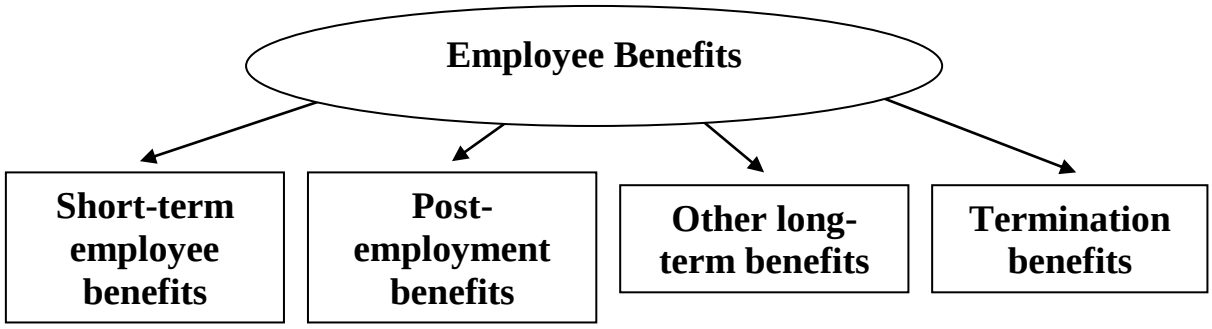
(b) the effects of changes in actuarial assumptions.

Past service cost is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (when benefits are introduced or changed so that the present value of the defined benefit obligation increases) or negative (when existing benefits are changed so that the present value of the defined benefit obligation decreases).

<u>IAS 19 classifies employee benefits into 4 main categories:</u>

- ***Short-term employee benefits*** = employee benefits (other than termination benefits) that are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service.

- ***Post-employment benefits*** = employee benefits (other than termination benefits and short-term employee benefits) that are payable after the completion of employment.
- ***Other long-term benefits*** = all employee benefits other than short-term employee benefits, post-employment benefits and termination benefits.
- ***Termination benefits*** = employee benefits provided in exchange for the termination of an employee's employment as a result of either:
  - (a) an entity's decision to terminate an employee's employment before the normal retirement date; or
  - (b) an employee's decision to accept an offer of benefits in exchange for the termination of employment.



- within 12 months - for current employees	- after the completion of employment - other than termination benefits	- other than any other category - for current employees	- result of terminating employment before retirement

Short-term employee benefits are employee benefits (other than termination benefits) that are due to be settled within twelve months after the end of the period in which the employees render the related service.

Short-term employee benefits include items such as:

(a) wages, salaries and social security contributions;

(b) short-term compensated absences (such as paid annual leave and paid sick leave) where the compensation for the absences is due to be settled within twelve months after the end of the period in which the employees render the related employee service;

(c) profit-sharing and bonuses payable within twelve months after the end of the period in which the employees render the related service; and

(d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Short-term employee benefits include all the following items (if payable within 12 months after the end of the reporting period):

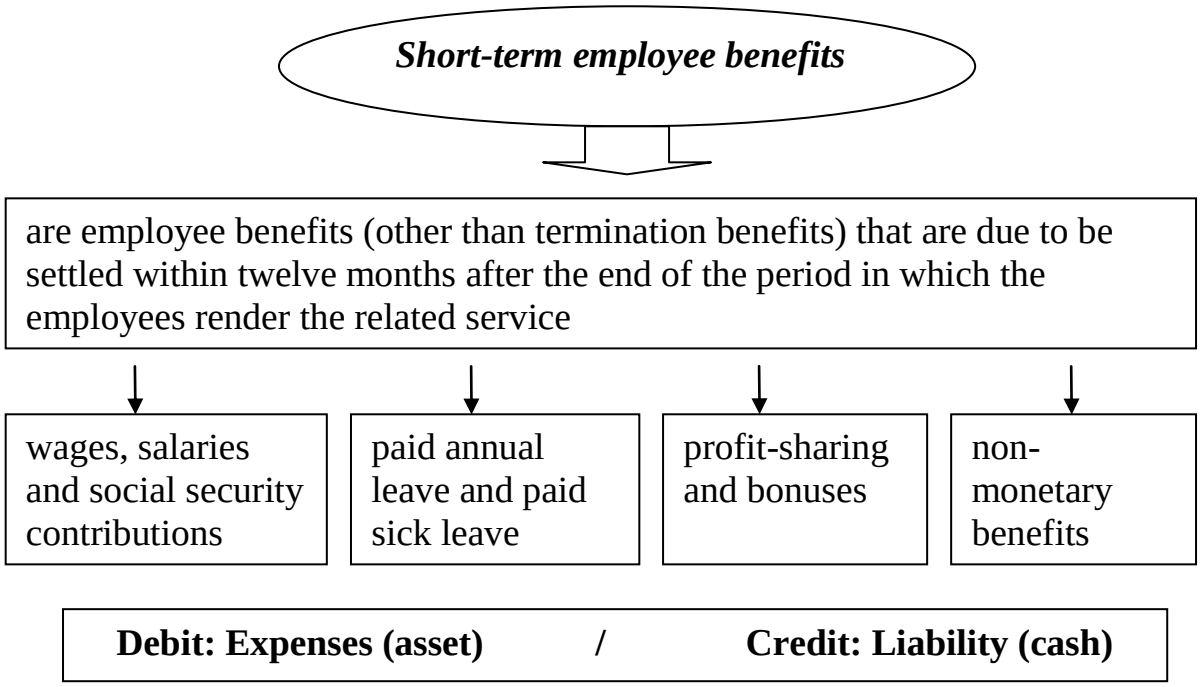
- wages, salaries and social security contributions;
- paid annual leave and paid sick leave;
- profit-sharing and bonuses; and
- non-monetary benefits (such as medical care, housing, cars and free or subsidized goods for current employees).

The entity shall recognize short-term employee benefits as ***an expense*** to profit or loss (unless another IFRS requires or permits the inclusion of the benefits in the cost of an asset).

