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MODULE 1. GENERAL PRINCIPLES OF ACCOUNTING ACCORDING TO IFRS

THEME 1. THE DEVELOPMENT AND IMPLEMENTATION OF IFRS

1. Read the article and discuss

WHAT IS IFRS? WHAT IS THE IMPORTANCE OF IFRS TODAY?

The most used language in communication today is English. When using this language, people can easily access many different types of knowledge, and easily exchange between people from different countries. For finance, IFRS is the common language used by businesses, financiers and accountants in one country to read and understand the financial statements of other countries when "exchanging" with each other.

IFRS known as International Financial Reporting Standards including accounting standards issued by **International Accounting Standards Council** (International Accounting Standards Board - IASB) with the goal of setting general rules for possible financial reporting **unified**, **transparent** , and **comparable** all around the world. Creating a global accounting language makes financial statements no longer distinguishable between countries and territories, becoming transparent, unified, reliable for analysis and reference.

IFRS defines how companies maintain and report their accounts, identifying other types of transactions and events that have a financial impact. The International Financial Reporting Standards (IFRS) were established to create a common accounting language, so that businesses and their financial statements can be consistent and reliable from company to company. another, country to country.

International Accounting Standards Board (IASB)

The International Accounting Standards Board (IASB) consists of a group of independent experts from many fields such as experts with experience in the field of accounting standards development, audit experts, accounting training specialists and experts in the preparation and practice of financial statements. In addition, according to the provisions of the IFRS Foundation Constitution, experts must also come from different geographical regions.

Committee members are responsible for developing and publishing IFRS Standards including the IFRS Standards for Small and Medium Enterprises. The Committee is also responsible for approving the IFRS Guidelines developed by the International Financial Reporting Standards Interpretation Committee (IFRIC). The members of the Committee are appointed by the Trustees of the Foundation through open and rigorous recruitment programs.

Why is there a transition from IAS to IFRS?

There used to be International Accounting Standards (IAS) but why is there a transition to IFRS. There are three possible explanations for this:

The original price principle is no longer relevant in the current context

IAS is mainly based on the original price principle. Meanwhile, IFRS leans towards the principle of fair value.

Currently, financial instruments, especially derivatives, information technology change every second, and investment in value-added fields, etc. is increasing day by day. This leads to the difference between the original price and the actual value of assets and liabilities. Therefore, the original price principle is no longer relevant in the current context and economy.

Although the IAS also has fair value principles in some standards. But, these are considered to be not enough, do not solve many problems, difficult to think and synchronize.

Therefore, International Financial Reporting Standards (IFRS) were born as a necessity to help accurately represent the fair value of assets and liabilities.

Inadequacies in conversion between accounting standards of each country and IAS

Previously, despite having IAS, countries had their own accounting standards that needed to be followed. This creates a significant inadequacy for companies operating in many countries. Even the case of a company incorporated in one country but listed on a stock exchange in another country is an impediment to the evaluation of the information presented and the consolidation of the reports.

Therefore, moving to a common standard like IFRS is absolutely necessary to save society's resources and help increase information transparency.

IFRS is an attempt to change from harmony to convergence

In the past, people working in the Accounting - Auditing - Finance - Tax industry will often talk about how to make accounting standards of one country can be harmonized with other countries. This means that standards are much different and we are moving towards reconciliation.

Meanwhile, IFRS was born as an effort to help countries' accounting standards get closer to each other. And in the future, accounting standards may meet, converging at a point.

In a nutshell, IFRS is understood as accounting standards in the preparation of financial statements that are commonly used by many countries around the world to remove barriers to differences in previous accounting standards, supporting transparency. , reliable for businesses. And IFRS has a great importance in the integration period like today.

2. Read the article and discuss

IFRS HISTORY: THE PROCESS OF FORMATION, RECOGNITION AND DEVELOPMENT

The history of IFRS stems from the need to create a common accounting language after the post-World War II economic boom and the rise of multinational corporations.

History of the formation of IFRS through each period

With the explosion of the global economy after World War II and the growth of multinational corporations, there was a need for a universal accounting

language. This led to the creation of the International Accounting Standards Committee (IASC), a consortium of nine original member countries including Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, and the United Kingdom. Great Britain/Northern Ireland and the United States.

IASC is the recognition of the International Organization of Securities Commissions (IOSCO) in 2000 when it made recommendations to member stock exchanges to allow or require listed companies to comply with 10 Standards. Basic International Accounting (IAS) at the time. This led to IAS becoming one of the mandatory requirements for listing on the world's major stock exchanges.

In 1997, the IASC realized that in order to continue to perform its role effectively, it had to find ways to bring about the merging of national accounting standards and practices with global accounting standards. As a result, on April 01, 04, the new International Accounting Standards Board (IASB) was born to replace the old IASC. In its first meeting, the IASB adopted the old International Accounting Standards (IAS) issued by the IASC and the Guidelines from the Accounting Standards Interpretation Committee (SIC). The IASB has since continued to develop new Standards and named them International Financial Reporting Standards (IFRS).

Following the recognition by IOSCO in 2000, another important step in the history of IFRS was the mandatory adoption of IFRS in Europe by Directive EC 1606, all members of the European Union and other member states. Members of the European Economic Area (EEA) are required to apply IFRS on the financial statements of listed companies beginning with the accounting period ended December 31, 12.

Currently, IFRS has grown worldwide and according to the data published by the IASB, there are now 131/143 countries and territories (accounting for 93% of the countries surveyed by the IASB) have declared about this allowing the application of IFRS in different forms. In many countries, IFRS has replaced all National Accounting Standards to facilitate the attraction of global investors.

How is IFRS different from IAS?

Many readers at first learning about IFRS are also confused with the concept of IAS (International Accounting Standards) and do not understand what it is related to IFRS. As described in the History of IFRS, the IAS is a System of Standards previously issued by the IASC. After the IASC changed its operating structure and was replaced by the IASB, the Standards developed by the IASB were later named IFRS (International Financial Reporting Standards).

However, the old IAS Standards issued by the IASC are all received and published by the IASB until it is changed by later IFRSs (eg IAS 18 is superseded by IFRS 15.), in addition to the new IFRS Standards there will still be valid old IASs.

Broadly understood, IFRS will include:

- The Conceptual Framework includes the most basic principles for Financial Reporting to be compliant with IFRS. The framework itself is not a stand-alone Standard but it is used as the basis for the development of Standards.
- International Accounting Standards (IAS) previously issued by IASC

(before 2001) are still valid.

- International Financial Reporting Standards (IFRS) are issued by the IASB.
- Additional Guidelines for IAS Standards (SIC Interpretation) were issued by the Standards Interpretation Committee (SIC) prior to 2001.
- Additional Guidelines for IFRS Standards (IFRIC Interpretation) are issued by the IFRS Standards Interpretation Committee (IFRIC).

In a nutshell, IFRS is understood as accounting standards in the preparation of financial statements that are commonly used by many countries around the world to remove barriers to differences in previous accounting standards, supporting transparency, reliable for businesses. The birth of IFRS has an important role in building a common "language" of financial statements and is of great significance in the current integration period.

3. Read the article and discuss

HISTORY AND DEVELOPMENT OF IFRS

The history and development of International financial Reporting standards (IFRS) is a fascinating journey that has reshaped the global accounting landscape. The story begins with the need for consistent, transparent, and comparable financial reporting across international borders. Let's delve into the intricacies of this journey, exploring various viewpoints, key milestones, and comparing options to understand how IFRS evolved into the global standard it is today.

1. The Birth of IFRS

IFRS had its origins in the early 1970s when the International Accounting Standards Committee (IASC) was formed. The IASC's initial mission was to develop a set of accounting standards that could be used globally, addressing the challenges of multinational companies operating in different regulatory environments.

Example: In 1973, the IASC issued its first International Accounting Standard (IAS 1), which focused on presentation of financial statements, marking the beginning of global accounting convergence.

2. Evolution and Global Adoption

Over the years, IFRS went through a series of revisions and updates. The IASB (International Accounting Standards Board) replaced the IASC in 2001 and took charge of developing and maintaining IFRS. Since then, the adoption of IFRS has been steadily increasing worldwide, especially in Europe, Asia, and other parts of the globe.

Example: The European Union adopted IFRS for listed companies in 2005, which harmonized financial reporting practices across its member states.

3. Advantages of IFRS

One of the key viewpoints supporting IFRS adoption is the promise of increased transparency and comparability of financial statements. IFRS focuses on principles rather than rigid rules, allowing companies more flexibility while maintaining accuracy and reliability.

Example: IFRS 15, the revenue recognition standard, provides a principles-based approach, allowing companies to recognize revenue when control of goods or services is transferred to customers.

4. Challenges and Criticisms

Critics argue that IFRS isn't without its flaws. They highlight concerns about complexity, lack of enforcement, and the potential for earnings management. Additionally, some believe that IFRS may not be suitable for all types of businesses.

Example: During the financial crisis of 2008, the fair value measurement principles under IFRS were criticized for contributing to market volatility.

5. Harmonization vs. National Standards

A significant debate revolves around whether global harmonization through IFRS is better than individual countries retaining their national accounting standards. Supporters argue that harmonization reduces reporting costs for multinational corporations and fosters international investment.

Example: Japan's decision to adopt IFRS in 2012 was seen as a move to attract more foreign investment and simplify reporting for Japanese companies.

6. Convergence vs. Endorsement

Some countries have chosen to converge their national standards with IFRS, while others have opted for endorsement. Convergence involves modifying national standards to align with IFRS, whereas endorsement means fully adopting IFRS without modification.

Example: Australia has chosen the endorsement approach, fully adopting IFRS as its national standard, which simplifies reporting for Australian companies with international operations.

The history and development of IFRS reflect the ongoing efforts to create a globally consistent accounting framework. It has come a long way since its inception and continues to evolve. Whether IFRS is the best option depends on the specific circumstances of each country or company. The global accounting community will continue to grapple with the nuances and complexities of financial reporting standards as the world's economic landscape evolves.

4. Read the article and discuss

BRIEF IFRS GLOSSARY

International Financial Reporting Standards are usually presented in a certain structure. Most of IFRS is clearly subdivided into several chapters that carry their titles, for example: Recognition, Measurement, Derecognition etc. This article defines the main terms as used in IFRS and shows example of their application.

Recognition

Recognition is recording a business transaction in an entity’s accounting records, including asset, liability, equity component, revenue or expense.

For example, when a company spends cash to buy a property, then it must record the transaction as Debit Property, Credit Cash. It means that the

company RECOGNIZES property in its financial statements.

When IFRS talks about recognition, it usually states rules WHEN the element or transaction should be recognized or recorded. In other words, IFRS prescribes WHAT CONDITIONS must be fulfilled to recognize the transaction or item.

Derecognition

Derecognition ***is the opposite of recognition***. It is the removal of a previously recognized asset, liability or equity (sometimes revenue and expense) from an entity's financial statements.

For example, a company sells a property. Then, the sale must be recognized as Debit Cash, Credit Property (plus minus some gain or loss). It means that the company DERECOGNIZED the property from its financial statements.

When there is a heading "Derecognition" in IFRS, the rules will state WHEN the element or transaction should be removed from the financial statements—or WHAT CONDITIONS must be fulfilled to derecognize the transaction or item.

Measurement

In IFRS, ***measurement*** means the financial amount attributed to asset, liability, equity, revenue or expense. IFRSs distinguish initial and subsequent measurement.

Initial Measurement

Initial Measurement is an AMOUNT in which asset, liability or equity shall be recorded in the financial statements AT ITS INITIAL RECOGNITION—or when it is recorded for the first time.

For example, a company that buys property must recognize the property in certain amount. IFRS prescribes rules HOW this amount shall be determined initially.

Subsequent Measurement

Subsequent Measurement is an AMOUNT in which asset, liability or equity shall be recorded in the financial statements AFTER ITS INITIAL RECOGNITION —or in the 2^{nd}, 3^{rd}, 4^{th} year of its recognizing in the financial statements.

Many assets or liabilities change their value with time due to various reasons – wear off, loss of credibility, amortization, etc. So the company owning and actually using the property has to assess the value of this property each year and determine the new, actual value.

It can be done by depreciation, amortization, determining of fair value—by many ways and IFRS usually prescribes the exact way of setting the subsequent measurement for individual types of assets or liabilities. Along with setting HOW the asset or liability shall be subsequently measured, IFRS sets HOW the change (difference between new value and previous year's value = gain or loss) shall be accounted for.

Disclosures

A ***disclosure*** is additional information attached to an entity's financial statements, usually as detailed breakdown of the numbers included in the financial

statements, description of various significant events, estimates, judgements and other items that influenced the company's results, etc.

For example, a company buying property would have to disclose in its notes to the financial statements the following items: method of depreciation, useful life, significant purchases, etc.

Each IFRS prescribes specific information that is required for certain items in the section Disclosures. Some IFRS standards talk purely about disclosures, for example standard IFRS 7 deals solely with disclosures related to financial instruments.

Presentation

A ***presentation*** is often confused with disclosure. However, there is a big difference: disclosure is additional information and presentation is a method of showing the information or numbers.

For example, a company buying property would present this property in a required way—as long term, probably separately showing the cost and accumulated depreciation.

5. Complete the following sentences

5.1. Here are some of the highlights from this major topic:

1. Debit means _____.
2. Credit means _____.
3. Every transaction affects two _____ or more.
4. At least one account will be _____ and at least one account will be _____.
5. The total of the amount(s) entered as debits must _____ the total of the amount(s) entered as credits.
6. When cash is received, _____ Cash.
7. When cash is paid out, _____ Cash.
8. To increase an asset, _____ the asset account.
9. To increase a liability, _____ the liability account.
10. To increase owner's equity, _____ an owner's equity account.
11. To increase revenues, _____ the revenues account.
12. To increase expenses, _____ the expense account.

5.2. Some general rules about debiting and crediting the accounts are:

1. Expense accounts are _____ and have _____ balances.
2. Revenue accounts are _____ and have _____ balances.
3. Asset accounts normally have _____ balances.
4. To increase an asset account, _____ the account.
5. To decrease an asset account, _____ the account.
6. Liability accounts normally have _____ balances.
7. To increase a liability account, _____ the account.
8. To decrease a liability account, _____ the account.

5.3. Bookkeeping

1. Liability accounts are decreased with a _____.

2. A credit will increase the balance in a _____ account.

3. Credits are entered on the _____ side of a T-account.

4. The accounting equation remains in balance due to _____-entry bookkeeping.

5. Debits are entered on the _____ side of a T-account.

6. Asset account balances are reduced by a _____ entry.

7. The accounting _____ should always be in balance.

8. The book of original entry. _____

9. Revenues cause an increase in owner's _____.

10. These cause owner's equity to decrease. _____

11. The amount entered on the right side of a T-account. _____

12. _____ are income statement accounts with debit balances.

13. Accounts _____ is a balance sheet account with a debit balance.

14. _____ Depreciation is a balance sheet account with a credit balance.

15. The Retained Earnings account will be reduced with a _____ entry.

16. _____ are income statement accounts with credit balances.

17. A sole proprietor's _____ account will have a debit balance.

18. Accounts _____ is a balance sheet account with a credit balance.

19. A _____ balance is an internal report to show that the general ledger's debit balances add up to the same total as the credit balances.

20. The requirement that each journal entry needs to have at least one debit and one credit is known as _____-entry bookkeeping.

21. These are entered on the left side of an account. _____

22. These are entered on the right side of an account. _____

23. These accounts will normally have a credit balance. _____

24. These accounts will normally have debit balances. _____

25. Sales are an example of retailers' operating _____.

26. Accounts are contained in the general _____.

27. Entries for depreciation are first written in the general _____.

28. The credit amount in the depreciation entry is recorded in _____.

29. Under _____-entry bookkeeping a transaction affects a minimum of two accounts.

30. The accounting or bookkeeping _____ is Assets = Liabilities + Stockholders' Equity.

31. Bona fide invoices from suppliers that are to be paid in 30 days are reported in Accounts _____.

32. These will reduce stockholders' equity. _____

33. The type of account that is affected by the accrual of an expense. _____

34. Another term for supplier. _____

35. One to whom money is owed. _____

36. Prepaid Insurance is _____ account.

37. Revenues minus expenses equals _____ _ _____.

38. Resources owned by a company (such as cash, accounts receivable, vehicles) are reported on the balance sheet and are referred to as _____

39. Obligations (amounts owed) are reported on the balance sheet and are referred to as_____.

40. Liabilities often have the word _____ _____ in their account title.

41. The listing of all of the accounts available for use in a company's accounting system is known as the _____ ___ _____.

42. Assets minus liabilities equals _____ _____.

43. Large corporations must follow the _____ basis of accounting.

44. Corporations whose stock is publicly traded must have their financial statements_____ by independent certified public accountants.

45. _____ entry bookkeeping will result in at least two accounts being involved in every transaction.

46. Every transaction will have one account being credited and one account being_____.

47. The accounting equation is Assets = _____ + Stockholders' (or Owner's) Equity.

48. Matching, cost, and full disclosure are examples of the fundamental or basic accounting__ _____.

49. The profitability of a company for a specified period of time is reported on the_____ statement.

50. The main components or elements of the income statement are _____, expenses, gains, and losses.

51. Prepaid insurance is reported as an _____ on a company's balance sheet.

52. The word «_____» is often in the title of liability accounts.

6. Choose the correct answer in the table below

1	Which term is associated with «left» or «left-side»?	Debit	Credit
2	Which term is associated with «right» or «right-side»?	Debit	Credit
3	When cash is received, the account Cash will be	Debited	Credited
4	When a company pays a bill, the account Cash will be	Debited	Credited
5	What will usually cause an asset account to increase?	Debit	Credit
6	What will usually cause the liability account Accounts Payable to increase?	Debit	Credit
7	Entries to expenses such as Rent Expense are usually	Debits	Credits
8	Entries to revenues accounts such as Service Revenues are usually	Debits	Credits

7. Use «Debit» or «Credit» to complete the table below

Account Classification	Normal Balance
Assets	
Contra asset	
Liability	
Contra liability	
Owner's Equity	
Stockholders' Equity	
Owner's Drawing or Dividends Account	
Revenues (or Income)	
Expenses	
Gains	
Losses	

8. Fill in the gaps with a suitable word from the box

Accounts Receivable, Cash, Cash, Cash, Cash, Notes Payable, Notes Payable, Supplies, Supplies, Accounts Payable, Rent Expense, Service Revenues

When a company borrows $1,000 from a bank, the transaction will affect the company's _____account and the company's _____ account.

When the company repays the bank loan, the _____ account and the _____ account are also involved.

If a company buys supplies for cash, its _____ account and its _____account will be affected. If the company buys supplies on credit, the accounts involved are _____ and _____.

If a company pays the rent for the current month, _____ and _____ are the two accounts involved. If a company provides a service and gives the client 30 days in which to pay, the company's _____ account and are _____affected.

9. Use «Debit» or «Credit» to complete the table below

Account Title	To Increase
Asset Accounts	
Cash	
Accounts Receivable	
Merchandise Inventory	
Supplies	
Prepaid Insurance	
Land	
Buildings	
Accumulated Depreciation - Buildings	
Equipment	
Accumulated Depreciation - Equipment	

Liability Accounts	
Notes Payable	
Accounts Payable	
Wages Payable	
Interest Payable	
Unearned Revenues	
Mortgage Loan Payable	
Owner's Equity Accounts	
Mary Smith, Capital	
Mary Smith, Drawing	
Operating Revenue Accounts	
Service Revenues	
Operating Expense Accounts	
Salaries Expense	
Wages Expense	
Supplies Expense	
Rent Expense	
Utilities Expense	
Telephone Expense	
Advertising Expense	
Depreciation Expense	
Non-Operating Revenues and Expenses, Gains, and Losses	
Interest Revenues	
Gain on Sale of Assets	
Loss on Sale of Assets	

10. Match these words with their meanings

Contra-accounts, Equity accounts, Expense accounts, Asset accounts, Liability accounts, Revenue accounts or income

Types of accounts

	represent the different types of economic resources owned or controlled by business, common examples of these accounts are cash, cash in bank, building, inventory, prepaid rent, goodwill, accounts receivable
	represent the different types of economic obligations by a business, such as accounts payable, bank loan, bonds payable, accrued interest
	represent the residual equity of a business (after deducting from Assets all the liabilities) including Retained Earnings and Appropriations
	represent the company's gross earnings and common examples include Sales, Service revenue and Interest Income
	represent the company's expenditures to enable itself to operate. Common examples are electricity and water, rentals, depreciation, doubtful accounts, interest, insurance.
	Some balance sheet items have corresponding contra accounts, with negative balances, that offset them. Examples are accumulated depreciation against equipment, and allowance for bad debts against long-term notes receivable.