The expense shall be recognized in the ***undiscounted amount of short-term employee benefits*** expected to be paid in exchange for employee's service rendered during an accounting period.

The accounting entry is as follows:

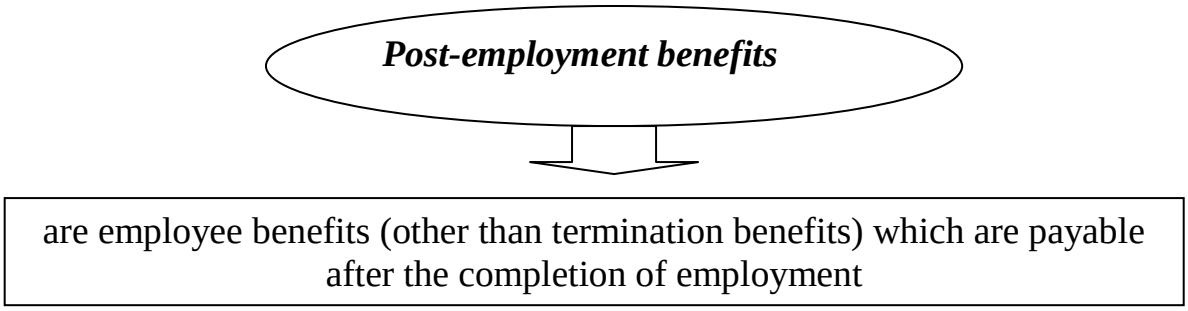
Debit: Expenses (asset) / Credit: Liability (cash)



Short-term paid absences: Expected cost of short-term paid absences shall be recognized when the employees render service that increases their entitlement to future paid absences (in the case of ***accumulating*** paid absences); or when the absences occur (in the case of ***non-accumulating*** paid absences).

Profit sharing and bonuses: An entity shall recognize the expected cost of profit-sharing and bonus payments when the entity has a ***present legal or constructive obligation*** to make such payments as a result of past events; and a ***reliable estimate*** of the obligation can be made. A present obligation exists when, and only when, the entity has no realistic alternative but to make the payments.

Post-employment benefits are employee benefits (other than termination benefits) which are payable after the completion of employment.



Post-Employment Benefits

Post-employment benefits include items such as various pensions, retirement benefits, post-employment life insurance and post-employment medical care.

Post-employment benefits include, for example:

(a) retirement benefits, such as pensions; and

(b) other post-employment benefits, such as post-employment life insurance and post-employment medical care.

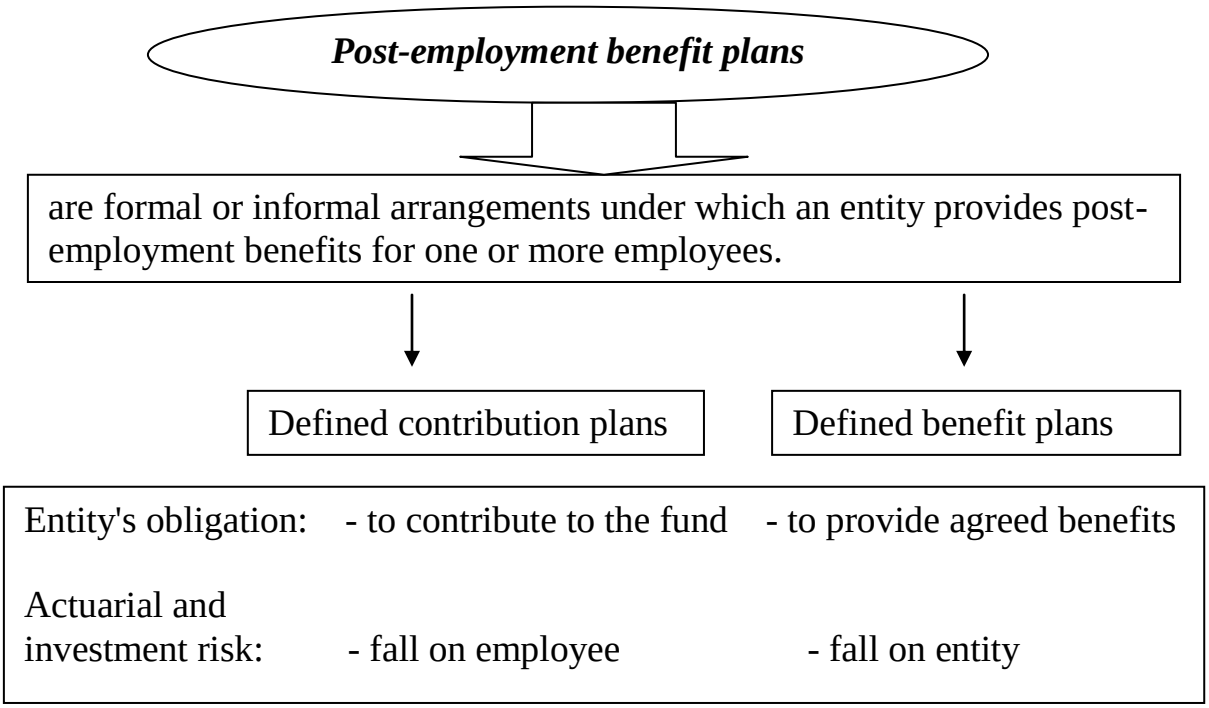
Post-employment benefit plans are formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.

There are 2 basic types of post-employment benefits:

- Defined contribution plans
- Defined benefit plans

It is absolutely crucial to know the difference between the two and to classify your post-employment benefit correctly, as the accounting treatment is

totally different for each of them.



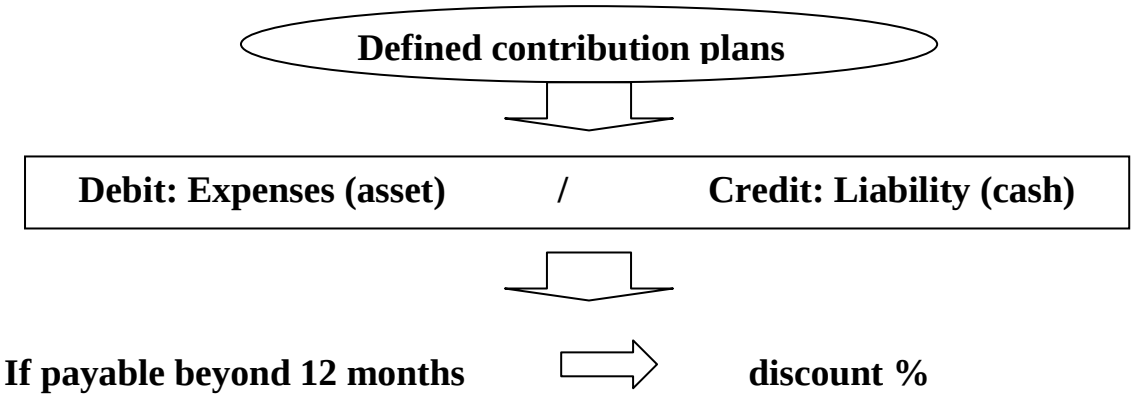
Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

The employer shall recognize contributions payable to a defined contribution plan ***as an expense*** to profit or loss (unless another IFRS requires or permits the inclusion of the benefits in the cost of an asset).

When the contributions are ***not expected to be settled wholly before twelve* months** after the end of the reporting period, they shall be discounted.

The accounting entry is as follows:

DEBIT: Expenses for employee benefits (profit or loss) / of another asset (statement of FP)	CREDIT: Liability or accrued expenses or cash if paid	or Cost



Defined benefit plans are post-employment benefit plans other than defined contribution plans.

Under defined benefit plan, the employer has the obligation to pay specified amount of benefits according to the plan to the employee and all investment and actuarial risk thus fall on the entity.

The employers shall perform the following steps in order to account for the defined benefit plan:

Step 1: Determine Deficit or Surplus

Deficit or surplus is a difference between the present value of defined benefit obligation and fair value of plan assets as at the end of the reporting period. In order to determine it, the entity must:

- Estimate the ***ultimate cost of a benefit***.
- The entity must use ***projected unit credit method*** to estimate how much the employees have earned for their work in the current and prior periods, to attribute the benefit to the periods of service and to incorporate estimates about demographic and financial variables ("actuarial assumptions") into calculations.
- ***Discount the benefit*** in order to determine the present value of the defined benefit obligation and the current service cost.
- ***Deduct the fair value of any plan assets*** from the present value of the defined benefit obligation.

Step 2: Determine amount in the statement of financial position

Although there is quite enough numbers involved in accounting for defined benefit plan, IAS 19 requires to present them as 1 single amount in the statement of

financial position – ***the net defined benefit liability (asset)***, which is basically deficit or surplus calculated in the step 1, but adjusted for the effect of asset ceiling.

Asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

Step 3: Determine amount in the profit or loss

The entity shall present the following amounts to profit or loss:

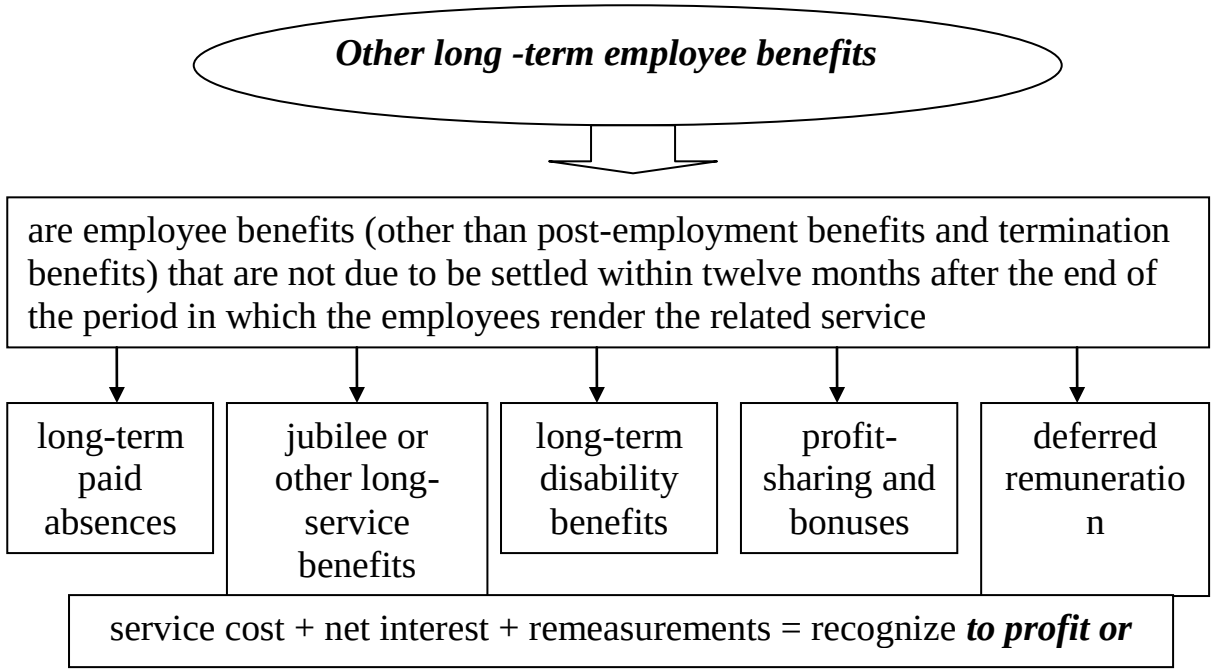
- ***Current service cost*** = the increase in the present value of the defined benefit obligation resulting from employee service in the current period;
- ***Any past service cost*** = the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment or a curtailment
- ***Any gain or loss on settlement***
- ***Net interest on the net defined benefit liability (asset)*** = the change in the net defined benefit liability (asset) during the period due to passage of time ("unwinding the discount")

Step 4: Determine remeasurements in other comprehensive income

The entity shall present the following remeasurements to other comprehensive income:

- ***Actuarial gains and losses*** = the changes in the present value of the defined benefit obligation resulting from experience adjustments or the effects of changes in actuarial assumptions
- Return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset)
- Any change in the effect of the asset ceiling.