11. For each of the transactions in items 1 through 12, indicate the two (or more) effects on the accounting equation of the business or company

1.	The owner invests personal cash in the business.			
	Assets:	Increase	Decrease	No Effect
	Liabilities:	Increase	Decrease	No Effect
	Owner's (or Stockholders') Equity:	Increase	Decrease	No Effect
2.	The owner withdraws business assets for personal use.			
	Assets:	Increase	Decrease	No Effect
	Liabilities:	Increase	Decrease	No Effect
	Owner's (or Stockholders') Equity:	Increase	Decrease	No Effect
3.	The company receives cash from a bank loan.			
	Assets:	Increase	Decrease	No Effect
	Liabilities:	Increase	Decrease	No Effect
	Owner's (or Stockholders') Equity:	Increase	Decrease	No Effect
4.	The company repays the bank that had lent money to the company.			
	Assets:	Increase	Decrease	No Effect
	Liabilities:	Increase	Decrease	No Effect
	Owner's (or Stockholders') Equity:	Increase	Decrease	No Effect
5.	The company purchases equipment with its cash.			
	Assets:	Increase	Decrease	No Effect
	Liabilities:	Increase	Decrease	No Effect
	Owner's (or Stockholders') Equity:	Increase	Decrease	No Effect
6.	The owner contributes her personal truck to the business.			
	Assets:	Increase	Decrease	No Effect
	Liabilities:	Increase	Decrease	No Effect
	Owner's (or Stockholders') Equity:	Increase	Decrease	No Effect
7.	The company purchases a significant amount of supplies on credit.			
	Assets:	Increase	Decrease	No Effect
	Liabilities:	Increase	Decrease	No Effect
	Owner's (or Stockholders') Equity:	Increase	Decrease	No Effect
8.	The company purchases land by paying half in cash and signing a note payable for the other half.			
	Assets:	Increase	Decrease	No Effect
	Liabilities:	Increase	Decrease	No Effect
	Owner's (or Stockholders') Equity:	Increase	Decrease	No Effect

Information for Items 9 through 12:

Company X provides consulting services to Client Q in May. Company X bills Client Q in May for the agreed upon amount of $5,000. The sales invoice shows that the amount will be due in June.

9.	In May, Company X records the transaction by a debit to Accounts Receivable for $5,000 and a credit to Service Revenues for $5,000. What is the effect of this entry upon the accounting equation for Company X?			
	Assets:	Increase	Decrease	No Effect
	Liabilities:	Increase	Decrease	No Effect
	Owner's (or Stockholders') Equity:	Increase	Decrease	No Effect
10.	In June, Company X receives the $5,000. What is the effect on the accounting equation and which accounts are affected at Company X?			
	Assets:	Increase	Decrease	No Effect
	Liabilities:	Increase	Decrease	No Effect
	Owner's (or Stockholders') Equity:	Increase	Decrease	No Effect

11.	What is the effect on Client Q's accounting equation in May when Client Q records the transaction as a debit to Consultant Expense for $5,000 and a credit to Accounts Payable for $5,000?			
	Assets:	Increase	Decrease	No Effect
	Liabilities:	Increase	Decrease	No Effect
	Owner's (or Stockholders') Equity:	Increase	Decrease	No Effect
12.	What is the effect on Client Q's accounting equation in June when Client Q remits the $5,000? Also, which accounts will be involved?			
	Assets:	Increase	Decrease	No Effect
	Liabilities:	Increase	Decrease	No Effect
	Owner's (or Stockholders') Equity:	Increase	Decrease	No Effect

12. Complete the following sentences

Revenues and gains are recorded in accounts such as Sales, Service Revenues, Interest Revenues (or Interest Income), and Gain on Sale of Assets. These accounts normally have _____ balances that are increased with a _____ entry.

The exceptions to this rule are the accounts Sales Returns, Sales Allowances, and Sales Discounts - these accounts have _____ balances because they are reductions to sales. Accounts with balances that are the opposite of the normal balance are called contra accounts; hence contra revenue accounts will have _____ balances.

Expenses normally have their account balances on the _____ side (____ side). A debit _____ the balance in an expense account; a credit _____ the balance. Since expenses are usually increasing, think "_____" when expenses are incurred. (We credit expenses only to reduce them, adjust them, or to _____ the expense accounts.) Examples of expense accounts include Salaries Expense, Wages Expense, Rent Expense, Supplies Expense, and Interest Expense.

Asset, liability, and most owner/stockholder equity _____ are referred to as «permanent accounts» (or «real accounts»). Permanent accounts are not closed at the end of the accounting year; their _____ are automatically carried forward to the next accounting year.

«Temporary accounts» (or «nominal accounts») include all of the revenue accounts, expense accounts, the owner drawing account, and the income summary account. Generally speaking, the balances in temporary accounts increase throughout the accounting year and are «zeroed out» and closed at the end of the accounting year.

Balances in the revenue and expense accounts are zeroed out by closing/transferring/clearing their balances to the Income Summary account. The net amount in Income Summary is then closed/transferred/cleared to an _____ account, such as Mary Smith, Capital (or to Retained Earnings if the company is a corporation). The owner drawing account (such as Mary Smith, Drawing) is a temporary account and it is closed directly to the _____ capital account (such as Mary Smith, Capital) without going through an income summary account.

Because the balances in the temporary accounts are transferred out of their respective accounts at the end of the accounting year, each temporary account will have a _____ balance when the next accounting year begins. This means that the new accounting year starts with no revenue amounts, no expense amounts, and no amount in the drawing account.

By using many revenue accounts and a huge number of expense accounts, a company is certain to have easy access to detailed information on revenues and expenses throughout the year. This allows the management of the company to monitor the performance of all parts of the company. Once the accounting year has ended, the need to know the balances in these temporary accounts has also ended, so the accounts are closed out and reopened for the next accounting year with _____ balances.

13. Read the article and discuss

IS ACCOUNTING A GOOD CAREER CHOICE?

Accounting has been around since the beginning of trade. Through the years of ongoing development, it has become a major player in the professional spectrum.

Today, it continues to accommodate a great number of business professionals around the world. Careers in accounting are flourishing due to the steady demand for its services. It is indeed one of the most promising professions.

And It's an Excellent Choice.

One of the frequently asked questions regarding this matter is: *"Is accounting a good career?"* I hear that a lot especially from my accounting and financial management students. I also see that question posted in accounting forums and around the net.

People have different takes on this and the answer depends upon what you want in life, really. Now that would be a totally different (and quite long) topic so let's not go into that. We'll get into the hard facts instead. If you ask me, well, I'd say *yes*. I think *accounting is a good career choice*. And I'll tell you why.

Stability

Accounting offers a stable rate of employment amidst economic fluctuations. Some professions take a big slap when the economy dives. But not accounting.

Businesses need to keep track of their operations to be able to find ways to survive economic plunges. They need to report their earnings to the state and pay taxes, regardless of the economic situation. Managers need to regularly furnish monthly or quarterly reports to the board. *Get the idea?*

Accounting is a necessity in business. And with the massive business activity we have (and will continue to have), there's just plenty of work for new and seasoned accountants.

Compensation

Accounting professionals enjoy decent remuneration. The salary range varies as to your job description, level of experience, educational background,

location and other factors.

Bookkeepers, accounting technicians and clerks receive an average of $15,000 to as high as $35,000 annually. Young certified accountants' salary ranges from $30,000 to $60,000 while seasoned accountants and top management officers receive as high as $200,000 per annum.

Diversity

In accounting, you have a wide selection of fields and areas of practice to choose from. You can work as an employee with steady shifts and routinary tasks if you want. Also, with sufficient qualifications, you can work *freelance* and have your own clients. Business organizations will need your expertise to prepare, analyze, or audit their financial statements. You can also work as an instructor in the academe; become a book author, a fraud investigator, or an information systems specialist.

14. Choose the correct answer

1. Unearned Revenues is what type of account?

a) Asset;

b) Liability;

c) Stockholders' (Owner's) Equity.

2. Accounting entries involve a minimum of how many accounts?

a) one;

b) two;

c) three.

3. Financial accounting is focused on the _____ financial statements of a company.

a) external;

b) internal.

4. Which of the following will cause owner's equity to increase?

a) expenses;

b) owner draws;

c) revenues.

5. Which of the following will cause owner's equity to decrease?

a) net income;

b) net loss;

c) revenues.

6. The accounting equation should remain in balance because every transaction affects how many accounts?

a) only one;

b) only two;

c) two or more.

THEME 2. THE FIRST APPLICATION OF IFRS

1. Read the article and discuss

HOW TO LEARN IFRS

The world has been constantly moving to the single set of global accounting rules. So yes, I understand that accountants and other finance people need to gain at least some degree of IFRS knowledge, since they might face IFRS directly in their job. Maybe it's also your case.

Now, how to learn IFRS? Where to start?

Well, it depends. First, you should ask yourself at least the following questions:

- What is your current knowledge of IFRS? None at all? Or have you already acquired some base?
- What is your purpose of learning IFRS? How deep knowledge would you like to possess? Do you want to obtain some certificate or "offcial" qualification or just learn it to be able to deal with it in your job?
- What is your budget for learning IFRS? Do you want to keep it free or with minimal financial cost? Or you have a quite generous budget for this?
- How much time are you able or willing to dedicate to your IFRS training? Are you very busy guy and have only evenings / weekends? Or can you afford to skip some days from your daily job and visit classes?

Yes, all this matters, because there are many options what and how to do. So let's say you are an accountant or financial guy with solid accounting base, but IFRS is something you have heard of but never really touched. There is a certain path to follow no matters tools you chose. Being me in your shoes, I would start my IFRS learning as a step-by-step process:

1. Learn the basic structure of IFRS
2. Read the Framework
3. Get some knowledge about individual standards
4. Develop your knowledge and be up-to-date

So let's start with the first one.

1. Learn the basic structure of IFRS

Familiarize yourself with the basic structure and concept of IFRS. This is not a hard part. To start digging a bit deeper into this complex topic, you should know what is in front of you. Let me draft a simple picture.

IFRS is an acronym for International Financial Reporting Standards and covers full set of principles and rules on accounting treatment of various items or situations. This full set comprises the following components:

- Framework for the Preparation and Presentation of Financial Statements
- International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS)
- Standing Interpretations Committee (SIC) and Interpretations originated from the International Financial Reporting Interpretations

Committee (IFRIC)

2. Read the Framework

For any beginner in IFRS, the Framework is the basic concept of IFRS and therefore it is a MUST READ document. Anyway, it's not so time consuming, as the Framework itself has only about 30 pages and as an experienced accounting professional you would be familiar with many concepts in it. You can find full text of the Framework in www.ifrs.org.

3. Get some knowledge about individual standards

Now while you can read the Framework yourself without any pain, it's almost impossible and ineffective to read and study the texts of individual standards, interpretations and accompanying docs – it's more than 3 000 pages!

There are many possibilities how to learn basic principles and rules in individual standards. You might want to pick one of them based on your time and budget available. In my opinion, 2 main streams of learning IFRS are face-to-face training and self-study.

Face-to-face training

What I mean by saying "face-to-face" is attending a classic form of the study: long-term courses in the class, short-term seminars or workshops, etc. This should work wonderfully – I learned most of my IFRS basics this way. Let me just sum up pros and cons of face-to-face training:

Pros:

- learning from experienced tutor with personal contact
- high level of interactivity – you might ask for additional explanations or any questions you don't understand and often you get a feedback from your tutor
- full focus on the topic – when you attend a lecture, you will not be distracted by so many things around you (like 5 minutes for coffee, 5 minutes for "very tiny help" to your colleague or family member) and therefore, your study will be very effective.

Cons:

- high costs – if you'd like to attend really high-quality training, you will pay for it – oh yeah. I remember that the cost of my 6-day course on IFRS was about 4 000 EUR. Of course, tutor and topics covered were wonderful, however, if cost is something that bothers you, then check out other forms of training.
- time consuming – face-to-face training usually takes place during your normal working or business hours and you must find a space in your overloaded schedule. That might be a problem, especially during a high or busy season.
- inconvenient – you might also suffer from certain form of inconvenience. Often, you have to travel to the location that is far far away from your office or home. Or, you might feel distracted by other attendants in the class.

Self-study

This is a great option for those of you with limited budget and necessity for some time flexibility. There is a range of self-study options, with various costs, level of interactivity, feedback, time demand, etc. I will mention a couple of those:

Books

Reading, reading, reading – that's an excellent way. But this could be time consuming and really ineffective, too, because you are not getting personal approach and feedback from authors. Also, in today's world of constant change, they might be out-of-date. However, I'd recommend this option for those of you who want to get quick insight into all standards and get basic or more advanced knowledge.

I sincerely recommend the book "Wiley IFRS: Practical Implementation Guide and Workbook". It's a huge book but worth to study. You will get explanations of IFRS treatment of many elements of financial statements together with solved examples.

Webinars

Webinar is a web seminar. It means that you register for the internet event that takes place on certain time, you are required to install some plug-in to your computer and when the event starts, you just sit back, take your headphones, log-in to your webinar and enjoy the lesson. It's a good option, since you don't have to travel anywhere and the tutor is still with you. You can even ask questions and discuss information.

Webinars are less cost-demanding than face-to-face training but still require that you will be there in the specific date and time. To find any webinar that might interest you, just google IFRS webinar in the net.

Webcasts

Webcasts is basically web-based event, or just recording of an event that took place in the past. The difference from webinar is that webcast is usually not interactive. However, it is a good source of information on IFRS and sometimes, you can get access to webcasts for free.

Free webcasts basically contain information on new developments and hot issues. I rarely watched an IFRS webcast on specific technical topic for free. If you find some, I'll be glad to receive a link.

E-learning courses

Along with webinars and webcasts, various e-learning opportunities are available on the net, including flash applications, videos, screencasts, training modules etc. Some of them are free, some of them are not, but basically you get the advantage from low cost and time flexibility.

4. Develop your knowledge and be up-to-date

Fine, you have already managed to get basic knowledge on IFRS, but you know that it's not time to take a break! Sometimes, you need to solve more technical and demanding IFRS or general accounting tasks. Also, you absolutely must stay up-to-date, because IFRS is changing every moment – new standards or interpretations are being issued each year. So what can you do?

Articles or magazines

Reading the professional magazines focusing on finances, business, taxes and accounting is absolutely beneficial to stay up-to-date. Articles are usually quick-read, providing brief or in-depth analysis of a specific problem. You can find a number of good professional magazines, whether printed or online.

Online forums or discussions

When you have a really difficult task to solve or you want to find an answer to some specific problem, online forums or discussions are a great choice. Just subscribe to several of them and ask questions. I am sure there are many experienced finance professionals willing to help you. By reviewing older contributions, you can learn from other people's questions and answers, too.

Subscribing to newsletters or e-zines

My absolutely favourite way of broadening my technical skills and staying tuned to IFRS is subscribing to newsletters and good e-zines. Thus, you can get summary of all important finance, business and technical news directly to your e-mail on a regular basis – what a wonderful service!

I personally like subscription to www.ifrs.org. IFRS Foundation is a standard setting organization with several bodies, so you get the most actual information on latest IFRS developments from the first hand. Moreover, by subscribing to their email alerts, you will get access to unaccompanied standards, you will be able to comment on exposure drafts, etc.

2. Read the article and discuss

HOW TO ADJUST YOUR LOCAL ACCOUNTS TO IFRS

Today's accounting world works on a single set of accounting and financial reporting standards. As a basis, IFRSs happen to play a crucial role. Nowadays, we are witnessing a huge progress of convergence to IFRS—not only by US GAAP, but also other countries are adopting more and more IFRS rules to their own accounting rules.

I have a feeling that until recently, this process has affected mostly bigger multinational companies who were required to report their financial results and position in accordance with both IFRS and their local accounting standards. That's not a problem for them – usually, those companies are very well equipped with all necessary human capital, software and business processes to make account transformation process running smoothly.

But! The things change every minute. One day, also small and medium sized enterprises might find themselves in a situation when making two sets of financial statements becomes absolute necessity and a must. And we know all very well, that the first steps have already been made—IASB has already issued and published **International Financial Reporting Standard (IFRS) designed for use by small and medium-sized entities (SMEs).**

Maybe you work for SME that would find presenting your financial position and results under IFRS beneficial or necessary from various reasons:

- maybe you would like to attract some foreign capital, whether new shareholders or other finance providers
- maybe you would like to extend your business overseas and need to cultivate your financial image
- maybe your company is big enough to have foreign subsidiaries that need to be consolidated under uniform standards
- maybe you are a foreign subsidiary that needs to submit

its IFRS financial statements to the parent company

- and many more

You always have the choice to start with external consultants with broad experience in this field. They can design full process step-by-step, implement it and educate you to use it—but often you find out that cost of hiring consultants might be too high. Then, you can start to do this yourself from scratch. If you do it properly, it will cost you only your time and you will have a good basis for further conversion process.

So let me try to guide you on where to start. Each step will be illustrated with hypothetical example from practice.

Step 1: Identify financial statements' items with differences

That's probably the most difficult and demanding part. You shall possess a solid knowledge about both your local GAAP and IFRS so that you can identify which transactions have been shown differently under your local GAAP than would have been shown under IFRS.

In my opinion, the best approach is always systematic. Take your financial statements—balance sheet and income statement—and go through each caption. Alternatively, you can do it on a more detailed level—instead of taking financial statements, take a trial balance or general ledger where accounts are not grouped. Ask yourself what major transactions have been recorded under those captions and whether applied local principles and IFRS are the same or not.

What captions can be affected? Well, every single one. The most common adjustments include finance leases, fair value adjustments, deferred tax adjustments, adjustments related to construction contracts, intangible assets and their recognition, and many more.

Here I would like to draw your attention to the standard IFRS 1—First-time Adoption of International Financial Reporting Standards which sets out the procedures that you must follow when adopting IFRSs for the first time. There are some basic rules and requirements related to assets and liabilities recognition, reclassifications, measurement, exceptions and exemptions when you do it for the first time. I highly recommend reviewing this standard before attempting to prepare the list of potential adjustments.

Example: You are in the process of preparing IFRS financial statements as of 31 December 20X1 and you find a significant rental expense related to leases in your income statement. You are sure that those leases are finance in accordance with IAS 17. However, your local GAAP treats finance lease payments as expenses to the income statement with no asset and lease liability recognition. This seems like significant adjustment that you will focus on during later stages of your accounts transformation.

Step 2: Prepare all information for IFRS adjustments related to each difference

Once you identified all potential differences between local GAAP and IFRS affecting your financial statements, you shall gather all related numerical information. This involves 2 stages:

2.1 Determine precisely how the transaction has been reported under

local GAAP

That means the necessity to obtain all accounting entries related to the transaction from its beginning until the reporting date. You don't need to obtain literally every single entry—this would not be practical. But you need to obtain at least total amounts that have been recognized to the individual captions in the financial statements (or general ledger) from the initial recognition of the transaction until the reporting date.

Example: You have identified that the following numbers have been recorded as rental expense related to finance leases since their initial recognition until 31 December 20X1:

Description	Amount in EUR	Debit	Credit
Rental expenses (financial leases)—previous period	1 200 000	IS—rental expense	Cash at bank
Rental expenses (financial leases)—current period	250 000	IS—rental expense	Cash at bank

Please note that periods from initial recognition until 31 December 20X0 are referred to as "previous periods" and a year ended 31 December 20X1 is referred to as "current period". IS means "income statement".

You should make sure that you gathered data only for finance leases still open or closed during the reporting period, because finance leases closed during previous reporting periods probably do not make any difference.

2.2 Precisely determine how the transaction should have been presented under IFRS

Now you have to apply your IFRS knowledge. You should calculate total amounts related to each affected transaction that should have been recognized in individual captions of the financial statements in line with IFRS.

Example: You have identified that the following numbers should have been recorded with respect to finance leases since their initial recognition until 31 December 20X1:

Description	Amount in EUR	Debit	Credit
PPE—cost of assets held under finance leases at initial recognition	1 400 000	PPE—cost	Finance lease liabilities
Deprecation expense—previous period	700 000	IS—deprecation expense	PPE—accumulated deprecation
Deprecation expense—current period	120 000	IS—deprecation expense	PPE—accumulated deprecation
Lease payments—capital part, previous period	900 000	Finance lease liabilities	Cash at bank
Lease payments—interest, previous periods	300 000	IS—interest expense	Cash at bank
Lease payments—capital part, current period	170 000	Finance lease liabilities	Cash at bank
Lease payments—interest, current period	80 000	IS—interest expense	Cash at bank

For every potential difference in accounting treatment of certain transactions in line with your local GAAP and IFRS, make similar accounting entries table. In this example, I just made up those figures out of a thin air. However, you shall prepare all the calculations in supporting documentation. In this specific finance lease example, you should really prepare a worksheet in which you split every single lease payment between repayment of a lease liability and interest payment, applying actuarial method.

Step 3: Prepare a bridge in excel and enter all adjustments in there

What do I mean by the "bridge"? It is a summary of all adjustments where each adjustment consists of 2 parts: derecognizing all the accounting entries in line with your local GAAP (in step 2.1) and recognizing all the accounting entries in line with IFRS (in step 2.2).

Basis of your bridge can be the trial balance, or general ledger as of the reporting date, put into 1 column. Make sure that total of the account balances gives you 0, all assets and expenses (or debit balances) are stated with plus (+) sign and all liabilities and revenues (credit balances) are stated with minus (-) sign.

Then in the next columns, you will enter all adjustments as you would have been doing regular accounting entries to your general ledger. Of course, you enter debits with plus and credits with minus. Remember to check your totals to be 0. To achieve transparency, I recommend entering each line from above tables to separate column.

When entering your pre-prepared adjustments from the step 2, I would like to warn you about 2 tricky things:

1. Entries according to your local GAAP must be DERECOGNIZED. It means that you enter them in the opposite way as they had been accounted for. In our example, you simply Debit Cash at bank and credit IS—Rental expense. Don't worry about cash balances now—after making full adjustment, they will be correct.
2. Remember that you are in the current accounting period. This means that entries made to income statement in the previous periods have already been transferred to equity—profit or loss from previous periods. So you just cannot recognize and derecognize figures related to income statement of previous periods to income statement of current period—that would be fatal error. You simply put all your previous years' figures related to income statement to equity.

Example: The bridge from our finance lease example would look like the following:

Description	Local GAAP balance	Finance leases - derecognizing local GAAP entries	
		Rental expenses (finance leases) - previous periods	***Rental expenses (finance leases) - current period***
PPE - cost	13 500 000		
PPE held under finance leases - cost	0		
PPE - accumulated depreciation	-7 420 000		
PPE held under finance leases - accumulated depreciation	0		
Inventories	4 560 000		
Receivables to customers	24 780 000		
Prepaid expenses	3 400 000		
Cash at bank	12 340 000	1 200 000	250 000
Share capital	-21 000 000		
Revaluation reserves	-390 000		
Profit from previous periods	-4 090 000	-1 200 000	
Long-term loans	-5 000 000		
Finance lease liability	0		
Payables to suppliers	-18 700 000		
Income tax payable	-500 000		
Cost of sales	54 670 000		
Transportation costs	11 300 000		
Rental expenses	4 300 000		-250 000
Salaries and wages	13 450 000		
Depreciation expenses	1 400 000		
Interest expenses	650 000		
Income tax expense	770 000		
Revenues - sales of goods	-87 600 000		
Interest income	-420 000		
TOTAL	**0**	**0**	**0**

I used simplified trial balance version and only some figures in it to make it clear. And note that sometimes you must add certain items to your trial balances, like finance lease liabilities in this case—that's because they are new in IFRS financial statements while they were not present in your local GAAP statements. I highlighted those new items in red.

Step 4: Calculate total impact of IFRS adjustments and IFRS balances

Once you are done with entering all adjustments to the bridge, the last 2 columns will represent horizontal totals:

- in the last but one column, you shall calculate total of all columns starting with column with the 1st adjustment (except for local GAAP balance column). Thus you'll get total impact of IFRS adjustments on the individual line items of your trial balance.

- in the last column, you shall calculate IFRS balance by adding local GAAP balance and total impact figure together.

Example: After making these totals, the bridge from our example would look like the following:

Description	**Local GAAP balance**	**Finance leases - derecognizing local GAAP entries**		**Total impact of IFRS adjustments**	**IFRS balance**
		Rental expenses (finance leases) - previous periods	***Rental expenses (finance leases) - current period***		
PPE - cost	13 500 000			0	13 500 000
PPE held under finance leases - cost	0			1 400 000	1 400 000
PPE - accumulated depreciation	-7 420 000			0	-7 420 000
PPE held under finance leases - accumulated depreciation	0			-820 000	-820 000
Inventories	4 560 000			0	4 560 000
Receivables to customers	24 780 000			0	24 780 000
Prepaid expenses	3 400 000			0	3 400 000
Cash at bank	12 340 000	1 200 000	250 000	0	12 340 000
Share capital	-21 000 000			0	-21 000 000
Revaluation reserves	-390 000			0	-390 000
Profit from previous periods	-4 090 000	-1 200 000		-200 000	-4 290 000
Long-term loans	-5 000 000			0	-5 000 000
Finance lease liability	0			-330 000	-330 000
Payables to suppliers	-18 700 000			0	-18 700 000
Income tax payable	-500 000			0	-500 000
Cost of sales	54 670 000			0	54 670 000
Transportation costs	11 300 000			0	11 300 000
Rental expenses	4 300 000		-250 000	-250 000	4 050 000
Salaries and wages	13 450 000			0	13 450 000
Depreciation expenses	1 400 000			120 000	1 520 000
Interest expenses	650 000			80 000	730 000
Income tax expense	770 000			0	770 000
Revenues - sales of goods	-87 600 000			0	-87 600 000
Interest income	-420 000			0	-420 000
TOTAL	**0**	**0**	**0**	**0**	**0**

Now, in the last column, there is a trial balance of your company in accordance with IFRS and you can easily prepare statement of financial position and statement of comprehensive income in line with IFRS. But before you do so, I highly recommend performing the last step.

Step 5: Verify consistency of IFRS equity

Verifying consistency of IFRS equity means comparing total equity INCLUDING previous year's profit or loss in line with IFRS as at the end

of previous period with total equity in line with IFRS as at the beginning of current reporting period. I will put it into equation to make it crystal clear:

(Profit/loss from previous periods + profit or loss of current period) at the end of previous reporting period (e.g. 31 December 20X0) = profit/loss at the beginning of current reporting period (1 January 20X1).

In practice, I do not compare the whole profit or loss line. I just do it with total impact of IFRS adjustments on profit or loss from previous periods' line as I assume that local GAAP balances are consistent (yellow figure in the above picture).

This is extremely important step for 2 basic reasons:

- First, if your equity is not consistent, you will not be able to prepare statement of changes in equity under IFRS and I am pretty sure that the other statements will contain errors, too.
- Second, verifying equity serves as a check of your work. Does it add up and equal? Fine, you have included all adjustments (I am not talking about reclassifications not impacting equity) and you made it correctly.

Example: In our example, total impact of IFRS adjustments on profit or loss from previous periods is -200 000 EUR. It is highlighted yellow in the above picture.

To verify consistency of equity, you would have to take the same bridge as of 31 December 20X0 or for previous year and look to the same figure, plus total impacts of IFRS adjustments to all income statement items. Hopefully, it would give you -200 000 EUR too.

That's it. Just take the trial balance and make IFRS statements out of it.

3. Read the article and discuss

US GAAP vs IFRS

IFRS and US GAAP come closer to each other and the dream was to have a single set of the reporting standards until 2015.

Now we know that that dream did not come true and there is still a long way to go. Until then, there are still many companies who need to cope with IFRS reporting as well as US GAAP reporting. Finance people working for those companies know it the best—identification of differences between IFRS and US GAAP and making correct adjustments is simply laborious and demanding work.

Here, I would like to outline the biggest differences between IFRS and US GAAP, at least those that I consider the biggest and the most challenging to remove. So let's take a look.

1. Revenue recognition

In my opinion, it is very difficult to simply list all the differences between US GAAP and IFRS related to revenue recognition. The reason is that the ***guidance on revenue recognition*** is significantly more extensive in US GAAP than in IFRS.

IFRSs deal with revenue recognition in 2 specific standards: IAS 18 Revenue and IAS 11 Construction Contracts. On the other hand, US GAAP outlines a few concepts and then provides detailed rules for revenue recognition in different industries.

Due to this fact, it is almost impossible to simply list the differences in this area. Instead, thorough analysis of each transaction must be performed prior considering the accounting treatment. However, let me just briefly come up with the main differences for illustration:

Timing of revenue recognition can be different in several cases, especially when price contingencies are involved. Simply speaking, it is possible to recognize revenue with price not fixed yet earlier in IFRS than in US GAAP.

IFRS requires recognizing the revenue when it is probable that economic benefits associated with transaction will flow to the entity and the revenue can be measured reliably. It means that also contingent revenue (not sure about the amount) shall be recognized when 2 conditions are fulfilled.

As opposed, US GAAP sets the criterion of fixed or determinable pricing in order to recognize revenue. Thus, revenue cannot be recognized until the contingency is resolved (so amount must be set). As a result, revenue with contingent or questionable amount can be recognized earlier according to IFRS than according to US GAAP.

Other most common revenue recognition differences involve setting when the transaction with ***multiple deliverables shall be separated into components, method of revenue allocation*** to the different components, ***customer loyalty programs*** within multiple-element arrangements, construction contracts, value attributed to barter transactions, discounting of revenue (required more broadly in IFRS than US GAAP), and many others.

To reduce those dissimilarities and bring US GAAP and IFRS closer a bit more, FASB (US GAAP setting body) and IASB (IFRS setting body) issued a revised proposal of the new revenue recognition standard. This standard designs main direction for revenue recognition and corrects inconsistencies between US GAAP and IFRS.

2. Financial assets (IAS 39/IFRS 9)

This is another area of fundamental dissimilarities. First of all, the amount of guidance is different. While US GAAP provides extensive guidance throughout various industry-specific standards and pronouncements, IFRS has only 2 standards dealing with financial assets—IFRS 7 for disclosures and IFRS 9 for other issues.

The first thing you do with any financial asset is ***classification***. IFRS 9 classifies financial assets into several categories, while US GAAP classifies financial assets in various pronouncements. Also, IFRS 9 classifies assets basically based on the nature of the instrument, whereas US GAAP reflects legal form in classification.

Please understand that the classification of financial assets is very important—based on classification, you measure these assets and recognize measurement gains or losses to income statement or equity. So, different

classification of the same financial asset in US GAAP vs. IFRS can lead to huge variations in amounts recognized in financial statements.

With regard to financial assets, there are great variations in ***derecognitions***—or when you remove the asset from your financial statements. US GAAP assesses whether the control (both effective and legal) over the asset was surrendered. On the other side, IFRS assesses whether there was a qualifying transfer of an asset with risks and rewards passed, and sometimes transfer of control.

As a result, some assets might be derecognized in line with US GAAP, but not in line with IFRS. For example, factoring of receivables with recourse—here, factored receivables can be derecognized according to US GAAP, but not according to IFRS (recourse factoring means that factoring company can transfer receivables back when these went bad and never would be collected; thus risk stays with original owner of receivable and not with factoring company).

There are many more variations with regard to financial assets, for example, treatment of embedded derivatives in hybrid instruments, measurement and reversal of impairment losses, fair value measurement and more. It is just impossible to include them all here in this informative article.

3. Impairment of assets (IAS 36)

There are broad differences in ***testing*** of impairment according to IFRS and US GAAP. These differences might lead to assessment whether the asset is impaired or not.

IAS 36 Impairment of Assets prescribes one-step test of impairment. The entity should compare asset's carrying amount with its recoverable amount (higher of asset's fair value less cost to sell or asset's value in use).

As opposed, ***US GAAP applies 2-step approach***: the first step is to compare asset's carrying amount with its undiscounted cash flows and if carrying amount is lower, then no impairment loss is recognized. In the second step, if the carrying amount is higher than undiscounted cash flows, an impairment loss is calculated as a difference between carrying amount and assets fair value.

So, asset might be impaired per IAS 36, but not per US GAAP.

Also, IFRS uses ***discounted*** cash flows in impairment testing (for value in use calculation), whereas US GAAP uses ***undiscounted*** cash flows. IFRS sets more precise requirements for types of items to include in cash flows than US GAAP. Therefore, a difference in amount of impairment loss can arise.

4. Intangible assets

One of the biggest differences in this area is that ***US GAAP does not permit to capitalize*** internally incurred development costs, while ***IFRS does allow*** it—when certain conditions in line with IAS 38 are fulfilled.

Also, there are some differences in impairment testing with regard to intangible assets with indefinite useful life. These differences may result in determination whether there is an impairment loss and in earlier recognition in IFRS.

5. Inventory

IFRS (IAS 2) does not allow LIFO (last-in-first-out) measurement of inventories, while ***US GAAP does.*** This is really huge difference for those US companies who use LIFO as their operating results and cash flows might be significantly different according to IFRS than US GAAP.

Final word

Now, you might argue with me that there are bigger differences than those listed above. Well, that's questionable and arguable, since everybody has his own favourite pick.

During my financial and accounting practice, I considered those 5 as the most laborious and requiring much more work to understand and make appropriate adjustments between IFRS and US GAAP. Just take inventory—those few lines above cost a lot of work in order to revalue year-end inventory from LIFO (per US GAAP) to FIFO or weighted average (by the way, FIFO is easier).

Sure there is much more variations, such as potential differences in the lease classification, variations in employee benefit plans classification and recognition and many other areas.

What I truly believe is that one day, IASB and FASB reach a conclusion and there will be no differences. How much work would be saved for all preparers of the financial statements!

MODULE 2. ACCOUNTING FOR ASSETS

THEME 3. PROPERTY, PLANT AND EQUIPMENT. INVESTMENT PROPERTY

Example 1

On 1 March 20XX Yucca acquired a machine from Plant under the following terms:

List price of machine **$**82,000
Import duty **$**1,500
Delivery fees **$**2,050
Electrical installation costs **$**9,500
Pre-production testing **$**4,900
Purchase of a five-year maintenance contract with Plant **$**7,000

In addition to the above information Yucca was granted a trade discount of 10% on the initial list price of the asset and a settlement discount of 5% if payment for the machine was received within one month of purchase. Yucca paid for the plant on 5 March 20XX.

How should the above information be accounted for in the financial statements?

Solution

In accordance with IAS 16, all costs required to bring an asset to its present location and condition for its intended use should be capitalised. Therefore, the initial purchase price of the asset should be:

List price _____**$**
Less: _____**$**
Import duty _____**$**
Delivery fees _____**$**
Electrical installation costs _____**$**
Pre-production testing _____**$**
Total amount to be capitalised at 1 March _____**$**

The maintenance contract of $_____ is an expense and therefore should be spread over a five-year period in accordance with the accruals concept and taken to the income statement. If the $_____ has been paid in full, then some of this cost will represent a prepayment.

In addition the settlement discount received of $_____ is to be shown as other income in the income statement.

Example 2

An item of plant was purchased on 1 April 2022 for $200,000 and is being depreciated at 25% on a reducing balance basis.

Prepare the extracts of the financial statements for the year ended 31 March 2024.

Solution

Statement of financial position extract

Working for depreciation:
31/03/23 Cost _____
Depreciation – _____
Carrying value _____
31/03/24 Carrying value _____
Depreciation – _____
Carrying value _____
Plant _____
Income statement extract
Depreciation expense $_____

Example 3

A machine was purchased on 1 April 2021 for $120,000. It was estimated that the asset had a residual value of $20,000 and a useful economic life of 10 years at this date. On 1 April 2023 (two years later) the residual value was reassessed as being only $15,000 and the useful economic life remaining was considered to be only five years.

How should the asset be accounted for in the years ending 31 March 2022/2023/2024?

Solution

31 March 2022

At the date of acquisition the cost of the asset of $120,000 would be capitalised. The asset should then be depreciated for the years to 31 March 2022/2023 as:

Cost – residual value = _____- per annum
Useful economic life 10 years
Income statement extract 2022
Depreciation $_____
Statement of financial position extract 2022
Machine _____

31 March 2023

Income statement extract 2023
Depreciation $_____
Statement of financial position extract 2023
Machine
_____

31 March 2024

As the residual value and useful economic life estimates have changed during the year ended 2024, the depreciation charge will need to be recalculated. The carrying value will now be spread according to the revised estimates.

Depreciation charge:
_____ per annum
5 years
Income statement extract 2024
Depreciation $_____

Statement of financial position extract 2024
Machine _____

Component depreciation
If an asset comprises two or more major components with different economic lives, then each component should be accounted for separately for depreciation purposes and depreciated over its own useful economic life.

Example 4
A company purchased a property with an overall cost of $100m on 1 April 2023. The property elements are made up as follows:
$000 Estimated life
Land and buildings
(Land element $20,000) 65,000 50 years
Fixtures and fittings 24,000 10 years
Lifts 11,000 20 years
100,000
Calculate the annual depreciation charge for the property for the year ended 31 March 2024
Solution
Land and buildings _____
Fixtures and fittings _____
Lifts _____
Total property depreciation _____

Example 5 - component parts
Aircraft: total cost R6 000 000
- Engine: estimated useful life of 10 years
- Body: estimated useful life of 20 years
Estimated % cost of total cost for main components:
- engine 60% = R3 600 000
- body 40% = R2 400 000
Depreciation policy of entity
Engine over 10 years (straight-line) _____
Body over 20 years (straight-line) _____
Calculate depreciation expenses for 20 years
_____ per year for the first 10 years
_____ per year for the next 10 years + depreciation on cost of new component (engine)
What would the effect be if the engine's depreciation was allocated based on the production unit method and expected useful life is 3 000 000 flying hours?
Depreciation based on hours flew and would differ annually.
Assume in year 4 flew 500 000 hours (year 1 to 3 only flew 2 000 000 hours) _____
Total depreciation in year 4: _____

Example 6 - self-constructed asset

Existing equipment (A) has a cost of R600 000, accumulated depreciation at beginning of the year of R200 000 & depreciation for the current year is R120 000.

Existing equipment (A) was used to construct another piece of equipment for 2 months during the current year.

Construction costs for the new equipment (B) amounted to R50 000 iro labour and materials.

Calculate cost of the new equipment: _____

The new asset is depreciated over 10 years and was ready for use as intended by management for the past 9 months of the present financial period.

Calculate depreciation on equipment for the present year:

Depreciation _____

Capitalised in new asset _____

Depreciation on new asset _____

Total depreciation _____

NOTE: The adjustment to the depreciation of asset A has no effect on the accumulated depreciation of asset A - it only influences the depreciation expense in the current year.

Key Differences Between PPE and Investment Property

Aspect	Property, Plant, and Equipment (PPE)	Investment Property
Purpose	Used for production, supply of goods / services, or administrative purposes	Held to earn rental income or for capital appreciation
Example	Factory building, machinery, office equipment	Office building rented out to others
Accounting Model	Cost model (depreciated)	Cost or fair value model
Depreciation	Depreciation is applied over the useful life	No depreciation if using fair value model

Example 7 - classifying assets

XYZ Ltd. has purchased the following assets during the year:

1. A factory building used for its manufacturing operations.
2. A piece of machinery used in the production process.
3. A piece of land that is held for future appreciation.
4. An office building that XYZ Ltd. rents out to other companies.