Other long-term employee benefits are employee benefits (other than post-employment benefits and termination benefits) that are not due to be settled within twelve months after the end of the period in which the employees render the related service.



Other long-term employee benefits include, for example:

(a) long-term compensated absences such as long-service or sabbatical leave;

(b) jubilee or other long-service benefits;

(c) long-term disability benefits;

(d) profit-sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related service; and

(e) deferred compensation paid twelve months or more after the end of the period in which it is earned.

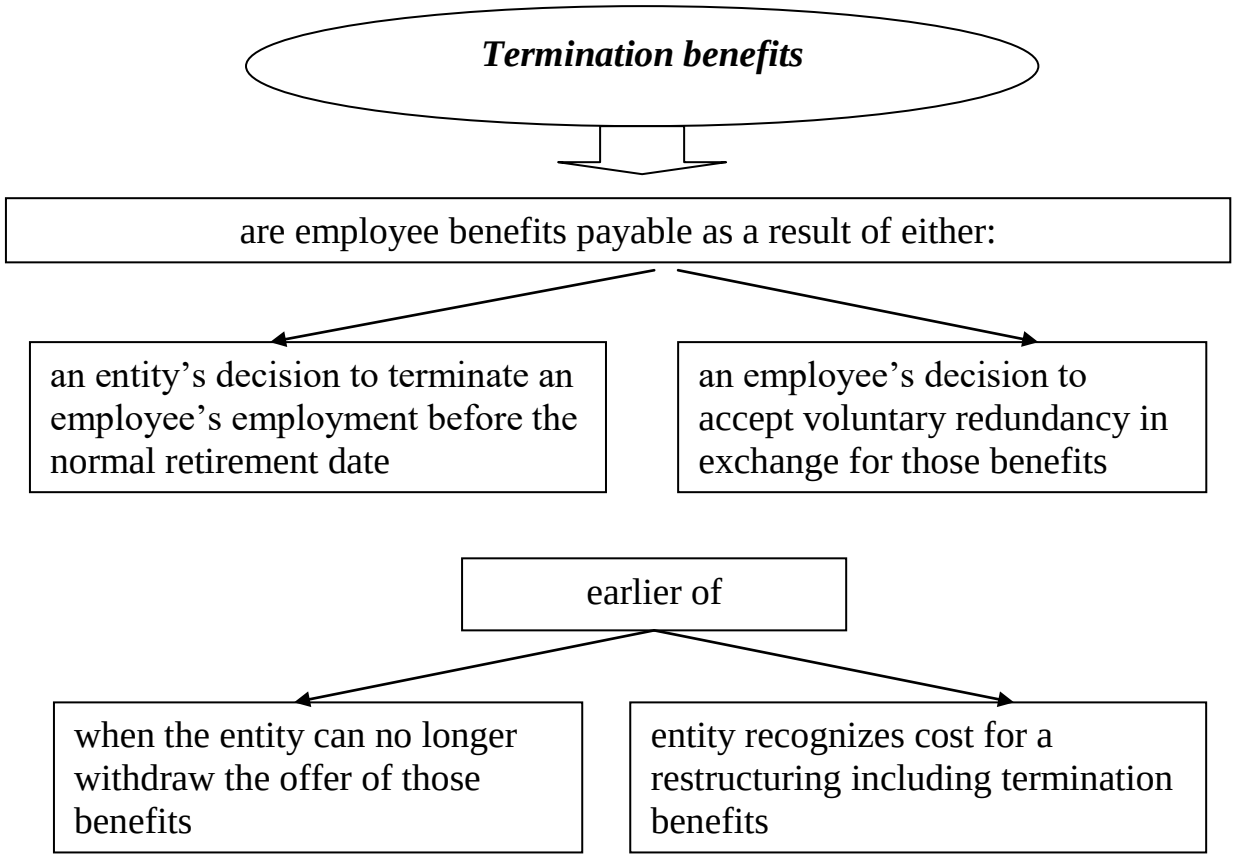
As other long-term benefits are not subject to so much uncertainty as defined benefit plans, the accounting treatment is a bit easier.

However, the entity should perform the same steps as I have described at defined benefit plans. The only difference is that all items such as service cost, net interest on the net defined benefit liability (asset) and remeasurements of the net defined benefit liability (asset) are presented ***in the profit or loss*** – so nothing goes to other comprehensive income.

Termination benefits are employee benefits payable as a result of either:

(a) an entity's decision to terminate an employee's employment before the normal retirement date; or

(b) an employee's decision to accept voluntary redundancy in exchange for those benefits.



Termination benefits

Termination benefits represent quite a different cup of tea than the previous 3 categories. Why? Because they are not provided in exchange for the service of the employee; instead, they are provided ***in exchange for the termination*** of employment.

However, be careful here, because the termination benefit sometimes includes the benefit for BOTH the termination of employment AND the service of employee at the same time.

For example, a company closes one of its production plants and offers the bonus of 1 000 USD to all employees who will be laid off. But because this company needs qualified people to perform the closure, it offers the bonus of 3 000 USD to each employee who stays with the company until the closure is completed.