Classify each asset as either Property, Plant, and Equipment (PPE) or Investment Property.

Solution

Asset	Classification	Explanation
Factory building		Used for manufacturing operations.
Machinery		Used in production processes.
Land (held for future appreciation)		Held for capital appreciation, not used in production.
Office building (rented out)		Held to earn rental income from other businesses.

Example 8 - depreciation calculation for PPE

ABC Manufacturing Ltd. purchased a machine for $100,000 on January 1, 2023. The machine has an estimated useful life of 10 years and no residual value.

Calculate the annual depreciation expense using the straight-line method.

Solution

- Cost of the machine = $100,000
- Useful life = 10 years
- Residual value = $0
- Depreciation expense per year = (Cost - Residual value) / Useful life

So, the annual depreciation expense is $_____.

Example 9 - fair value model for Investment Property

ABC Ltd. owns an office building that is rented out to other businesses. The company chooses to account for this property using the fair value model.

At the beginning of the year, the building had a fair value of $500,000. At the end of the year, the fair value increased to $550,000.

Calculate the gain or loss to be recognized in the profit and loss account.

Solution

- Initial fair value = $500,000
- Ending fair value = $550,000
- Gain on revaluation = Ending fair value - Initial fair value

Gain on revaluation=_____
_____

The gain of $_____ will be recognized in the profit and loss account.

Example 10 - Journal Entry for Purchase of PPE

On March 1, 2023, XYZ Ltd. purchased a new piece of machinery for $150,000. The company paid $10,000 for installation costs. The machinery is expected to last 5 years and has no residual value.

Prepare the journal entry for the purchase of the machinery.

Solution

1. Initial cost of the machinery = $_____
2. Installation cost = $_____
3. Total cost of the machinery = $_____

Journal Entry:

Date	Account Title	Debit	Credit
March 1, 2023			

The machinery is recorded at its total cost, which includes both the purchase price and the installation cost.

Example 11

An asset was purchased 3 years ago, on 1 st January 20X0 for $120,000. The directors chose to depreciate the asset using the reducing balance method, so used a rate of 20% per annum.

On 1 st January 20X3, the directors decided that a fairer presentation would be given if the depreciation method was changed to straight line. At this time, the directors estimated that the remaining useful life was 7 years and the residual value was $12,000.

Calculate the depreciation charge for the year end 31st December 20X3.

Solution

The original depreciation was as follows:

Year 1: _____

Year 2: _____

Year 3: _____

The asset had been depreciated for three years when the change of depreciation method occured and therefore, CA would be:

Carrying value = _____

Example 12

Asset A cost $80,000 on 1 January 20X4. This asset came with a useful life of 10 years and was revalued to $40,000 on 31 December 20X9.

Asset B cost $80,000 on 1 January 20X7. This asset came with a useful life of 5 years and was revalued to $30,000 on 31 December 20X9.

Show how each of the gains or losses will be recorded within the revaluation reserve on the statement of profit or loss.

Solution

Asset A:

On 31 December 20X9, Asset A has a carrying amount of _____ _____.

The cost account will reduce from _____ to _____.

The accumulated depreciation of $_____ will be removed from the books.

Overall, the carrying amount of the asset has increased from _____to _____. This increase of _____will be credited to the revaluation reserve.

Remember, next year's depreciation will be based on the revalued amount of _____over the remaining life of 4 years

Debit		
Credit		
Credit		

Asset B:

On 31 December 20X9, Asset B had a carrying amount of _____ _____.

The cost account will reduce from _____to _____.

The accumulated depreciation of _____will be removed from the books.

Overall, the carrying amount of the asset decreased in value from _____ to _____. The decrease of _____is charged against profits in the SPL. This asset has not been revalued in the past and does not have a revaluation reserve. You cannot use the reserve from Asset A.

We must note that next year's depreciation will be based on the revalued amount of $_____ over the remaining life of 2 years

Debit		
Debit		
Credit		

Example 13

An entity originally purchased a piece of land on 01/01/X7 for $120,000. On 31/12/X8, the land was revalued at $180,000. The land was eventually sold for $220,000 on 31/12/Y1.

Calculate the profit or loss on disposal to be shown in the statement of profit or loss and any revaluation adjustments that need to be made.

Solution

When the land was revalued the entries would have been made as follows:

This asset increases in value from _____ to _____.

The increase is credited to the revaluation reserve

Debit		
Credit		

When the asset was sold, the carrying amount was _____.

The gain on disposal on the statement of profit or loss would be _____ _____This would be accounted for by the following:

Debit		
Credit		
Credit		

The revaluation reserve for the land would now be released into profits as the gain is now realised.

Debit		
Credit		

Example 14

The following information relates to three assets held by an entity:

	X	Y	Z
Carrying amount	500	500	500
Net selling price	390	440	600
Value in use	420	480	450

Calculate the impairment losses, if any, in respect of the three assets.

Solution

	X	Y	Z
Recoverable amount (highest of net selling price and value in use)			
Carrying amount			
Impairment			

Example 15 - Diminishing balance depreciation with residual value

An entity purchased a piece of high-tech PP&E subject to increased technical obsolescence for $12 million. The entity estimates that the asset will be used for five years, with most of its performance utilised in the early years. The residual value is $2 million.

The depreciation is calculated using the diminishing balance method as shown below.

Year	Net book value	Depreciation charge
1		
2		
3		
4		
5		
Residual value		

Example 16 - Diminishing balance depreciation without residual value

The entity purchased the same asset as in the example above, but this time the residual value is zero:

- Rate for diminishing balance depreciation: 30%
- Rate for straight-line depreciation: 20%
- Cost of PP&E: $12m
- Depreciation charge under straight-line depreciation: $2.4m
- Residual value: $0m

Year	Net book value	Depreciation charge	
1			@ Diminishing balance rate
2			@ Diminishing balance rate
3			@ Straight line rate
4			@ Straight line rate
5			@ Straight line rate (until NBV = 0)
Residual value			

Example 17 - Sum of the digits depreciation

For this example, we use the same high-tech PP&E item purchased for $12 million with no residual value, to be used over five years.

The entity recognises the depreciation expense using the sum of the digits method as follows:

- Year 1: _____
- Year 2: _____
- Year 3: _____
- Year 4: _____
- Year 5: _____
- Total: _____

18. Read the article and discuss

OUR MACHINES ARE FULLY DEPRECIATED, BUT WE STILL USE THEM! WHAT SHALL WE DO?

Do you work in the production company? And did you find out that some of your production assets are ***still in operation but they were fully depreciated***?

In this case, the original estimate of machinery's useful life proved to be incorrect.

Here's one of the questions I received:

"Dear Silvia, we are a manufacturing company. We use our existing machinery for a longer period than its useful life and therefore, our machinery is fully depreciated. What can we do to correct it?"

What's wrong with that?

The problem is that as these machines are ***used beyond their useful life***, they are ***fully depreciated*** and their carrying amount is zero.

But in this case, ***what depreciation expense*** can you recognize in the profit or loss?

None, of course – because the carrying amount of your property, plant and equipment ***cannot decrease below zero***.

So in fact, you use the machines, but you can't really recognize any depreciation expense, because there's nothing left. You have fully depreciated these assets in the previous reporting periods.

And as a result, the ***matching principle does not work*** here. The expenses simply do not match the benefits gained from these machines.

The problem is in the machines' useful lives

The standard IAS 16 Property, plant and equipment defines the ***useful life*** as either:

- The ***period*** over which an 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.

Revised depreciation charge	=	Carrying amount (at the revision date)	/	Remaining useful life

It ***is not the potential or economic life*** of the asset. These two will often not be the same!

For example, normal economic life of a car is 4 years, but the company's policy is to renew car park every 2 years. In this case, car's useful life is just 2 years.

Or, the economic life of a machine is 6 years, but after 3 years, the company's experts assess that the machine can be used for another 5 years. In this case, total useful life is 8 years.

Now this is extremely important: ***Standard IAS 16 requires entities to review assets' useful lives at least at each financial year-end.***

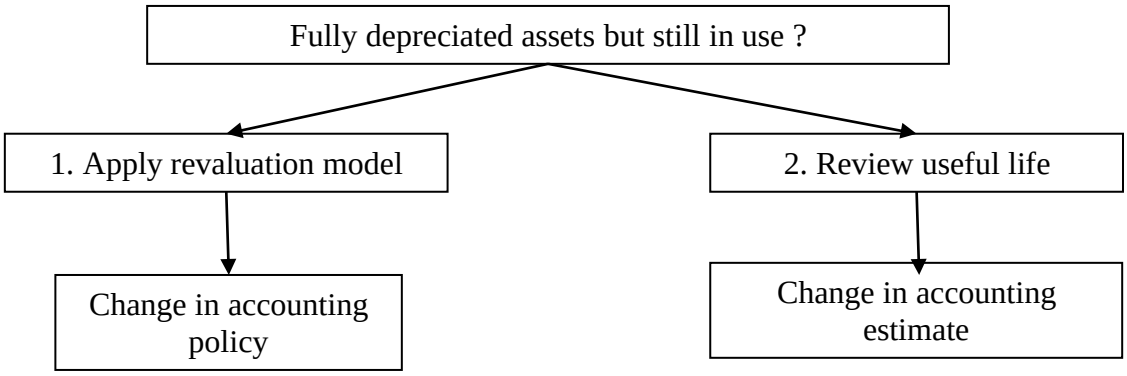
You would not believe how many entities simply forget it!

They just book the annual depreciation charge based on the rates determined for some group of assets and that's it.

They do not revise the useful lives of their assets and as a result, they end up with using fully depreciated assets in the production process.

How to fix this situation?

Let me suggest 2 possible corrective actions for this situation.



Solution 1: Review useful lives at each financial year-end.

Useful life is ***an accounting estimate*** and if you find out that it is different from what you initially set, you need to book this change in line with the standard IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.

It means that you simply set the new remaining useful life, take the carrying amount and recognize the depreciation charge based on the carrying amount and new remaining useful life.

Revised depreciation charge	=	Carrying amount (at the revision date)	/	Remaining useful life

No restatement of previous periods' financial statements is permitted. IAS 8 requires recognizing change in accounting estimates ***prospectively*** (now and in the future).

Now you might say: OK Silvia, I got it, but what should I do when the carrying amount (net book value) of my assets is zero?

Well, it depends.

If you reviewed the useful lives in the past regularly and during the current reporting period you find out that you'd like to use the assets even longer, then there's not much to do. Just leave these assets as they are and make sure you avoid this situation in the future.

However, if you really forgot to revise the useful lives in the previous reporting period, this failure to apply IAS 16 results in the ***accounting error***.

If this error is material, then you should ***correct it retrospectively in line with IAS 8***. It means restating the previous periods using the revised estimated useful lives. Huge amount of work!

Solution 2: Revalue your assets to their fair value.

Standard IAS 16 permits 2 models for subsequent measurement of your property, plant and equipment: cost model and revaluation model.

And it is true that if you still plan to use existing machines in the future, their fair value is for sure greater than zero.

Revaluing machines with nil book value would effectively mean that you are ***changing your accounting policy*** and here the standard IAS 8 gets the word again.

In line with IAS 8, you shall change the accounting policy only if:

1. The change is required by an IFRS. This is definitely not the case.
2. The change results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

You (and your auditors) can argue that point 2 exactly reflects your situation. But does it really?

It definitely solves nil book value at the end of the current reporting period. Like a pill provides immediate relief from headaches.

But the accounting policy represents some ***rules and standards*** setting how you will report certain transactions in the financial statements – not only now, but also in the future.

It's not like a pill providing immediate relief. It is like a remedy treating the route cause and making you healthy for a long time, so that you don't need to take pills anymore. But what if you apply the wrong pill?

So, do you think that changing your accounting policy from cost model to revaluation model would make you provide better information about your machinery, not only now but also in the future?

Before you answer that question to yourself, please consider this:

- You need to apply the standard ***IFRS 13 Fair Value Measurement*** in order to determine the ***fair value*** of your machines. It's very difficult and impracticable.

How can you set the market value of used production machines (mainly if they are so specific to your company)?

- ***Revaluation model*** is used for buildings and land in 99.9% of cases, because it's easy to set the market value of these assets regularly.

Is it the case for used production machines, with some specialized nature that only a few similar companies can use them?

- You need to revalue your machinery with the ***sufficient regularity***. Can you set the fair value let's say annually?
- You need to ***revalue the entire class of assets***, not on an individual basis. Can you really set the fair value of all machinery? ***How practical is it?***

If after considering all these aspects you still want to switch from cost model to revaluation model, then IAS 8 makes it easy for you. You don't need to apply the new policy retrospectively, just prospectively – so ***no restatement of previous periods***.

What solution should we select?

It depends, really.

In my opinion, it's much better to ***review estimated useful lives at each financial year-end*** and recognize the change in accounting estimate, rather than opt to change the accounting policy just for the purpose of curing immediate headaches.

From the long-term point of view, revaluation model is not really suitable for machines used in the production process, especially when they have a specialized nature and their main recovery lies in the production of other assets and not in the capital gains resulting from the movements of their market prices.

Yes, I understand that the potential correction of error resulting from failure to review useful lives in the past can be quite painful process, because you need to make lots of calculations. But you do it JUST ONCE.

19. Choose the correct answer

1. Which of the following should be accounted for as capital expenditure?

A. The cost of repairing a car.

B. Cost of upgrading land.

C. Scheduled repair of factory machinery.

D. Salaries and wages for factory workers.

2. Which one of the following items would we recognize as subsequent expenditure on a non-current asset and to capitalise, as required by IAS 16 Property, Plant and Equipment?

A. The company made an addition to the boilers current processor to give more output per hour, costing $50,000.

B. The admin office building was badly damage in fire. The cost to restore the building to its original condition will be $300,000.

C. The cost of installing a new engine in the accidental delivery van. The cost estimate is $5,000.

D. Scheduled maintenance of factory equipment costing $30,000 per month.

THEME 4. INTANGIBLE ASSETS

1. Read the article and discuss

5 KEY EXAMPLES TO UNDERSTAND THE IAS 38 INTANGIBLE ASSETS

Intangibles under IAS 38 can be classified into five parts.

- The separate acquisition of intangibles.
- Internally generated intangibles.
- Acquisition as part of a business combination.
- Acquisition through a government grant.
- Intangible due to exchange assets.

According to paragraph 27 of IAS 38, the **cost of an intangible** asset acquired **separately** comprises:

- Its **purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.**
- Any directly attributable cost of preparing the asset for its intended use.

Example 1.1

In January of year 1, an entity acquired facial recognition software to improve security within the company; the cost of the asset is as follows:

- Acquisition price: 200,000
- Recoverable taxes: 15,000
- Non-recoverable taxes: 20,000
- Discounts: 35,000
- For the intangible to work properly, it is necessary to perform a calibration; this costs 12,000
- As part of the staff training in software management, the company incurred 8,000.

What is the total cost of the asset?

Solution

_____

_____

_____

_____

Total asset cost: _____

The total **intangible cost** does not include the recoverable taxes, since **paragraph 27 of IAS 38 intangible assets** prohibits the accounting recognition of this element as a **higher value of the asset.**

Besides, the paragraph of this standard also **leaves outside the costs of introducing a new product or service**, including costs of advertising and promotional activities.

Costs of **conducting business in a new location** or with a new class of customers, including staff training costs.

And administration **and other general overhead costs**

Example 1.2

An entity acquired a commercial brand worth 500,000 from its competition company.

With this acquisition, the company seeks to increase its sales by 20% and its share in the market.

The brand is legally registered in the entity's name as of its acquisition.

The **previous example** corresponds to an intangible for the following reasons:

The first is that the asset has **no physical appearance** and is non-monetary.

A non-monetary asset is an asset that is held in currency or an asset that will receive a fixed or specified amount of money.

The second reason is that the asset is**identifiable;** that is, the entity has control of the intangible.

Besides, the company is expected to obtain the **economic benefits** associated with purchasing the asset.

When we refer to an **identifiable asset,** it means that it is separable.

In other words, it can be **separated** or spun off from the entity and sold, transferred, put into operation, leased, or exchanged.

The **separability concept** explains why a trademark generated internally by an entity is not recognized as an intangible, **while the acquired brand is recognized in the financial statements.**

Then, when an entity purchases an intangible, the separability **requirement is met for the company acquiring the asset.**

And on the other hand, the **identifiability concept** is related to the fact that acquiring an asset with these characteristics must arise from **legal rights.**

In the example, we see that the **brand is registered.**

This means that **the economic benefits resulting from the use of the asset are exclusive to the buyer.**

If, for example, the brand were in the **public domain,** it would **not meet the definition** of intangible because the economic benefits would share with the community.

In addition to the above, the asset must comply **with the control concept.**

The **legal registration** of the brand **proves** control.

And finally, it must bring **economic benefits** to the acquiring entity.

This element is evidenced because the company expects to **increase its sales and participation in the market.**

Internally generated intangible assets must meet two stages, the research phase and the development phase.

The costs associated with **the research phase** must always be recognized in profit and loss.

In contrast, the **development costs** must be capitalized as long as they meet the requirements of **paragraph 57 of IAS 38 intangible assets.**

Example 2

In January of year 1, a pharmaceutical company began the studies to develop a vaccine against the common cold.

Investigation expenses of 700,000 are incurred during the year.

In August, the entity evaluates the project, obtaining the following results:

The entity estimates that once the project is completed, it will have the necessary production to respond to demand.

The vaccine is expected to be ready in March of year 2.

The pharmaceutical company has contracts for the sale of 100 million doses.

The company, for now, does not have all the funding to complete the project.

During year 1, 500,000 are incurred in development expenses.

On January 2, the company finally obtained the financing to complete the project and incurred 2 million in development expenses.

Based on the above information, what is the cost of the asset?

The total cost of the asset amounts to 2,000,000.

Research expenses should be recognized in profit and loss, as we said previously.

Now, what about the development **expenses in year 1?**

Should recognize these in profit or loss under paragraph 57 of IAS 38 intangible assets since all the requirements contemplated in this paragraph are not met.

For this reason, it is not possible to **capitalize them.**

However, could think that **these expenses may be capitalized** in year two since in this year, the entity obtained the **project financing,** which was the only requirement that it had pending to **capitalize on the development expenses.**

However, **paragraph 71 of IAS 38 intangible assets** states the following.

Expenditures on an intangible item that was initially recognized as an expense shall not be recognized as **part of the cost of an intangible** asset at a later date.

Then, the standard does not allow these **expenses to be recognized as part of the intangible cost.**

Continuing with the analysis, **paragraph 57 of IAS 38** identifies the following requirements to recognize the development **expenses as a higher value of the intangible.**

Technically, it is possible to complete the **production of the intangible asset to be available for use or sale.**

This requirement is met because the entity **expects all production in March of year 2.**

The entity intends to complete the intangible asset to use or sell it, and it is **expected to generate economic benefits:**

This requirement is met because the pharmaceutical company has s**igned contracts to sell 100 million doses.**

The availability of adequate technical, financial, or other resources to **complete the development and to use or sell the intangible asset:**

This requirement is not met in year 1; for this reason, it is not possible

to **capitalize on development expenses this year.**

However, in year 2, this requirement is **met because the entity obtains financial viability.**

So, it is possible to capitalize on these expenses.

For this reason, the entity must **recognize the intangible for 2,000,000.**

Finally, it is essential to say that according to paragraph 63 of IAS 38 intangible assets, Internally generated brands, mastheads, publishing titles, and customer lists shall not be recognized as intangible assets.

A business combination is the union of two or more separate entities **or businesses into a single reporting entity.**

Most business combinations result in **one entity,** the acquirer, obtaining control of one or **more businesses other than the acquired company.**

Example 3

Entity A buys all the shares of Entity B for 66,000.

Company B's financial statements are shown below:

Assets	Entity B	Fair value
Property, plant and equipment	18.000	25.000
Trademarks	0	16.000
Licenses	12.000	17.000
Total assets	30.000	58.000

The accounting record of the business combination is as follows:

Account	Debit	Credit
Property, plant and equipment	7.000	
Trademarks	16.000	
Goodwill	8.000	
Licenses	5.000	
Equity (entity B's equity before acquisition)	30.000	
Investment of company A in entity B		66.000

The acquiring company must always recognize the acquired entity's assets **at fair value in business combinations.**

In this way, the recognized value in the property, plant, equipment, and licenses equals **7,000 and 5,000, respectively.**

These values correspond to the **difference between the fair value and the carrying amount assets entity B.**

On the other hand, **entity B has a brand.**

This brand has not been recognized in the financial statements of entity B due to **was generated internally.**

However, this brand behaves as an intangible **acquired** by entity A in the business combinations.

For this reason, it is necessary to recognize it **at fair value.**

The difference generated between the assets recognized at fair value and the value paid for the shares of entity B shall be recognized as goodwill.

Total consideration paid to acquire the shares: 66,000

Total assets at fair value: 58,000

Goodwill: 8,000

Intangible assets acquired through a **government grant** will be recognized at fair value.

Example 4

As part of the aid to companies, the city's local government-issued 100 licenses to store information in the cloud to improve access to technology.

The fair value of each license is 150,000 and allows information to be stored for five years.

The entity must recognize a grant income against an intangible equivalent to 150.000, which must be amortized over five years.

Exchanges of intangible assets can be commercial or non-commercial in nature.

An exchange of a commercial nature is one where there is a change in the **cash flows** of both parties, and the specific value for the companies is modified as a **result of the exchange.**

In other words, exchanging a software for **105,000** for a license for **80,000** shows that there is a change in the cash flows of each entity, unlike if the change were a list of customers for a license and the two assets have the same **commercial value.**

And on the other hand, the difference identified is significant when compared with the fair value of the assets exchanged.

Under paragraph 45 of IAS 38 intangible assets, an entity will always measure the cost of the asset received at the fair value of the asset received; **if it is not possible to determine this value, it will be recognized** at the fair value of the asset given up.

Example 5

An entity that has a software whose carrying amount is 45,000 and its fair value is 55,000 exchanges this asset for a license that has a fair value of 95,000 and a carrying amount of 75,000.

The entity must recognize the cost of the **intangible** at the fair value of the asset acquired.

In other words, a license for **95,000.**

If the fair value of the license could not have been reliably measured, it would have been recognized for **55,000** which is equal to the fair value of the asset given up.

Now, if the fair value of neither of the two assets is available, **the asset received** should be recognized for **75,000,** which is the carrying amount of the asset acquired.

2. Read the article and discuss

ACCOUNTING RECOGNITION OF BRANDS ACCORDING TO IFRS

Internally generated brands should **not be recognized as intangibles.**

However, brands acquired in a purchase transaction or acquired through a **business combination should be recognized as intangibles.**

Paragraph 63 of IAS 38 states the following:

Internally generated brands, mastheads, publishing titles, customer lists and items similar in substance shall not be recognized as intangible assets.

Why are the brands internally generated not recognized as intangible?

An intangible must meet **three requirements** to be recognized in the financial statements:

Non-monetary in nature

No physical appearance

Identifiable

An asset is identifiable if it's separable; this means that it can be separated or divided from the entity and **sold, transferred, licensed, leased, or exchanged,** either individually or together with a contract.

It arises from contractual rights or other **legal rights.**

The main obstacle to recognizing an i**nternally generated brand** as an intangible is that they do not meet with the concept of **separability.**

In other words, it is **not possible to distinguish** which part of the disbursements incurred by an entity is directly associated with the **construction of a brand** and which part corresponds to **developing the business** as such.

For example, big brands like **Coca-Cola – Google, and Apple** invest hundreds of millions of dollars in advertising, property, plant, equipment, research, and human talent, among other aspects.

All these elements mentioned above undoubtedly help **generate a remembrance and a commercial reputation among the clients.**

However, it **is not possible** to distinguish which part of these disbursements is associated with the **development of the business** and which part is related to the **generation of the brand.**

Therefore, the IASB in **paragraph BCZ45** of the Basis for Conclusions on **IAS 38** states the following:

IAS 38 expressly **prohibits the recognition as intangible** assets of **brands, newspaper headlines, publication titles, customer lists**, and essentially similar elements that are **generated internally.**

The IASB considered that internally-generated intangibles of this type rarely or perhaps never meet the recognition criteria in **IAS 38.**

However, to avoid any misinterpretations, the IASB decided to draw that it prohibited the recognition of **brands internally generated.**

Brands recognized as part of a purchase transaction

A brand acquired in a purchase transaction must meet the following requirements to be **recognized as an intangible:**

- **No physical appearance.**
- **Identifiable.**
- **Demonstrate control.**
- **Demonstrate future economic benefits.**

The moment an entity **acquires a brand from another company**, this company must demonstrate **control.**

Control can be demonstrated when the respective registration of the **brand is made before the regulatory entities.**

In addition, the company must **demonstrate the future economic benefits** associated with this asset.

Paragraph 25 of **IAS 38** states that the separate acquisition of an intangible will always reflect expectations about the **probability that future economic benefits will flow to the entity of this asset.**

This means that **acquiring an intangible in a purchase transaction** is sufficient evidence to determine that this **acquisition will bring economic benefits to the company.**

And on the other hand, it is **identifiable** because it **arises from legal rights.**

In other words, it is the result of the **negotiation between two or more companies.**

Brands recognized as part of a business combination.

A **business combination** is a union of two or more separate entities or businesses into a **single reporting entity.**

An entity must recognize all intangible assets acquired in a business combination **at fair value.**

Paragraph 13 of IFRS 3 states that there may be a series of assets and liabilities that the acquire entity has not recognized in its financial statement.

Inside these assets, we find trade **names, lists of clients, and brands, among others,** that do not meet the condition to be recognized as intangibles because they are **internally generated.**

However, in a **business combination,** the acquirer must recognize these **assets.**

This is so because all the intangibles' assets **acquired the separability characteristic when carrying out a business combination process.**

3. Choose the correct answer "True" or "False"

Depreciation

1.	Depreciation Expense shown on a company's income statement must be the same amount as the depreciation expense on the company's income tax return.	True	False
2.	The purpose of depreciation is to have the balance sheet report the current value of an asset.	True	False
3.	Depreciation Expense reflects an allocation of an asset's original cost rather than an allocation based on the economic value that is being consumed.	True	False
4.	An asset's useful life is the same as its physical life?	True	False

5.	One company might depreciate a new computer over three years while another company might depreciate the same model computer over five years...and both companies are right.	True	False
6.	Depreciation Expense is shown on the income statement in order to achieve accounting's matching principle.	True	False
7.	Accumulated Depreciation will appear as a deduction within the section of the balance sheet labeled as Property, Plant and Equipment.	True	False
8.	If a company continues to use equipment past the useful life that was assumed in determining the depreciation, there will be no Depreciation Expense in those additional years.	True	False
9.	A company may depreciate equipment over 10 years on a straight-line basis for its financial statements, but might use an accelerated method of depreciation over a shorter time period on its income tax return?	True	False
10.	Depreciation Expense is sometimes referred to as a noncash expense.	True	False
11.	Both Land and Land Improvements will generally be depreciated.	True	False
12.	Amortization of intangible assets and depletion of natural resources is conceptually similar to depreciation of constructed assets.	True	False
13.	Depreciation Expense shown on the financial statements is a precise amount that is continuously refined.	True	False
14.	Over the life of an asset subject to depreciation, the accelerated method will result in more Depreciation Expense in total than the total Depreciation Expense using the straight-line method.	True	False
15.	When a company purchases a 10-acre parcel of land and a building located on the land, the company will depreciate the entire cost over the useful life of the building.	True	False
16.	The book value of an asset indicates the asset's fair market value at that time.	True	False
17.	If a company revises the estimated useful life of one of its assets being depreciated, the company will need to reissue its earlier financial statements as the earlier depreciation was incorrect.	True	False

4. Choose the correct answer

1. Which of the following depreciation methods is NOT an accelerated method?

a) Double-declining balance
b) Straight-line
c) Sum-of-the-years' digits

2. The book value of an asset is defined as

a) Cost minus Salvage Value
b) Cost minus Accumulated Depreciation
c) Cost minus Salvage Value minus Accumulated Depreciation
d) Estimated fair market value

THEME 5. INVENTORIES

Example 1

The ABC Stationery Company bought 20 boxes of photocopier paper at $5 per box. Following a flood in their stockroom 5 of the boxes were damaged. They were offered for sale at $3 per box. All were unsold at the end of the company's financial year.

At what price will they be valued in the annual accounts?

_____ boxes will be valued at their cost of $____ per box, a total of $____.

_____ boxes will be valued at $_____ per box, a total of $_____.

The total stock value will be $_____.

Example 2

The Good Look Clothing Company carries a variety of stocks. At their year end they produce the following data in respect of it:

Item	Cost Price $	Net Realisable Value $	Selling Price (when new) $
New dresses	1,000	1,500	2,000
Children's clothes	2,000	3,000	3,000
Bargain Fashions*	1,200	900	2,000

What will be the total stock value for the accounts?

New dresses $ _____

Children's clothes $ _____

Bargain fashions $ _____

Total Stock Value $ _____

***Example* 3**

The XYZ Manufacturing Company manufactures wooden doors for the building trade. For the period under review it manufactured and sold 10,000 doors. At the end of the trading period there were 1,000 completed doors ready for despatch to customers and 200 doors which were half completed as regards direct material, direct labour and production overheads.

Cost for the period under review were, $

Direct material used 20,000

Direct labour 5,000

Production overheads 8,300

Non-production overheads 10,000

Total Costs for the period 43,300

Calculate the value of work in progress and finished goods.

Total units sold 10,000

Finished goods units 1,000

Half completed units (200 x 0.5) 100

Production for the period _____

Attributable costs $_____

Cost per unit _____

Value of work in progress:

_____

Value of finished goods:

_____

Note that overheads are excluded from the calculations.

The value of finished goods ($3,000) will be compared with their net realisable value when preparing the final accounts.

4. Read the article and discuss

PERPETUAL VS PERIODIC INVENTORY SYSTEM

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

In perpetual inventory system, merchandise inventory and cost of goods sold are updated continuously on each sale and purchase transaction. Some other transactions may also require an update to inventory account for example, sale/purchase return, purchase discounts etc. Purchases are directly debited to inventory account whereas for each sale two journal entries are made: one to record sale value of inventory and other to record cost of goods sold. Purchases account is not used in perpetual inventory system.

In periodic inventory system, merchandise inventory and cost of goods sold are not updated continuously. Instead purchases are recorded in Purchases account and each sale transaction is recorded via a single journal entry. Thus cost of goods sold account does not exist during the accounting period. It is determined at the end of accounting period via a closing entry.

Differences Between Perpetual and Periodic System

Following are the main differences between perpetual and periodic inventory systems:

- **Inventory Account and Cost of Goods Sold Account** are used in both systems but they are updated continuously during the period in perpetual inventory system whereas in periodic inventory system they are updated only at the end of the period.
- **Purchases Account and Purchase Returns and Allowances Account** are only used in periodic inventory system and are updated continuously. In perpetual inventory system purchases are directly debited to inventory account and purchase returns are directly credited to inventory account.
- **Sale Transaction** is recorded via two journal entries in perpetual system. One of them records the sale value of inventory whereas the other records cost of goods sold. In periodic inventory system, only one entry is made.
- **Closing Entries** are only required in periodic inventory system to update inventory and cost of goods sold. Perpetual inventory system does not require closing entries for inventory account.

Complete the following sentences

1. Inventory is reported as a _____ asset.

2. Inventory is often reported at the _____ of cost or market.

3. FIFO and LIFO are examples of cost flow _____.

4. Under this inventory system the balance in the Inventory account changes with each sale. _____

5. Under this inventory system the balance in the Inventory account does not change with each sale. _____

6. A _____ will report raw materials, work-in-process, and finished goods inventory.

7. The annual cost of goods sold divided by the average inventory balances is the inventory _____ ratio.

8. The normal selling price minus the estimated cost to complete and sell is the net _____ value.

9. Net Purchases is Gross Purchases minus Purchase Returns and Allowances and_____ _____.

10. The difference between the Cost of Goods Available and the Cost of Goods Sold is_____ _____.

5. Read the article and discuss

FORMULA AND EXAMPLES OF NET REALIZABLE VALUE ACCORDING TO IFRS

The **net realizable value** is calculated using ***the estimated selling price less the estimated costs to finish production and those necessary to carry out a sale.***

This article will carry out a series of examples related to the **net realizable value** according to **IAS 2.**

This value is essential to set out if the inventories present impairment.

In other words, if when comparing the c**arrying amount** asset against the **net realizable value**, the latter is below that of the carrying amount means that the entity must adjust inventories **for this difference.**

The **estimated costs to complete the sale** are all those costs necessary to carry out the transaction.

For example, if an entity hires a sales agent or carries out an advertising campaign to promote the company products, these costs must be deducted from the sale price to calculate net realizable value.

Example 1 net realizable value

In January of year 1, an entity located in the United States purchased inventory from a supplier in the European Union.

The acquisition costs are presented below.

Purchase price: 120,000

Import duties: 24,000

Non-recoverable taxes: 12,000

Recoverable taxes: 10,000

Transportation from the port to the warehouse: 5,000

The company receives a 5% discount on the total asset cost and a 10%

discount if the entity pays for the merchandise within two months.

The entity pays for the inventory on January 28 of year 1, and on January 31 of that same year, the inventory is ready for sale.

As of December 31 of year 1, the estimated sale price is 140,000, and the estimated cost to complete the sale is 25,000

According to the above information, what is the asset's carrying amount as of January 31 of year 1 and December 31 of the same year?

The entity must consider paragraphs 10 and 11 of IAS 2 to calculate the asset cost.

These paragraphs set out that a company should not include within the cost of inventories:

Recoverable taxes.

Abnormal amounts of material waste.

Storage costs.

Indirect administration costs.

Selling costs.

In this way, the cost of the asset is as follows:

_____
_____
_____
_____
_____
_____
_____
_____
_____

According to the proposed example, the net realizable value at the end of year 1 is the following.

Net realizable value : Estimated sales price – estimated costs to complete the sale.

The net realizable value is: _____

Inventory Impairment: Carrying amount vs. net realizable value

Inventory Impairment: _____

Thus, the carrying amount as of January 31 of year 1 is _____ and as of December 31 of the same year is _____

Example 2 net realizable value

In December of year 1, a manufacturing company produced inventory with the following characteristics.

Raw material: 105,000

Labor Cost: 15,000

Indirect manufacturing costs: 45,000

Total production cost: 165,000

The entity estimates that it will complete its production in February of year

2; for this, it will need to incur 55,000 to end production at that date.

In addition, it is also estimated that the sale price of the finished product will be 210,000, and the estimated costs to complete the sale of 25,000

What is the carrying amount as of December of year 1?

To calculate the impairment of inventories in a production process, the following formula is used:

Inventory Impairment: Production Costs - (estimated selling price - estimated costs to complete production - estimated costs to complete sale)

Formula NRV

Inventory impairment: _____

The carrying amount as of December of year 1 is _____

Many people think that the calculation of net realizable value and impairment is used only for finished products.

However, paragraph 32 of IAS 2 sets out that generally, the raw materials held in inventory production are not impaired.

The above considering that the final cost of the finished products is not above the selling price, less the estimated costs to complete the sale.

Now, since the company, as of December of year 1, does not know what the final cost of the finished product will be, it must estimate this value to determine whether there is impairment.

In this way, specifically, paragraph 32 states the following:

Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold at or above cost.

However, when a decline in the price of materials indicates that the cost of the finished products exceeds net realizable value, the materials are written down to net realizable value.

In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value.

Example 3 net realizable value

A company has two lines of business, line 1 and line 2; in number one, it has two products, A and B, and in the second line, it has products C and D.

The financial information at the end of the reporting period is shown below:

Line	Product	Carrying amount	Net realizable value
1	A	50.000	45.000
1	B	70.000	120.000
2	C	83.000	75.000
2	D	65.000	55.000

Products A and B: Product A shows an impairment of 5,000, equivalent to the difference between the carrying amount and its net realizable value.

And on the other hand, product B does not show impairment since its carrying amount is below the net realizable value.

However, before recognizing impairment from product A, we must review paragraph 29 of IAS 2.

This paragraph establishes that when determining whether an inventory is impaired, we must consider whether the products belong to the same business line since an entity must assess the loss of value of the products as a whole.

In this way, if we evaluate the inventory of line 1 comprehensively, we obtain the following:

Product	Carrying amount	Net realizable value	Impairment
A	50.000	45.000	
B	70.000	120.000	
Total	120.000	165.000	No impairment

As you can see, the impairment check as a whole gives a result that the carrying amount is below the net realizable value, for this reason, it is not necessary to reduce the inventory.

Paragraph 29 determines the following:

Inventories are usually written down to net realizable value item by item.

However, it may be appropriate to group similar or related items in some circumstances.

This may be the case with items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area, and cannot be practicably evaluated separately from other items in that product line.

It is not appropriate to write inventories down on the basis of a classification of inventory, for example, finished goods, or all the inventories in a particular operating segment.

Finally, in the other line of business, the deterioration of the inventory of each product must be recognized, since the carrying amount of the two is above the net realizable value, that is, product C must be adjusted by 8,000 and product D in 10,000.

6. Read the article and discuss

COST FORMULAS FOR INVENTORIES – FIFO, LIFO AND WEIGHTED AVERAGE COST (IAS 2)

IAS 2 permits the use of approximations when determining the cost of inventories. Widely-used approximations include the standard cost method and the retail method (IAS 2.21-22). The standard cost method takes into consideration typical levels of materials, labour, efficiency, and capacity utilisation. On the other hand, the retail method bases the cost of inventory on selling prices, adjusted downwards by a profit margin. Typically, an average percentage is used, as it's unrealistic to consider all elements influencing the selling price of specific merchandise. Such averaging is expressly permitted by IAS 2.22.

For many businesses, tracking the cost of identical inventory items on a unit-by-unit basis is infeasible. As a result, IAS 2 permits the use of either the first-in, first-out (FIFO) method or a weighted average cost formula to represent inventory movements.

Interchangeable inventories

Cost of interchangeable inventories, which aren't allocated for a specific project, should be determined using either the FIFO or weighted average cost formula. The chosen formula should be consistently applied to all inventories of similar nature and use to the entity (IAS 2.25-26).

FIFO method

FIFO method presumes the earliest purchased or produced inventories are sold first. Thus, items still in inventory are the most recently acquired or made (IAS 2.27).

Example: FIFO method

On 1 January 20X1, Entity A has 1,000 units of product X, each costing $10. January 20X1 sees the following purchases:

Date	Volume	Cost per item
Opening balance	1,000	$10
5 January	300	$9.5
11 January	200	$9.7
20 January	400	$9.6

By the end of January 20X1, Entity A has sold 1,400 units of product X, leaving 500 units. Using the FIFO method, the 500 units left comprise 400 items bought on ___ January at _____each and _____items from ___ January at _____ each. The closing inventory value is $4,810. The cost of goods sold is _____, calculated as:

Date of purchase	Volume	Cost per item	Total cost in P/L
Opening balance			
Total			

Weighted average cost

This method calculates the cost of each inventory item from the weighted average cost of similar items at the start and throughout a period. It can be determined periodically or upon each delivery (IAS 2.27).

Example: Weighted average cost

On 1 January 20X1, Entity A holds 1,000 units of product X, each costing an average of $10. January sees the following purchases:

Date	Volume	Cost per item
Opening balance	1,000	$10
5 January	300	$9.5
11 January	200	$9.7
20 January	400	$9.6
Opening balance+ purchases	**1,900**	**$9.81***

By January's end, 1,500 units of product X are sold, leaving 400.
These 400 are valued at _____.
The cost of the 1,500 sold units is _____.