In this small example, the bonus of 1 000 USD paid to all fired employees represents ***termination benefit*** and additional 2 000 USD paid to all employees

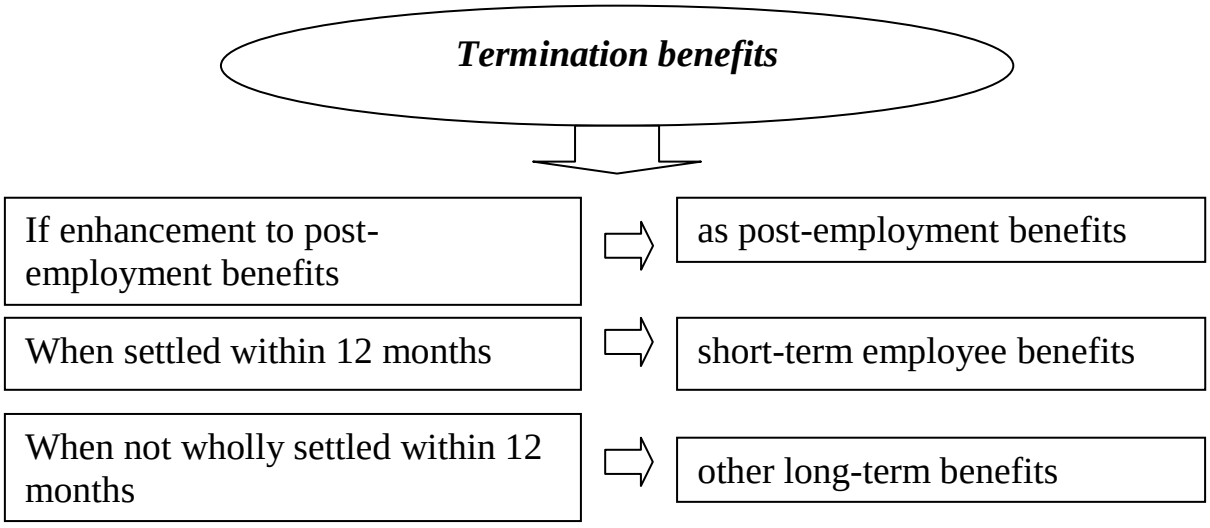
who stay until the closure is completed represents ***the benefit for the employee's service***, mostly classified as ***other long-term benefit in line with IAS 19***.

The primary question here is ***WHEN*** to recognize the liability and expense for termination benefits. It is at the earlier of:

- when the company can no longer withdraw the offer of those benefits (either the termination plan exists or employee accepts the offer of benefits) and
- when the company recognizes cost for a restructuring (IAS 37) and involves the payment of termination benefits.

The next question is ***HOW*** to recognize termination benefits. This depends on the specific terms of the benefits:

- if the termination benefits ***are expected*** to be settled wholly before 12 months after the end of the reporting period, then we should apply the requirements for ***short-term employee benefits*** (so recognize it as an expense to profit or loss on undiscounted basis)
- if the termination benefits ***are not expected*** to be settled wholly before 12 months after the end of the reporting period, then we should apply the requirements for ***other long-term employee benefits*** (so recognize it as an expense to profit or loss on undiscounted basis)



THEME 11. INCOME TAXES

11.1. Objective of IAS 12 and key definitions

11.2. Recognition and measurement of deferred taxes

11.3. Presentation

Key words: tax base, temporary differences, taxable temporary differences, deductible temporary differences, deferred tax liabilities, deferred tax assets

11.1. Objective of IAS 12 and key definitions

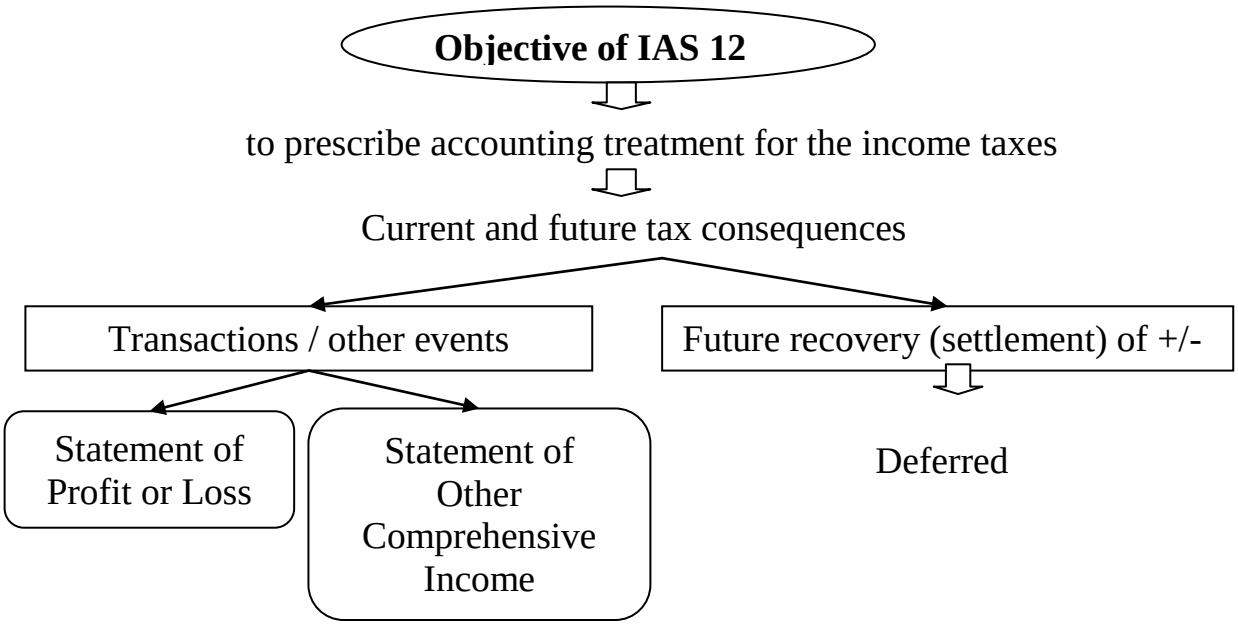
The objective of IAS 12 is to prescribe ***the accounting treatment for income taxes***. The main issue here is how to account for the ***current and future consequences*** of

- The ***future recovery (settlement) of the carrying amount of assets (liabilities)*** recognized in the entity's financial statements.

Here, if the future recovery or settlement will make future tax payments larger or smaller than they would be if such recovery or settlement were to have no tax consequences, then an entity must recognize ***deferred tax liability or asset***.

- ***Transactions and other events*** of the current period recognized in the entity's financial statements.

IAS 12 requires accounting for current and deferred income tax from certain transaction or event exactly ***in the same way*** as the transaction or event itself.



I. Accounting versus taxable profit

Accounting profit is profit or loss for a period before deducting tax expense. IAS 12 defines accounting profit as a ***before-tax*** figure (not after tax) in order to be consistent with the definition of a taxable profit.

Taxable profit (tax loss) is the profit (loss) for a period determined in accordance with the rules established by the taxation authorities upon which income taxes are payable (recoverable).

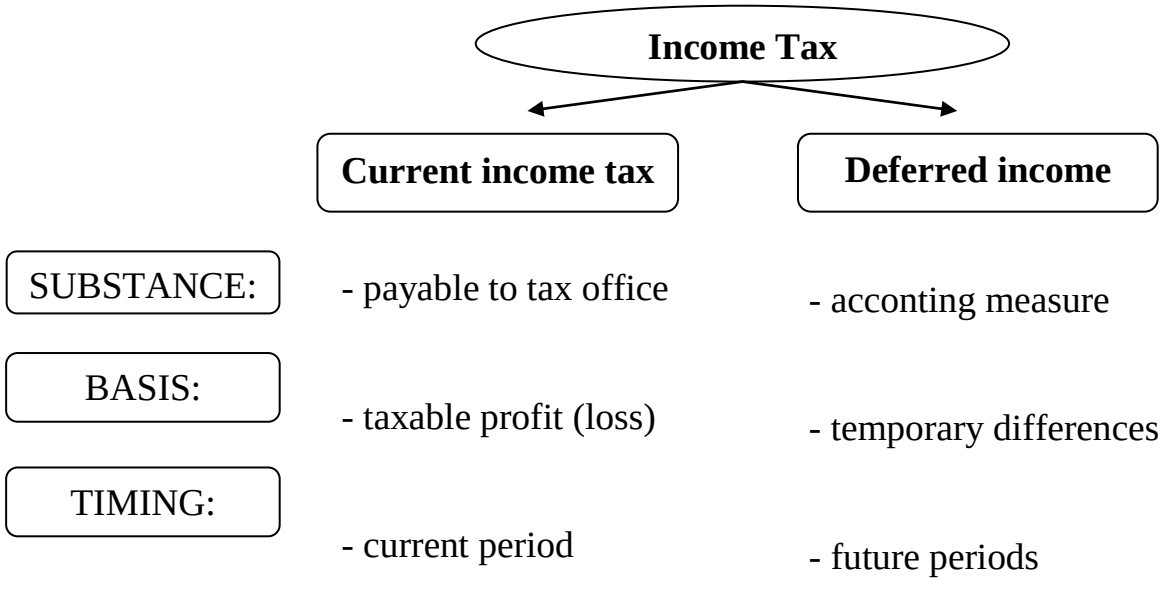
These 2 numbers can differ significantly because accounting and tax rules are not the same. A number of differences can pop out between accounting profit and taxable profit the following adjustments must be made to accounting profit:

- Add back the expenses recognized but non-deductible for tax purposes
- Add income not recognized but included under tax regulations
- Deduct expenses not recognized but deductible for tax purposes
- Deduct income recognized but not taxable under tax regulations.

II. Current tax versus deferred tax

Current income tax is the amount of income tax that should actually be paid to the tax office.

Deferred income tax is an accounting measure used to match the tax effect of transactions with their accounting impact and thereby produce less distorted results.



Current tax is the amount of income tax payable (recoverable) in respect of the taxable profit (loss) for a period.

11.2. Recognition and measurement of deferred taxes

Measurement of current tax liabilities (assets) is very straightforward. It is necessary to use the tax rates that have been enacted or substantively enacted by the end of the reporting period and apply these rates to the taxable profit (loss).

Current income tax	=	**Taxable profit (loss)**	X	**Tax rate**

Current income tax expense shall be ***recognized*** directly to profit or loss in most cases. However, if the current tax arises from a transaction or event recognized outside profit or loss, either in other comprehensive income or directly in equity, then current income tax shall be recognized in the same way.

Deferred income tax is the income tax payable (recoverable) in future periods in respect of the temporary differences, unused tax losses and unused tax credits.

Deferred tax liabilities result from ***taxable*** temporary differences and ***deferred tax assets*** result from ***deductible*** temporary differences, ***unused tax losses and unused tax credits***.

Deferred tax is calculated as the temporary difference multiplied by the applicable tax rate.

Deferred income tax	=	Temporary difference	X	Tax rate
		⇩		
		Carrying amount - Tax base		

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

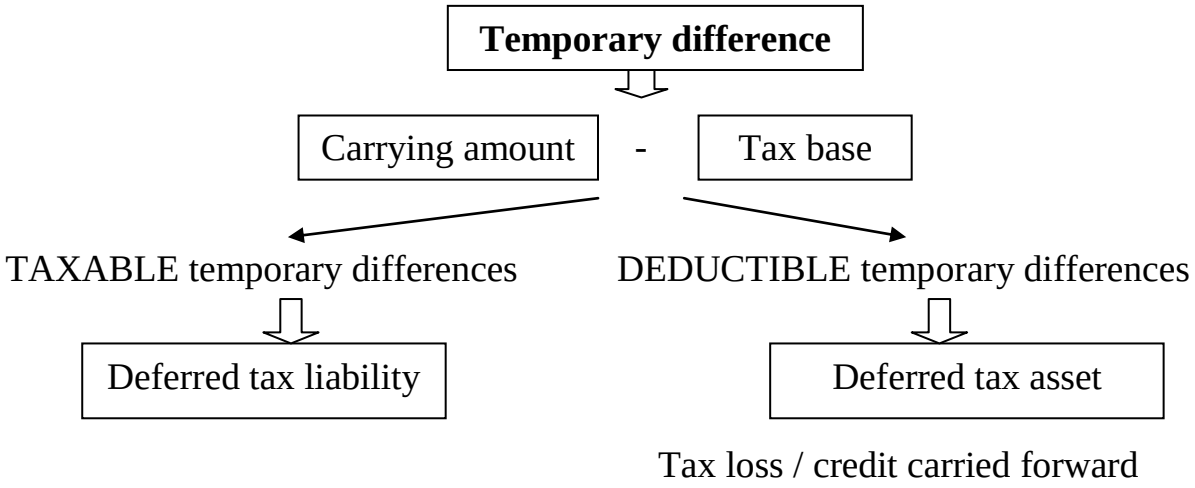
Tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset.