LIFO method

The LIFO method (last-in, first-out) is not permitted as explained in IAS 2. BC9-BC21. However, businesses can adopt specific costing formulas that align actual physical inventory flows with direct costs, potentially yielding LIFO-like results.

Inventories that are not interchangeable

Inventories that aren't typically interchangeable should have their costs specifically identified. This approach also applies to items designated for a particular project (IAS 2.23-24).

Consignment arrangements

Inventories delivered to another party (like a dealer or distributor) under a consignment arrangement remain on the delivering party's statement of financial position until the criteria for revenue recognition are satisfied. Such consignment arrangements are outlined in IFRS 15.B77-B78.

Recognition in P/L

Upon sale of inventories, their carrying amount becomes an expense in the same period as the corresponding revenue is recognised. If inventories are used in creating other assets, they form part of that asset's cost. Any reductions to the net realisable value (and their reversals) are immediately recognised in P/L (IAS 2.34-35).

7. Choose the correct answer

1. The inventory cost flow assumption where the cost of the most recent purchase is matched first against sales revenues is
   a) FIFO;
   b) LIFO;
   c) Average.
2. The inventory cost flow assumption where the cost of the most recent purchases are likely to remain in inventory
   a) FIFO;
   b) LIFO;
   c) Average.
3. The inventory cost flow assumption where the oldest cost of inventory items is likely to remain on the balance sheet is
   a) FIFO;
   b) LIFO;
   c) Average.
4. The account Inventory will appear on the balance sheet as a current asset at an amount that often reflects the _____ of the merchandise on hand.
   a) cost;

b) sales value.

5. The inventory system that does NOT update the Inventory account automatically at the time of each purchase or sales is the _____ method/system.

a) periodic;

b) perpetual.

6. If a company is experiencing continuous cost increases for the merchandise that it purchases, which cost flow assumption will result in the least amount of profit and the least amount of income tax expense?

a) FIFO;

b) LIFO;

c) Average.

7. A company in the computer industry is experiencing continuously lower costs. Which cost flow assumption will result in less income tax expense for this company?

a) FIFO;

b) LIFO;

c) Average.

8. A company purchased items for inventory during 2023 at continuously higher costs. Its last two purchases of 2023 were 20 units on December 20 at a cost of $14 per unit and 30 units on December 30 at a cost of $15 per unit. On December 28, 2023 the company made its last sale for the year when it sold 10 units. Which inventory cost flow assumption will cause the $15 cost per unit to be expensed as part of the year 2023 cost of goods sold?

a) LIFO periodic;

b) LIFO perpetual;

c) Neither.

Use the following information for questions 9 through 14:

A company purchased merchandise to be resold at increasing costs during the year 2024. The purchases were made at the following costs...

January 1, 2024 (carried over from 2022)	20 units at $10
January 25, 2024 purchase	40 units at $11
June 20, 2024 purchase	40 units at $12
October 10, 2024 purchase	50 units at $13

The company sold 10 items at the end of each month.

9. What are the number of units and the cost of the goods available for sale?

_____ units $_____ cost of goods available for sale

10. Assuming the LIFO periodic cost flow assumption, what will be the company's cost of goods sold for the 120 items sold in 2024?

a) $1,380;

b) $1,386;

c) $1,400;

d) $1,460.

11. Assuming the FIFO periodic cost flow assumption, what will be the company's cost of goods sold for the 120 items sold in 2024?

a) $1,380;
b) $1,386;
c) $1,410;
d) $1,460.

12. Assuming the periodic weighted-average cost flow assumption, what is the company'scost of goods sold for the 120 items sold in 2024?

a) $1,386;
b) $1,410;
c) $1,416;
d) $1,460.

13. Assuming the perpetual moving-average cost flow assumption, what is the company'scost of goods sold for the 120 items sold in 2024?

a) $1,386;
b) $1,410;
c) $1,416;
d) $1,460.

14. A company's inventory was destroyed in a fire on January 28, 2024. The company's December 31, 2023 inventory had a cost of $40,000. The company's gross profit has consistently been 30% of sales. During January the company purchased merchandise costing $36,000 and sales of $50,000 at regular selling prices. What is the estimated cost of the inventory that was destroyed on January 28, 2024?

a) $26,000;
b) $35,000;
c) $41,000.

15. A company has properly recorded all of its purchases of merchandise inventory, but made an error when counting its ending inventory. As a result of the error the company's Inventory account is overstated by $24,000. (This means that the amount in the Inventory account is too high by $24,000.) What is the impact of this error on the company's income statement? Specifically, the company's reported profit (ignoring income tax expense) in the period of the error is....

a) Too High;
b) Too Low;
c) Not Affected.

THEME 6. BIOLOGICAL ASSETS

1. Complete the following table

Sheep, Milk, Wool, Sausages, Picked fruit, Wine, Bushes, Clothing, Grapes, Tea, Dairy cattle, Pigs, Cotton, Processed fruit, Yarn, Plants, Carcass, Cheese, Leaf, Fruit trees, Vines

Biological assets	Agricultural produce	Products that are the result of processing after harvest

2. Complete the following table

Vines, Land used for agricultural activity, Sheep, Grapes, Pigs, guard dogs, Dairy cattle, a trailer that is used in a farming operation, trees, fish farming, Milk, Wool, Carcass, tea leaves, a tractor that is used for agricultural activity

within the scope of IAS 41	within the scope of IAS 2	within the scope of IAS 16

1. Read the article and discuss

TOP 3 QUESTIONS ABOUT IAS 41 AGRICULTURE

Question #1: Is it agriculture?

The first and primary question when dealing with living plants and animals is – ***what is agricultural activity***?

It is the management of the biological transformation (e.g. growth) of biological assets for (IAS 41.5):

- Sale, or

- into agricultural produce, or
- into additional biological assets.

You have to make your best effort to answer that question correctly, because the accounting and reporting depends on it.

Why?

Imagine you have a dog.

Logically, it is a living animal, and therefore it is a biological asset. You might think: "well, biological assets are governed by IAS 41, so I need to measure the dog at fair value at the end of each year".

Not so fast.

Why do you have that dog?

Is it a guard dog, protecting your property and barking at everyone passing by?

If yes, then you should NOT apply IAS 41, but IAS 16 Property, plant and equipment and measure the dog at cost less accumulated depreciation.

The reason is that protecting the property is NOT an agricultural activity and IAS 41 does NOT apply.

Or, do you have that dog in order to produce and raise puppies and sell the puppies?

In this case, IAS 41 applies, because breeding and selling puppies is an agricultural activity.

So, if you think that OK, I'm not a farmer, so I don't need to bother with IAS 41, you might be surprised where the agriculture can hide.

Just a few examples:

- ***Pharmaceutical companies***

Some pharma companies grow their own plants in order to produce drugs. Yes, this is an agricultural activity and IAS 41 applies.

- ***Diary producers***

If a company grows its own bacteria and cultures and then adds them to its yoghurts, well – this is an agricultural activity and IAS 41 applies.

- ***Jewelry producers***

Some big jewelry producers produce their own pearls by planting foreign objects (such as pieces of shells or parasites) into the soft bodies of living oysters. Then, the oyster produces a pearl by secreting crystalline substance around the object to protect itself. Yes, this is an agricultural activity and IAS 41 applies.

On the other hand, not everything involving living plants or animals is agricultural activity.

Again, few examples:

- ***ZOO***

The main purpose of the ZOO (and safari, recreational park, riding hall, etc.) is to make money from showing the animals off to the public – this is NOT an agricultural activity and IAS 41 does NOT apply (IAS 16 does).

Yes, animals living in the ZOO sometimes pair and produce a baby – but if it's a natural process, not managed by the ZOO, it is NOT an agricultural activity.

The situation would be different when the ZOO would implement an active program of reproduction and managed that program. In this case, breeding animals would NOT be an incidental and ZOO would have to apply IAS 41.

- ***Fishing***

All fishermen catching fish in the ocean can breathe with relief. If you are NOT actively farming fish, but you're merely harvesting the fish from the ocean, it's NOT an agricultural activity.

The reason is that fish grew naturally in the ocean, which was NOT an agricultural activity.

The same applies for hunting and other similar activities of harvesting biological assets from nature.

- ***"Working animals"***

When you hold an animal primarily to do some work, such as cart-horses, guard dogs, elephant taxis, etc., then you do NOT apply IAS 41, because all these activities do NOT represent biological transformation.

Instead, IAS 16 is the right way to go.

Question #2: Is it a biological asset?

Very common misconception in the agriculture accounting is the belief that everything coming out of agriculture is a biological asset.

Not true.

Biological assets are only living plants and animals.

The harvested products of biological assets are agricultural produce.

Apples, palm oil, pearls, milk, coffee beans, tea leaves – all this is agricultural produce.

Why do we bother?

Well, once you detach the agricultural produce from a biological asset, in other words – once you harvest the produce, it becomes your inventories and you apply IAS 2 Inventories.

At the moment of harvest, you should measure your new inventories at their fair value less costs to sell and subsequently, you measure them under IAS 2 at lower of cost and net realizable value.

You do NOT remeasure agricultural produce to fair value less cost to sell.

Question #3: Are biological assets always measured at fair value less costs to sell?

No, they are not.

It is true that the general rule in IAS 41 Agriculture is to measure all biological assets at ***fair value less costs to sell***.

However, there are few exceptions:

1. The biological asset is ***NOT a part of agricultural activity***.

I've explained it above – guard dogs, fish caught in the ocean, etc.

2. The biological asset is ***a bearer plant***.

This is a relatively new thing in both IAS 41 and IAS 16 adopted in 2014.

A bearer plant is a living plant used in production or supply of agricultural produce that is expected to produce for more than 1 period.

1. The examples are fruit trees, oil palms, vines etc.

As it was difficult and impractical to set the fair value of these assets at the end of each reporting period, they were taken out of IAS 41's scope.

So, you can keep these assets at cost less accumulated depreciation under IAS 16.

Careful – this is only about plants, not animals. So, if you own expensive dogs and use them to breed new dogs, then sorry, it's NOT a bearer plant.

2. ***The fair value is not reliably measurable***

When the fair value cannot be measurable, you can measure the asset at its ***cost less accumulated depreciation***.

However, this is almost never relevant and IAS 41 says that the fair value CAN be measured reliably for biological assets.

Also, this exemption is available ONLY at initial recognition, never later. So, if you received the biological asset as a gift and market prices are not available, you would be able to use cost model.

Other situations are highly unlikely.

2. Read the article and discuss

HOW TO MEASURE FAIR VALUE IN AGRICULTURE – IAS 41 AND IFRS 13

What type of agricultural asset is that?

From the accounting aspect, you can have a few types of assets involved in agriculture and your primary goal is to identify what type it is.

It is very similar as with financial instruments – classify it first, apply appropriate standard and then measure it accordingly.

How to measure different types of assets in agriculture?

I. Biological assets

By definition in IAS 41, a biological asset is a living animal or plant.

I find this definition vague, because not all living animals and plants automatically fall within the scope of IAS 41.

First of all, you need to ask yourself a question:

Is the asset used in an agricultural activity?

In other words, are you ***managing the biological transformation and harvest*** of biological assets for specified purposes?

- If yes, then OK, the biological asset falls within the scope of IAS 41. For example, fish that you are growing on a farm.
- If not, then the asset is outside of IAS 41 scope. For example, fish that you pick from the sea (you did not manage the biological transformation of wild ocean fish, did you?).

Another example is dog – holding a dog for breeding puppies is agricultural activity (IAS 41 applies), but holding a guard dog for security purposes is not (IAS 41 does not apply).

The second question to ask is:

Is the biological asset bearer or consumable?

Consumable biological assets

Consumable biological assets are those that will be either:

- ***Harvested as agricultural produce***; for example farmed fish, hogs for meat, trees grown for lumber etc.; or
- ***Sold as biological assets***; for example seedlings of apple trees, young puppies, etc.

Consumable assets fall within the scope of IAS 41 and shall be measured ***at fair value less cost to sell***.

Bearer biological assets

Bearer biological assets are ***other than consumable biological assets***, for example apple tree held for harvesting apple, or cattle for milk production.

Here, IFRS makes a distinction between bearer plants and bearer animals:

- Bearer plants fall within the scope of IAS 16; but
- Bearer animals fall within the scope of IAS 41.

In conclusion – basically all animals do fall within the scope of IAS 41, regardless whether they are consumable or bearer.

Therefore, you need to measure them at fair value less cost to sell as well.

With plants, you need to differentiate and correctly assess what they are. And, as this question requires special attention, I will make up a Q&A session soon on this point.

Bearer plants fall within the scope of IAS 16 and therefore they are measured either applying cost model or revaluation model.

II. Agricultural produce

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

Examples are apples, eggs, milk, or meat.

Be careful – products made from agricultural produce are NOT agricultural produce anymore; rather they are inventories, for example apple juice, cheese, salami, etc.

Also, some people get confused about living animals.

Imagine you have a chicken farm and raise young chicks for further sale.

These young chicks are NOT an agricultural produce. Instead, they are biological assets, because they are living animals (thus meet the definition of a biological asset).

Agricultural produce shall be measured at ***fair value less cost to sell at the point of harvest***.

After this point, agricultural produce becomes inventories and you need to apply the standard IAS 2.

III. Agricultural land

I mention this asset just to include it here, but it should be crystal clear.

Agricultural land that you use for agricultural activity is definitely ***within the scope of IAS 16*** and measured using cost or revaluation model.

It is NOT an investment property under IAS 41, because you are using it for agriculture (own revenue-generating activity).

The following table sums up the measurement of agricultural assets:

What?	Example	Measurement
Consumable biological asset	Seedlings of apple tree, chicken for sale, etc.	Fair value less cost to sell at the reporting date
Bearer plant	Apple tree used to grow and harvest apples	IAS 16 – cost model or revaluation model
Bearer animal	Cow held for milking	Fair value less cost to sell at the reporting date
Agricultural produce	Apples, eggs, milk…	Fair value less cost to sell at the harvest date
Agricultural land	Forestry land	IAS 16 – cost model or revaluation model

How to measure fair value of agricultural assets

Once we have identified what to measure at fair value less cost to sell and when to measure it, we need to look at the standard IFRS 13 Fair Value Measurement.

Yes, IFRS 13 applies even here with its principles.

IFRS 13 contains ***fair value hierarchy*** that classifies inputs to use for setting the fair value and sets priorities of these inputs:

- ***Level 1 inputs:*** Quoted prices in active markets for identical assets on the measurement date. This is by far the most preferred and accepted method of measurement.

However, you can apply this only for assets with ***active market*** for similar assets with the same condition.

No problem for agricultural produce like raw milk, eggs or meat – usually there is a strong active market to derive the fair value of these assets.

Also, no problem for consumable biological assets close to their sale or harvest date.

- ***Level 2 inputs:*** Other than quoted market prices within Level 1 that are directly or indirectly observable for the asset.

Basically we are talking about ***market-determined prices*** where active market does not exist. Imagine that some asset would be so rarely traded that the last trade happened some time ago. You can use most recent price as the input to fair valuation – that's basically level 2 input.

- ***Level 3 inputs:*** Unobservable inputs for the asset.

In agriculture, Level 3 is used when there is ***no active market for the asset in its present condition*** (e.g. age, height, weight). In practice, companies use present value of cash flows generated by the asset as Level 3 input to valuation technique.

To sum it up, here's the order of valuation techniques to use:

1. ***Market price for the identical asset in an active market*** at the reporting date (or at the harvest date, based on the type of an asset) – that's Level 1.
2. ***Recent transaction prices*** for the identical assets when no active market exists – that's Level 2.
3. ***Market price for similar assets*** in an active market – that's Level 2.
4. ***Present value of future cash flows*** from the assets – that's Level 3.
5. ***Cost as an approximation of fair value*** – that's Level 3, too and it can be used only in some situations as described below.

What does it practically mean?

For harvested ***agricultural produce and some consumable biological assets***, there is an active market with exactly the same assets in the same condition and you can take the market price as ***level 1*** input into your valuation.

For ***most biological assets that take longer time*** to produce, to mature and will not be harvested or sold until some distant time in the future, active market does NOT exist and you need to apply ***discounted cash flow technique***.

Let's illustrate it in the example.

Example – fair value of biological assets by discounted cash flows

ABC is a company that grows eucalyptus trees for harvesting them and using them for production of pulp.

In 20X1, ABC planted 1 000 trees. Eucalyptus trees are mature and ready for harvest after 7 years.

At the end of 20X3, the market price of one mature eucalyptus tree is CU 3 000.

Each year, ABC incurs costs to grow the trees amounting to CU 100 per tree.

ABC uses the discount rate of 5% (being market rate of return).

The fair value of ABC's trees was CU 1 850 000 at the end of 20X2.

Calculate the fair value of ABC's trees at the end of 20X3.

For the sake of simplicity, we will ignore inflation and other economic parameters here. I want to show the basic mechanics to you.

ABC's 1 000 trees will be ready in 20X8, so at the end of 20X3, we need to list all the cash flows in the years 20X4 to 20X8 as I have done here:

Year	Expenses	Income	Net cash flow	Discount factor	Present value
20X4	-100	0	-100	0,952	-95,20
20X5	-100	0	-100	0,907	-90,70
20X6	-100	0	-100	0,864	-86,40
20X7	-100	0	-100	0,823	-82,30
20X8	-100	3 000	2 900	0,784	2 274,60
Total					1 920,00

This is the fair value of one tree; ABC has 1 000 trees, so the fair value of all eucalyptus trees is 1 920 000 CU – pardon for rounding involved here.

The total change in FV of the trees is therefore CU 70 000 (1 920 000 less 1 850 000).

Two remarks to this example:

1. Don't forget to ***deduct the cost to sell from this fair value***. In the table, we included cash outflows related to cost to grow the trees, but not cost to sell, so just bear in mind that once you have your fair values, you need do take cost to sell into account.
2. IAS 41 encourages you to disclose the fair value change over the year and ***to split this change*** into:
   - Change in FV ***due to physical change (trees grow and thus their FV increases)***; and
   - Change in FV due to ***change in prices (market prices can change over time).***

This disclosure is especially important for biological assets with production cycle longer than one year (e.g. eucalyptus trees in this example).

How to set the cash flows from biological asset?

General rule in IFRS 13 says that you should include ***all directly attributable cash inflows and outflows*** to the asset.

Which ones?

This strongly depends on the specific activity you are doing, specific biological assets that you are measuring and yes, it requires some judgment from you.

Examples of cash flow are:

- ***Cash inflows from sale*** of an asset or agricultural produce in the future. You might estimate it based on:
  - assumed asset's weight, age, volume, etc.; and
  - market prices of a specific biological asset or agricultural produce.

For example, let's say you take care of forest with trees that will be chopped for wood after some time. You can estimate future cash inflow from the forestry assets (trees) based on assumed volume (cubic meters) of wood harvested from the forest and market price of wood from similar trees.

One big NO: do NOT determine the fair value based on future prices in your contracts.

- ***Cash outflows to grow the asset.***

Examples are numerous here: animal food, vaccination of animals, fertilizers, herbicides, labor cost and other.

Two big NOs: Do not include income tax and financing cash outflows.

Any exceptions from setting fair value of biological assets?

Yes, there are two situations when you don't have to set the fair value:

1. ***Cost as an approximation of fair value.***

You can use cost instead of fair value, but only when either:

- Little biological transformation happened since initial costs were incurred – for example, you plant seedlings of trees very short time before the end of the reporting period.
- The biological transformation does not have a material impact on price, for example the trees with long production cycle right after planting.

2. ***The fair value cannot be reliably measured.*** This is extremely rare because you can almost always measure the fair value for biological assets, either based on Level 1, Level 2 or Level 3 inputs.

THEME 7. CASH AND CASH EQUIVALENTS

1. Read the article and discuss

1) What is the difference between the direct method and the indirect method for the statement of cash flows?

The main difference between the direct method and the indirect method involves the *cash flows from operating activities*, the first section of the statement of cash flows. (There is no difference in the cash flows reported in the investing and financing activities sections.)