Tax base of a liability is its carrying amount, less any amount that will be deductible for tax purposes in respect of that liability in future periods.

Temporary differences are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base.

When the carrying amount of an asset or a liability is greater than its tax base, then there is a ***taxable temporary difference*** and it gives rise to ***deferred tax liability***.

In the opaque situation, when the carrying amount of an asset or a liability is lower than its tax base, then there is a ***deductible temporary difference*** and it gives rise to ***deferred tax asset***.



Deferred tax liability

The general principle in IAS 12 is that a deferred tax liability is recognised for all taxable temporary differences. There are three exceptions to the requirement to recognise a deferred tax liability, as follows:

- liabilities arising from initial recognition of goodwill
- liabilities arising from the initial recognition of an asset/liability other than in a business combination which, at the time of the transaction, does not affect either the accounting or the taxable profit and at the time of the transaction, does not give rise to equal taxable and deductible temporary differences
- liabilities arising from temporary differences associated with investments in subsidiaries, branches, and associates, and interests in joint

arrangements, but only to the extent that the entity is able to control the timing of the reversal of the differences and it is probable that the reversal will not occur in the foreseeable future.

The most common examples of taxable temporary differences giving rise to deferred tax liabilities are:

1. ***Timing differences***

Timing difference arises when the recognition of certain item in the financial statements occurs in a different time than its recognition in tax return, for example, interest received is taxed deductible only when cash is received.

2. ***Business combinations***

In a business combination identifiable assets and liabilities can be revalued ***upwards*** to fair value at the acquisition date, but no adjustment is made for tax purposes. As a result, taxable temporary difference arises.

3. ***Assets carried at fair value***

When a company applies policy of revaluation (for example, revaluation model for property, plant and equipment in line with IAS 16) and some assets are revalued ***upwards*** to their fair value, taxable temporary difference arises.

4. ***Initial recognition of an asset / liability***

When an asset or liability are initially recognized in the financial statements, part or all of it could be tax-non-deductible or not taxable. In this case, deferred tax liability is recognized based on the specific situation.

Deferred tax asset

A **deferred tax asset** shall be recognized for all deductible temporary differences ***to the extent that it is probable that taxable profit will be available*** against which the deductible temporary difference can be utilized.

No deferred tax asset shall be recognized from initial recognition of asset or liability in a transaction that is not a business combination and at the time of the transaction it affects neither accounting nor taxable profit (loss).

The most common examples of deductible temporary differences giving rise to deferred tax assets are:

1. ***Timing differences***

Timing difference arises when the recognition of certain item in the financial statements occurs in a different time than its recognition in tax return, for example, accrued expenses are tax deductible only when paid.

2. ***Business combinations***

In a business combination identifiable assets and liabilities can be revalued ***downwards*** to fair value at the acquisition date, but no adjustment is made for tax purposes. As a result, deductible temporary difference arises.

3. ***Assets carried at fair value***

When a company applies policy of revaluation (for example, revaluation model for property, plant and equipment in line with IAS 16) and some assets are revalued ***downwards*** to their fair value, deductible temporary difference arises.

4. ***Initial recognition of an asset / liability***

When an asset or liability are initially recognized in the financial statements, part or all of it could be tax-non-deductible or not taxable. In this case, deferred tax asset is recognized based on the specific situation.

Measurement of deferred tax

In measuring deferred tax assets / liabilities, ***the tax rates*** that are expected to apply to the period in which the asset is realized or the liability is settled must be applied. However, these expected rates need to be based on tax rates or tax laws that have been enacted or substantively enacted by the end of the reporting period.

The measurement of deferred tax should reflect the tax consequences that would follow from the ***manner of expected recovery or settlement***.

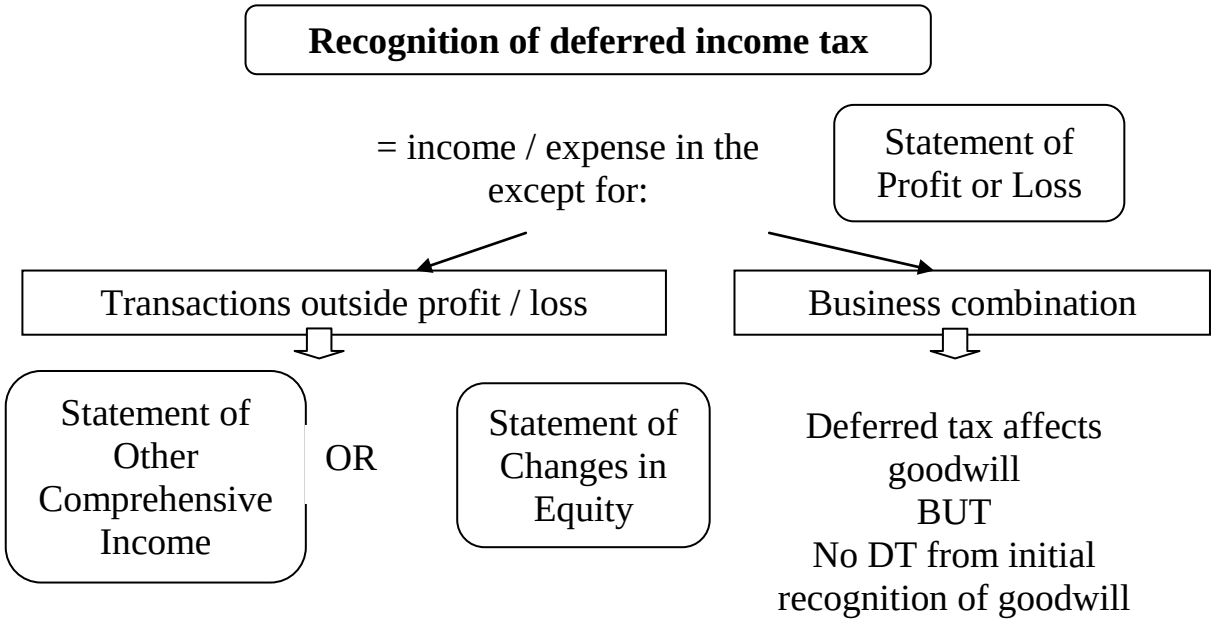
How to recognize deferred taxes

In almost all situations deferred tax is recognized as an income or an expense in ***profit or loss*** for the period.