Under the direct method, the cash flows from operating activities will include the amounts for lines such as *cash from customers* and *cash paid to suppliers*. In contrast, the indirect method will show net income followed by the adjustments needed to convert the total net income to the cash amount from operating activities.

The direct method must also provide a reconciliation of net income to the cash provided by operating activities. (This is done automatically under the indirect method.)

Nearly all corporations prepare the statement of cash flows using the indirect method.

2) What is the difference between net cash flow and net income?

Under the accrual method of accounting, net income is calculated as follows: *revenues earned* minus the *expenses incurred* in order to earn those revenues. If a company earns revenues in December but allows those customers to pay in 30 days, the cash from the December revenues will likely be received in January. In this situation the December revenues will increase the December net income, but will not increase the company's December net cash flow.

Under accrual accounting, expenses are matched to the accounting period when the related revenues occur or when the costs have expired. For example, a retailer may have purchased and paid for merchandise in October. However, the merchandise remained in inventory until it was sold in December. The company's net cash flow decreases in October when the company pays for the merchandise. However, net income decreases in December when the cost of the goods sold is matched with the December sales.

There are many other examples of expenses occurring in one accounting period but the payments occur in a different accounting period.

In short, the statement of cash flows is a needed financial statement because the income statement does not report cash flows.

3) What is the difference between cash flow and free cash flow?

A corporation's cash flow from operations is available from the first section of the statement of cash flows. Usually the calculation begins with the accrual accounting net income followed by adding back depreciation expense and then adjusting for the changes in the balances of current assets and current liabilities.

Free cash flow is often defined as the cash flow from operations (or net cash flows from operating activities) minus the cash necessary for capital expenditures. Occasionally, dividends to stockholders are also deducted.

4) How can a company have a profit but not have cash?

A company can have a profit but not have cash because *profit* is computed using revenues and expenses, which are different from the company's cash receipts and cash disbursements. In other words, there is a difference between revenues and receipts. There is also a difference between expenses and expenditures.

To illustrate, let's assume that a new company uses the accrual method of accounting. It provides $10,000 of services to its clients in its first month and the clients are allowed to pay in 30 days. The company will have $10,000 of revenues in its first month, but the cash will not be received until the second month. If the company's expenses are $7,000 in the first month, the company will report a profit of $3,000 but will not have received any cash from its clients.

Another company might have a profit of $60,000 in its first year, but during its first year it uses $65,000 of cash to acquire equipment that will be put into service at the beginning of the second year. This company will have a profit, but will not have the cash.

Other examples where cash is paid out, but the profits are not reduced at the time of the payment, include prepayments of insurance, payments to increase the inventory of merchandise on hand, and payments to reduce liabilities.

2. Complete the following sentences

1. The first section of the statement of cash flows reports the cash flows from _____ activities.
2. The second section of the statement of cash flows reports the cash flows from _____ activities.
3. The third section of the statement of cash flows reports the cash flows from _____ activities.
4. Under the indirect method, an increase in _____ assets other than cash will cause a decrease in cash from operating activities.
5. Under the indirect method, a decrease in current _____ will cause a decrease in cash from operating activities.
6. The cash _____ from the sale of a long-term asset will be reported in the investing activities section of the statement of cash flows.
7. A corporation's _____ on its stock will appear as a deduction in the financing activities section of the statement of cash flows.
8. Capital _____ are a significant deduction in the investing activities section of the statement of cash flows.
9. The purchase of _____ stock will cause a negative amount in the financing activities section of the statement of cash flows.
10. The _____ of bonds payable will be reported as a negative amount in the financing activities section of the statement of cash flows.

3. For each of the following items, indicate which part will be affected:
Operating, Investing, Financing, Supplemental

1.	Depreciation Expense	
2.	Proceeds from the sale of equipment used in the business	
3.	The Loss on the Sale of Equipment in Question #2.	
4.	Declaration and payment of dividends on company's stock	
5.	Gain on the Sale of Automobile formerly used in the business	
6.	The *proceeds* from the sale of the automobile in Item #5.	
7.	An increase in the balance in a retailer's Merchandise Inventory	
8.	An increase in the balance in Accounts Payable	
9.	Retirement of long-term Bonds Payable	
10.	Purchase of Treasury Stock (company's own stock)	
11.	The purchase of a new delivery truck to be used in the business	
12.	A decrease in the balance of Accounts Receivable	
13.	An increase in Bonds Payable (a long-term liability)	
14.	A decrease in the current asset account Prepaid Insurance	
15.	A decrease in the current liability Income Taxes Payable	
16.	The proceeds from issuing additional Common Stock	
17.	The amortization of the cost of an intangible asset	
18.	The exchange/conversion of long-term bonds into common stock	

4. For items 1 – 12 indicate whether they will have a positive or negative effect on cash.

A **positive effect** could also be thought of as a *source* of cash, an *increase* in cash, or a *positive amount* on the cash flow statement.

A **negative effect** could also be thought of as a *use* of cash, a *decrease* in cash, or a *negative amount* on the cash flow statement.

1.	An increase in the balance of Prepaid Insurance	
2.	A decrease in Supplies on hand	
3.	The proceeds from the sale of equipment formerly used in the business	
4.	The Loss on the Sale of Equipment in the previous question	
5.	An increase in the current liability Income Taxes Payable	
6.	A decrease in Accounts Payable	
7.	An increase in Accounts Receivable	
8.	An increase in the current liability Warranty Liability	
9.	Dividends declared and paid	
10.	Proceeds from the issuance of Preferred Stock	
11.	The Gain on the Sale of Equipment formerly used in the business	
12.	An increase in the long-term asset Investment in Another Company	

5. Choose the correct answer

1. For a recent year a corporation's financial statements reported the following:

Net Income	$100,000
Depreciation Expense	10,000
Increase in Accounts Receivable	30,000
Decrease in Accounts Payable	15,000

Based on the above information, what amount will the corporation report as Cash Provided by Operating Activities on the cash flow statement?

a) $65,000;
b) $125,000;
c) $155,000.

2. A corporation reported the following information for the past year:

Net Income	$200,000
Depreciation Expense	30,000
Gain on Sale of Truck	5,000
Proceeds from Sale of Truck	8,000
Decrease in Accounts Receivable	10,000

Assuming these are the only facts, what amount will the corporation report as the Cash Provided by Operating Activities on the cash flow statement?

a) $225,000;
b) $235,000;
c) $253,000.

6. Use «Increases» or «Decreases» to complete the table below

1.	When Mary Smith invests her personal money into her new company, what will happen to her company's Cash account?	
2.	When a company purchases inventory (merchandise purchased in order to be resold) what will happen to its Cash account?	
3.	What happens to the company's Cash account if it borrows money from the bank by signing a note payable?	
4.	What happens to a company's Cash account if it declares a dividend on its shares of stock?	
5.	What is the effect on its Cash account when a company pays some of its Accounts Payable?	
6.	What is the effect on its Cash account when a company prepays a 6-month insurance premium?	
7.	What is the effect on its Cash account when a company sells merchandise, but allows the customer to pay in 30 days?	
8.	What is the effect on its Cash account when a company receives payment from one of its customers 30 days after the sale was recorded?	
9.	If a company's Accounts Payable account decreased, what is the likely effect this will have on Cash?	
10.	If the asset account Prepaid Insurance increased, what is the likely effect on Cash?	
11.	If the asset account Land increased, what's the likely effect on Cash?	
12.	If the asset account Land decreased, what's the likely effect on Cash?	
13.	If the liability account Bonds Payable increases, what is the likely effect on Cash?	
14.	If the liability account Bonds Payable decreases, what is the likely effect on Cash?	

7. Read the article and discuss

Cash transactions are ones that are settled immediately in cash. Cash transactions also include transactions made through cheques. Cash transactions may be classified into cash receipts and cash payments.

Cash receipts are accounted for by debiting cash / bank ledger to recognize the increase in the asset. Following are common types of cash receipt transactions along with relevant accounting entries:

Cash Sale:

Debit	Cash
Credit	Sales

Cash receipt from receivable:

Debit	Cash
Credit	Receivable

Capital contribution from shareholders:

Debit	Bank
Credit	Share Capital

Receipt of loan from a bank:

Debit	Bank
Credit	Loan

Cash Payments

Cash payments are accounted for by crediting the cash / bank ledger to account for the decrease in the asset.

Following are common types of cash payment transactions along with relevant accounting entries:

Cash payment to a payable:

Debit	Payable
Credit	Cash

Purchase of inventory for cash:

Debit	Purchases
Credit	Cash

Purchase of a machine for cash:

Debit	Machinery - Asset
Credit	Cash

Cash Drawings by owner:

Debit	Drawing
Credit	Cash

Repayment of loan installment:

Debit	Loan
Credit	Cash

MODULE 3. ACCOUNTING FOR FINANCIAL INSTRUMENTS, REVENUE AND LIABILITIES

THEME 8. FINANCIAL INSTRUMENTS

1. Read the article and discuss

What is a Financial Instrument?

Financial instruments are contracts for monetary assets that can be purchased, traded, created, modified, or settled for. In terms of contracts, there is a contractual obligation between involved parties during a financial instrument transaction.

For example, if a company were to pay cash for a bond, another party is obligated to deliver a financial instrument for the transaction to be fully completed. One company is obligated to provide cash, while the other is obligated to provide the bond.

Basic examples of financial instruments are cheques, bonds, securities.

There are typically three types of financial instruments: cash instruments, derivative instruments, and foreign exchange instruments.

Types of Financial Instruments

1. Cash Instruments

Cash instruments are financial instruments with values directly influenced by the condition of the markets. Within cash instruments, there are two types; securities and deposits, and loans.

Securities: A security is a financial instrument that has monetary value and is traded on the stock market. When purchased or traded, a security represents ownership of a part of a publicly-traded company on the stock exchange.

Deposits and Loans: Both deposits and loans are considered cash instruments because they represent monetary assets that have some sort of contractual agreement between parties.

2. Derivative Instruments

Derivative instruments are financial instruments that have values determined from underlying assets, such as resources, currency, bonds, stocks, and stock indexes.

The five most common examples of derivatives instruments are synthetic agreements, forwards, futures, options, and swaps. This is discussed in more detail below.

Synthetic Agreement for Foreign Exchange (SAFE): A SAFE occurs in the over-the-counter (OTC) market and is an agreement that guarantees a specified exchange rate during an agreed period of time.

Forward: A forward is a contract between two parties that involves customizable derivatives in which the exchange occurs at the end of the contract at a specific price.

Future: A future is a derivative transaction that provides the exchange of derivatives on a determined future date at a predetermined exchange rate.

Options: An option is an agreement between two parties in which the seller grants the buyer the right to purchase or sell a certain number of derivatives at a predetermined price for a specific period of time.

Interest Rate Swap: An interest rate swap is a derivative agreement between two parties that involves the swapping of interest rates where each party agrees to pay other interest rates on their loans in different currencies.

3. Foreign Exchange Instruments

Foreign exchange instruments are financial instruments that are represented on the foreign market and primarily consist of currency agreements and derivatives.

In terms of currency agreements, they can be broken into three categories.

Spot: A currency agreement in which the actual exchange of currency is no later than the second working day after the original date of the agreement. It is termed "spot" because the currency exchange is done "on the spot" (limited timeframe).

Outright Forwards: A currency agreement in which the actual exchange of currency is done "forwardly" and before the actual date of the agreed requirement. It is beneficial in cases of fluctuating exchange rates that change often.

Currency Swap: A currency swap refers to the act of simultaneously buying and selling currencies with different specified value dates.

Asset Classes of Financial Instruments

Beyond the types of financial instruments listed above, financial instruments can also be categorized into two asset classes. The two asset classes of financial instruments are debt-based financial instruments and equity-based financial instruments.

1. Debt-Based Financial Instruments

Debt-based financial instruments are categorized as mechanisms that an entity can use to increase the amount of capital in a business. Examples include bonds, debentures, mortgages, U.S. treasuries, credit cards, and line of credits (LOC).

They are a critical part of the business environment because they enable corporations to increase profitability through growth in capital.

2. Equity-Based Financial Instruments

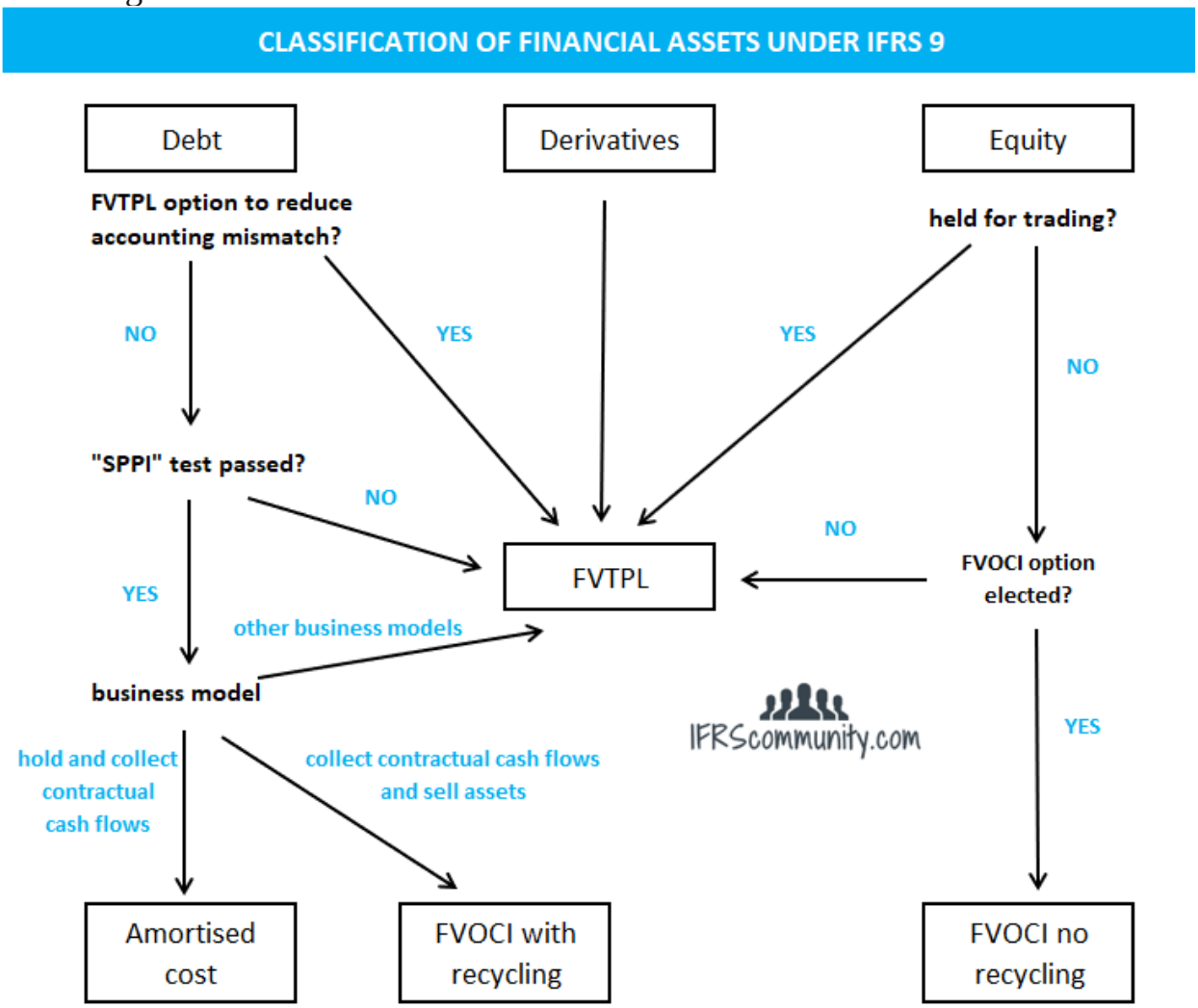
Equity-based financial instruments are categorized as mechanisms that serve as legal ownership of an entity. Examples include common stock, convertible debentures, preferred stock, and transferable subscription rights.

They help businesses grow capital over a longer period of time compared to debt-based but benefit in the fact that the owner is not responsible for paying back any sort of debt.

A business that owns an equity-based financial instrument can choose to either invest further in the instrument or sell it whenever they deem necessary.

The way financial assets and liabilities are classified determines how they are accounted for in financial statements, particularly how these financial instruments are measured following their initial recognition.

The following decision tree summarises the classification of financial assets according to IFRS 9.



Decision tree for classification of financial assets under IFRS 9

Financial assets are classified into one of the following measurement categories:

- Amortised cost.
- Fair value through other comprehensive income with recycling to P/L ('FVOCI with recycling').
- Fair value through other comprehensive income without recycling to P/L ('FVOCI no recycling').
- Fair value through profit or loss ('FVTPL').

These two factors are pivotal to classifying financial assets (IFRS 9.4.1.1):

- The entity's business model for managing financial assets, and
- The contractual cash flow characteristics of the financial asset.

Categories of financial liabilities under IFRS 9

Financial liabilities are classified into one of the following categories (IFRS

9.4.2.1):

Measured at amortised cost.
Measured at fair value through profit or loss (FVTPL).
Designated at fair value through profit or loss (FVTPL).

2. Read the article and discuss

What is a financial instrument?

Let us start by looking at the definition of a financial instrument, which is that a financial instrument is a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of an other entity.

With references to assets, liabilities and equity instruments, the statement of financial position immediately comes to mind. Further, the definition describes financial instruments as contracts, and therefore in essence financial assets, financial liabilities and equity instruments are going to be pieces of paper.

For example, when an invoice is issued on the sale of goods on credit, the entity that has sold the goods has a financial asset – the receivable – while the buyer has to account for a financial liability – the payable. Another example is when an entity raises finance by issuing equity shares. The entity that subscribes to the shares has a financial asset – an investment – while the issuer of the shares who raised finance has to account for an equity instrument – equity share capital. A third example is when an entity raises finance by issuing bonds (debentures). The entity that subscribes to the bonds – ie lends the money – has a financial asset – an investment – while the issuer of the bonds – ie the borrower who has raised the finance – has to account for the bonds as a financial liability.

So when we talk about accounting for financial instruments, in simple terms what we are really talking about is how we account for investments in shares, investments in bonds and receivables (financial assets), how we account for trade payables and long-term loans (financial liabilities) and how we account for equity share capital (equity instruments). (Note: financial instruments do also include derivatives, but this will not be discussed in this article.).

In considering the rules as to how to account for financial instruments there are various issues around classification, initial measurement and subsequent measurement.

This article will consider the accounting for equity instruments and financial liabilities. Both arise when the entity raises finance – ie receives cash in return for issuing a financial instrument.

Distinguishing between debt and equity

For an entity that is raising finance it is important that the instrument is correctly classified as either a financial liability (debt) or an equity instrument (shares). This distinction is so important as it will directly affect the calculation of the gearing ratio, a key measure that the users of the financial statements use to assess the financial risk of the entity. The distinction will also impact on the

measurement of profit as the finance costs associated with financial liabilities will be charged to the statement of profit or loss, thus reducing the reported profit of the entity, while the dividends paid on equity shares are an appropriation of profit rather than an expense.

When raising finance the instrument issued will be a financial liability, as opposed to being an equity instrument, where it contains an obligation to repay. Thus, the issue of a bond (debenture) creates a financial liability as the monies received will have to be repaid, while the issue of ordinary shares will create an equity instrument. In a formal sense an equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

It is possible that a single instrument is issued that contains both debt and equity elements. An example of this is a convertible bond – ie where the bond contains an embedded derivative in the form of an option to convert to shares rather than be repaid in cash. The accounting for this compound financial instrument will be considered in a subsequent article.

Equity instruments

Equity instruments are initially measured at fair value less any issue costs. In many legal jurisdictions when equity shares are issued they are recorded at a nominal value, with the excess consideration received recorded in a share premium account and the issue costs being written off against the share premium.

Example 1: Accounting for the issue of equity

Dravid issues 10,000 $1 ordinary shares for cash consideration of $2.50 each. Issue costs are $1,000.