There are just 2 exceptions of this rule:

- if a deferred tax arose from a transaction or even recognized outside profit or loss, then the deferred tax must be recognized in the same way (in other comprehensive income or directly in equity)

- if a deferred tax arose in a business combination, deferred tax affects goodwill or bargain purchase gain.



11.3. Presentation

The principal issue in **presenting income taxes** is ***offsetting***.

Offsetting the current income tax

Current tax assets and current tax liabilities can only **be offset** in the statement of financial position if

- the entity has the legal right

- the intention to settle on a net basis.

Deferred tax assets and deferred tax liabilities can only be offset in the statement of financial position if the entity has the legal right to settle current tax amounts on a net basis and the deferred tax amounts are levied by the same taxing authority on the same entity or different entities that intend to realise the asset and settle the liability at the same time.

The amount of tax expense (or income) related to profit or loss is required to be presented in the statement(s) of profit or loss and other comprehensive income.

SUGGESTED READING

International Financial Reporting Standards (IFRS)

№	Name	Issued
IFRS 1	First-time Adoption of International Financial Standards	2008*
IFRS 2	Share-based Payment	2004
IFRS 3	Business Combinations	2008*
IFRS 4	Insurance Contracts	2004
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations	2004
IFRS 6	Exploration for and Evaluation of Mineral Assets	2004
IFRS 7	Financial Instruments: Disclosures	2005
IFRS 8	Operating Segments	2006
IFRS 9	Financial Instruments	2013*
IFRS 10	Consolidated Financial Statements	2011
IFRS 11	Joint Arrangements	2011
IFRS 12	Disclosure of Interests in Other Entities	2011
IFRS 13	Fair Value Measurement	2011
IFRS 14	Regulatory Deferral Accounts	2014
IFRS 15	Revenue from Contracts with Customers	2014
IFRS 16	Leases	2016
IFRS 17	Insurance Contracts	2017

International Accounting Standards (IASs)

№	Name	Issued
IAS 1	Presentation of Financial Statements	2007*
IAS 2	Inventories	2005*
IAS 7	Statement of Cash Flows	1992
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors	2003
IAS 10	Events After the Reporting Period	2003
IAS 12	Income Taxes	1996*
IAS 16	Property, Plant and Equipment	2003*
IAS 19	Employee Benefits (2011)	2011*
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance	1983
IAS 21	The Effects of Changes in Foreign Exchange Rates	2003*
IAS 23	Borrowing Costs	2007*
IAS 24	Related Party Disclosures	2009*
IAS 26	Accounting and Reporting by Retirement Benefit Plans	1987
IAS 27	Separate Financial Statements (2011)	2011

IAS 28	Investments in Associates and Joint Ventures (2011)	2011
IAS 29	Financial Reporting in Hyperinflationary Economies	1989
IAS 32	Financial Instruments: Presentation	2003*
IAS 33	Earnings Per Share	2003*
IAS 34	Interim Financial Reporting	1998
IAS 36	Impairment of Assets	2004*
IAS 37	Provisions, Contingent Liabilities and Contingent Assets	1998
IAS 38	Intangible Assets	2004*
IAS 40	Investment Property	2003*
IAS 41	Agriculture	2001

IFRIC Interpretations

№	Name	Issued
IFRIC 1	Changes in Existing Decommissioning, Restoration and Similar Liabilities	2004
IFRIC 2	Members' Shares in Co-operative Entities and Similar Instruments	2004
IFRIC 4	Determining Whether an Arrangement Contains a Lease	2004
IFRIC 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds	2004
IFRIC 6	Liabilities Arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment	2005
IFRIC 7	Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies	2005
IFRIC 9	Reassessment of Embedded Derivatives	2006
IFRIC 10	Interim Financial Reporting and Impairment	2006
IFRIC 12	Service Concession Arrangements	2006
IFRIC 14	IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction	2007
IFRIC 16	Hedges of a Net Investment in a Foreign Operation	2008
IFRIC 17	Distributions of Non-cash Assets to Owners	2008
IFRIC 18	Transfers of Assets from Customers	2009
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments	2009
IFRIC 20	Stripping Costs in the Production Phase of a Surface Mine	2011
IFRIC 21	Levies	2013
IFRIC 22	Foreign Currency Transactions and Advance Consideration	2016
IFRIC 23	Uncertainty over Income Tax Treatments	2017

SIC Interpretations

№	Name	Issued
SIC-7	Introduction of the Euro	1998
SIC-10	Government Assistance – No Specific Relation to Operating Activities	1998
SIC-15	Operating Leases – Incentives	1999
SIC-25	Income Taxes – Changes in the Tax Status of an Enterprise or its Shareholders	2000
SIC-27	Evaluating the Substance of Transactions in the Legal Form of a Lease	2000
SIC-29	Disclosure – Service Concession Arrangements	2001
SIC-32	Intangible Assets – Web Site Costs	2001

The IFRS® Foundation [Electronic resource]. – Mode of access: http://www.ifrs.org

The #1 website for global accounting news [Electronic resource]. – Mode of access: https://www.iasplus.com/en

Навчальне видання

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