Required

Explain and illustrate how the issue of shares is accounted for in the financial statements of Dravid.

Solution

The entity has raised finance (received cash) by issuing financial instruments. Ordinary shares have been issued, thus the entity has no obligation to repay the monies received; rather it has increased the ownership interest in its net assets. As such, the issue of ordinary share capital creates equity instruments. The issue costs are written off against share premium. The issue of ordinary shares can thus be summed up in the following journal entry.

Dr	Cash	$24,000		The gross cash received is 10,000 x $2.5 = $25,000 but the issue costs of $1,000 have to be paid
Cr	Equity Share Capital		$10,000	The 10,000 shares issued are recorded at their nominal value of $1 each
Cr	Share Premium		$14,000	The excess consideration received of $15,000 ($1.50 x 10,000) is recorded in share premium but net of the issue costs of $1,000

Equity instruments are not remeasured. Any change in the fair value of the

shares is not recognised by the entity, as the gain or loss is experienced by the investor, the owner of the shares. Equity dividends are paid at the discretion of the entity and are accounted for as reduction in the retained earnings, so have no effect on the carrying value of the equity instruments.

As an aside, if the shares being issued were redeemable, then the shares would be classified as financial liabilities (debt) as the issuer would be obliged to repay back the monies at some stage in the future.

Financial liabilities

A financial instrument will be a financial liability, as opposed to being an equity instrument, where it contains an obligation to repay. Financial liabilities are then classified and accounted for as either fair value through profit or loss (FVTPL) or at amortised cost.

Financial liabilities at amortised cost

The default position is, and the majority of financial liabilities are, classified and accounted for at amortised cost.

Financial liabilities that are classified as amortised cost are initially measured at fair value minus any transaction costs.

Accounting for a financial liability at amortised cost means that the liability's effective rate of interest is charged as a finance cost to the statement of profit or loss (not the interest paid in cash) and changes in market rates of interest are ignored – ie the liability is not revalued at the reporting date. In simple terms this means that each year the liability will increase with the finance cost charged to the statement of profit or loss and decrease by the cash repaid.

Example 2: Accounting for a financial liability at amortised cost

Laxman raises finance by issuing zero coupon bonds at par on the first day of the current accounting period with a nominal value of $10,000. The bonds will be redeemed after two years at a premium of $1,449. The effective rate of interest is 7%.

Required

Explain and illustrate how the loan is accounted for in the financial statements of Laxman.

Solution

Laxman is receiving cash that it is obliged to repay, so this financial instrument is classified as a financial liability. There is no suggestion that the liability is being held for trading purposes nor that the option to have it classified as FVTPL has been made, so, as is perfectly normal, the liability will be classified and accounted for at amortised cost and initially measured at fair value less the transaction costs. The bonds are being issued at par, so there is neither a premium nor discount on issue. Thus Laxman initially receives $10,000. There are no transaction costs and, if there were, they would be deducted. Thus, the liability is initially recognised at $10,000.

In applying amortised cost, the finance cost to be charged to the statement of profit or loss is calculated by applying the effective rate of interest (in this example 7%) to the opening balance of the liability each year. The finance cost will increase the liability. The bond is a zero coupon bond meaning that no actual interest is paid

during the period of the bond. Even though no interest is paid there will still be a finance cost in borrowing this money. The premium paid on redemption of $1,449 represents the finance cost. The finance cost is recognised as an expense in the statement of profit or loss over the period of the loan. It would be inappropriate to spread the cost evenly as this would be ignoring the compound nature of finance costs, thus the effective rate of interest is given. In the final year there is a single cash payment that wholly discharges the obligation. The workings for the liability being accounted for at amortised cost can be summarised and presented as follows.

	Opening balance	Plus statement of profit or loss finance charge @7% on the opening balance	Less the cash paid	Closing balance, being the liability on the statement of financial position
Year 1	$10,000	$700	(Nil)	$10,700
Year 2	$10,700	$749	($11,449)	Nil

Example 3: Accounting for a financial liability at amortised cost

Broad raises finance by issuing $20,000 6% four-year loan notes on the first day of the current accounting period. The loan notes are issued at a discount of 10%, and will be redeemed after three years at a premium of $1,015. The effective rate of interest is 12%. The issue costs were $1,000.

Required

Explain and illustrate how the loan is accounted for in the financial statements of Broad.

Solution

Broad is receiving cash that is obliged to repay, so this financial instrument is classified as a financial liability. Again, as is perfectly normal, the liability will be classified and accounted for at amortised cost and, thus, initially measured at the fair value of consideration received less the transaction costs.

With both a discount on issue and transaction costs, the first step is to calculate the initial measurement of the liability.

Cash received – the nominal value less the discount on issue	($20,000 x 90%)	$18,000
Less the transaction costs		($1,000)
Initial recognition of the financial liability		$17,000

In applying amortised cost, the finance cost to be charged to the statement of profit or loss is calculated by applying the effective rate of interest (in this example 12%) to the opening balance of the liability each year. The finance cost will increase the liability. The actual cash is paid at the end of the reporting period and is calculated by applying the coupon rate (in this example 6%) to the nominal value of the liability (in this example $20,000). The annual cash payment of $1,200 (6% x $20,000 = $1,200) will reduce the liability. In the final year there is an additional cash payment of $21,015 (the nominal value of $20,000 plus the premium of $1,015), which extinguishes the remaining balance of the liability. The workings for the liability being accounted for at amortised cost can be summarised and presented as follows.

	Opening balance	Plus statement of profit or loss finance charge @12% on the opening balance	Less the cash paid (6% x 20,000)	Closing balance, being the liability on the statement of financial position
Year 1	$17,000	$2,040	($1,200)	$17,840
Year 2	$17,840	$2,141	($1,200)	$18,781
Year 3	$18,781	$2,254	($1,200)	$19,835
Year 4	$19,835	$2,380	($1,200) ($21,015)	Nil
Total finance costs		$8,815		

Because the cash paid each year is less than the finance cost, each year the outstanding liability grows and for this reason the finance cost increases year on year as well. The total finance cost charged to income over the period of the lo an comprises not only the interest paid, but also the discount on the issue, the premium on redemption and the transaction costs.

Interest paid	(4 years x $1,200)	=	$4,800
Discount on issue	(10% x $20,000)	=	$2,000
Premium on redemption			$1,015
Issue costs			$1,000
Total finance costs			$8,815

Financial liabilities at FVTPL

Financial liabilities are only classified as FVTPL if they are held for trading or the entity so chooses. This is unusual and only examinable in Paper P2. The option to designate a financial liability as measured at FVTPL will be made if, in doing so, it significantly reduces an 'accounting mismatch' that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases, or if the liability is part or a group of financial liabilities or financial assets and financial liabilities that is managed and its performance is evaluated on a fair value basis, in accordance with an investment strategy. In addition, a financial liability may still be designated as measured at FVTPL when it contains one or more embedded derivatives that would require separation.

Financial liabilities that are classified as FVTPL are initially measured at fair value and any transaction costs are immediately written off to the statement of profit or loss.

By accounting for a financial liability at FVTPL, the financial liability is also increased by a finance cost and reduced by cash repaid but is then revalued at each reporting date with any gains and losses immediately recognised in the statement of profit or loss. The measurement of the new fair value at the year end will be its market value or, if not known, the present value of the future cash flows, using the current market interest rates. The interest rate used subsequently to calculate the finance cost will be this new current rate until the next revaluation.

Example 4: Accounting for a financial liability at FVTPL

On 1 January 2011 Swann issued three year 5% $30,000 loans notes at nominal value when the effective rate o f interest is also 5%. The loan notes will be redeemed at par. The liability is classified at FVTPL. At the end of the first accounting period market interest rates have risen to 6%.

Required

Explain and illustrate how the loan is accounted for in the financial statements of Swann in the year ended 31 December 2011.

Solution

Swann is receiving cash that is obliged to repay so this financial instrument is classified as a financial liability. The liability is classified at FVTPL so, presumably, it is being held for trading purposes or the option to have it classified as FVTPL has been made.

Initial measurement is at the fair value of $30,000 received and, although there are no transaction costs in this example, these would be expensed rather than taken into account in arriving at the initial measurement.

With an effective rate of interest and the coupon rate both being 5%, at the end of the accounting period the carrying value of the liability will still be $30,000. This is because the finance cost that will increase the liability is $1,500 (5% x $30,000 – the effective rate applied to the opening balance), and the cash paid reducing the liability is also $1,500 (5% x $30,000 – the coupon rate applied to the nominal value).

As the liability h as been classified as FVTPL this carrying value at 31 December 2011 now has to be revalued. The fair value of the liability at this date will be the present value (using the new rate of interest of 6%) of the next remaining two years' payments.

	Cash flow	6% discount factor		Present value of the future cash flow
Payment due 31 December 2012 (interest only)	$1,500 x	0.943	=	$1,415
Payment due 31 December 2013 (the final interest payment and the repayment of the $30,000)	$31,500 x	0.890	=	$28,035
Fair value of the liability at 31 December 2011				$29,450

As Swann has classified this liability at FVTPL, it is revalued to $29,450. The reduction of $550 in the carrying value of the liability from $30,000 is regarded as a profit, and this is recognised in the statement of profit or loss. If, however, the higher discount rate used was not because general interest rates have risen, rather the credit risk of the entity has risen, then the gain is recognised in other comprehensive income. This can all be summarised in the following presentation.

	Opening balance	Plus statement of profit or loss finance charge @5% on the opening balance	Less cash paid (5% x 30,000)	Carrying value of the liability at year end	Fair value of the liability at year end	Gain to income statement of profit or loss
1/1/2011	$30,000	$1,500	($1,500)	$30,000	$29,450	$550

We can briefly consider the accounting in the remaining two years. The finance charge in the statement of profit or loss for the year end 31 December 2012 will be the 6% x $29,450 = $1,767, and with the cash payment of $ 1,500 being made, the carrying value of the liability will be $29,717 ($29,450 plus $ 1,767 less $1,500) at the year end.

If at 31 December 2012 the market rate of interest has fallen to, say, 4%, then the fair value of the liability at the reporting date will be the present value of the last repayment due of $31,500 in one year's time discounted at 4% (ie $31,500 x 0.962 = $30,288), which in turn means that as the fair value of the liability exceeds the carrying value, a loss of $571 (ie $30,288 less $29,717) arises which is recognised in the statement of profit or loss.

In the final year ending 31 December 2013 the finance cost to the statement of profit or loss will be 4% x $30,288 = $1,212, increasing the liability to $31,500 before the final cash payment of $31,500 is made, thus extinguishing the liability. As you may know from your financial management studies, and as is demonstrated here, when interest rates rise so the fair value of bonds fall and when interest rates fall then the fair value of bonds rises.

Following initial recognition, financial assets and liabilities are measured according to their classification. The table below summarises measurement requirements, which are elaborated further in the subsequent sections.

Category	Type of financial instrument	Interest at amortised cost	Dividends	Impairment (ECL)	Foreign exchange gains/losses	Fair value gains/losses	Recycling from OCI to P/L?
Assets measured at amortised cost	Debt	P/L	-	P/L	P/L	-	-
Assets measured at fair value through other comprehensive income (with recycling) - "FVOCI with recycling"	Debt	P/L	-	P/L	P/L	OCI*	yes
Assets measured at fair value through other comprehensive income (no recycling) - "FVOCI no recycling"	Equity	-	P/L	-	OCI	OCI	no
Liabilities measured at amortised cost	Debt	P/L	-	-	P/L	-	-
Assets/liabilities measured at fair value through profit or loss - "FVTPL"	Debt, Equity, Derivatives	-	P/L	-	P/L	P/L**	-

* fair value changes excluding impacts recognised in P/L

** or OCI for own credit risk impact on fair value for financial liabilities

Difference between long-term and short-term financial instruments

Here is the list of differences between long-term and short-term financial instruments.

Long-term Financial Instruments	Short-term Financial Instruments
Examples: Bonds, mortgages, long-term loans	Examples: Certificates of deposit, Treasury bills
Usually provide a higher rate of return	Generally offer lower returns but higher liquidity
Suited for long-term investment and capital appreciation	Used for managing short-term liquidity and cash flow needs

3. Choose the correct answer

1. What is the primary purpose of a financial instrument?
A. To increase profits
B. To hedge risk
C. To diversify investments
2. Which of the following are examples of financial instruments?
A. Stocks
B. Bonds
C. Real estate
D. Commodities
3. What is a bond?
A. A share in a company
B. A loan made by an investor to a borrower
C. A type of currency
D. A derivative contract
4. What is the difference between a stock and a bond?
A. Stocks represent ownership in a company, while bonds are debt obligations
B. Stocks have fixed interest rates, while bonds have variable interest rates
C. Stocks are always riskier investments than bonds
5. Which factors affect the value of a financial instrument?
A. Interest rates
B. Economic conditions
C. Market demand
D. Political stability
6. Which of the following is considered a derivative financial instrument?
A. Stock
B. Bond
C. Option
D. Real estate
7. What is the role of a credit rating in evaluating financial instruments?
A. Credit ratings determine the market value of the instrument
B. Credit ratings assess the creditworthiness of the issuer
C. Credit ratings impact the interest rates on the instrument
8. Which financial instruments are typically considered low-risk investments?

A. Government bonds

B. Treasury bills

C. Savings accounts

D. Mutual funds

9. What is the primary purpose of a financial derivative?

A. To increase the company's revenue

B. To provide dividends to shareholders

C. To hedge against risk or speculate on price movements

D. To hold cash reserves

10. What role does liquidity play in financial instruments?

A. Liquidity refers to the ease of buying or selling an instrument without significant price changes

B. Liquidity is irrelevant for evaluating financial instruments

C. Liquidity determines the tax implications of owning an instrument

11. What are the main categories of financial instruments?

A. Equity instruments

B. Debt instruments

C. Derivative instruments

D. Real estate investments

12. Which of the following best describes a mutual fund?

A. A type of bond issued by corporations

B. An investment vehicle pooling funds from many investors to buy a diversified portfolio of securities

C. A derivative used for hedging

D. A government-issued security

13. What is the function of a futures contract as a financial instrument?

A. Futures contracts lock in future prices for commodities

B. Futures contracts are only used for currency exchange

C. Futures contracts provide insurance against inflation risks

14. Which factors should be considered when choosing a financial instrument for investment purposes?

A. Risk tolerance

B. Investment horizon

C. Market conditions

D. Tax implications

15. Which financial instrument represents ownership in a company?

A. Bond

B. Stock

C. Option

D. Certificate of Deposit

16. What is the significance of duration in fixed-income financial instruments?

A. Duration measures the sensitivity of the instrument's price to interest rate changes

B. Duration determines the issuer's credit rating

C. Duration reflects the maturity date of the instrument

17. Which characteristics should investors consider when evaluating a financial instrument?

A. Yield

B. Volatility

C. Liquidity

D. Credit rating

18. What is the role of a clearing house in the trading of financial instruments?

A. Clearing houses facilitate the settlement of trades and manage counterparty risks

B. Clearing houses determine the market value of financial instruments

C. Clearing houses issue credit ratings for financial instruments

19. How do interest rates impact the value of different financial instruments?

A. Interest rate increases lower bond prices

B. Interest rate decreases increase stock prices

C. Interest rate changes affect mortgage-backed securities

D. Interest rates have no impact on financial instruments

Short Answer Questions

1. Explain the difference between a stock and a bond.

Answer: A stock represents ownership in a company and entitles the holder to a share of the company's profits and assets. A bond is a debt security, in which the investor loans money to an entity (typically corporate or governmental) that borrows the funds for a defined period of time at a fixed interest rate.

2. What is the purpose of a stock exchange?

Answer: A stock exchange is a marketplace where stocks, bonds, and other securities are bought and sold. It provides a regulated and transparent environment for investors to trade securities, ensuring liquidity, price discovery, and fairness in trading.

3. How does an option work in the financial markets?

Answer: An option is a financial derivative that gives the holder the right, but not the obligation, to buy or sell an underlying asset (such as a stock) at a specified price (strike price) before or on a certain date (expiration date). There are two types of options: call options (right to buy) and put options (right to sell).

4. What is the role of a mutual fund manager?

Answer: A mutual fund manager is responsible for making investment decisions for the fund's portfolio. This includes selecting securities to buy or sell, managing the overall strategy of the fund, and ensuring the fund meets its investment objectives and risk profile.

THEME 9. REVENUE FROM CONTRACTS WITH CUSTOMERS

1. Read the article and discuss

WHAT ARE THE DIFFERENCES AMONG ACCOUNTING REVENUE, GAIN, AND NET INCOME?

Sometimes there is confusion when words**revenue, income, gross profit, gain, profit**, and **net income** are used. These are all accounting terms that have different meanings in light of an income statement. Unfortunately, it is not always understood that the word revenue can be used interchangeably with the word profit, for example. To clear up things with these accounting terms, let's review them in detail and then look at an example of an income statement with all these elements.

We will start at the top of income statement and progress downwards by explaining each element.

Revenue is usually understood to be total income of a company resulting from its main operating activities. Main operating activities may be manufacturing and selling goods for a manufacturing company, providing legal services for a law firm, or providing leased assets for a leasing company. Revenue represents the total amount of income before any expenses are subtracted. In pure accounting terms, revenue is an increase in assets or decrease in liabilities on the company's books. Revenues are also called **sales**, especially in context of companies producing or selling tangible products.

Income may have several meanings. First, income can be used interchangeably with revenue. Second, income may refer to revenue from sources other than main operating activities (we will call them secondary revenue types); for example, interest income, rent income, or commission income. Third, income may refer to the excess of revenue over expenses: this excess represents *net income*. In our example in the following section we will use the second meaning of income (i.e., secondary types of revenues).

Gross profit is the difference between revenue and cost of goods sold (cost of sales). Revenue was defined above. Cost of goods sold is the cost of goods which a company sold to generate that revenue. In pure accounting terms, cost of goods sold is the difference between cost of goods available for sale and cost of goods on hand at the end of an accounting period. As we will see in the example presented further, gross profit is an intermediate step in arriving at net income.

Gain is similar to income as a secondary type of revenue, except that gain refers to incidental and nonrecurring transactions. For example, rent income may be received by a company regularly, which is why it will be an income. On the other hand, gain on disposal of fixed assets is called a gain because sale of fixed assets does not take place regularly.

Profit is the difference between revenue and expenses. Profit can also be called **net income, net profit**, or**"bottom line"** because it's usually the last line on an income statement.

Example of revenue, income, gross profit, profit, net income, and gain

Let us take a look at an example of a multiple-step income statement with cross-references to the terms we have discussed. Note that in the income statement that we refer to income is a secondary type of revenue.

Company ABC Income Statement For the Year Ended December 31, 20X1		
Sales Revenue	$ 1,000,000	This line is sales revenue (or just revenue).
Cost of Goods Sold	600,000	
Gross Profit	**400,000**	This line is gross profit (difference between revenue and cost of goods sold).
Operating Expenses:		
Selling Expenses	160,000	
Administrative Expenses	140,000	
Income from Operations	**100,000**	
Interest Income	20,000	This is an example of income.
Rental Income	7,000	This is another example of income.
Gain on Sale of Fixed Assets	3,000	This is an example of gain.
Income before Income Tax	**130,000**	
Income Tax	50,700	
Net Income	**79,300**	This is net income (profit, "bottom line").

2. Read the article and discuss

IFRS 15 REVENUE FROM CONTRACTS WITH CUSTOMERS – SUMMARY

What is the objective of IFRS 15?

IFRS 15 sets the principles to apply when reporting about:

- the nature;
- the amount;
- the timing; and
- the uncertainty

of revenue and cash flows from a contract with a customer.

Let me stress ***"a customer"*** here. If you have a contract with party other than a customer, then IFRS 15 does not apply.

Sometimes, it's quite difficult to determine whether you deal with a customer or simply with a collaborating party (e.g. some mutual development projects with other entities), therefore take care!

- Also, be aware that there are some exclusions from IFRS 15, namely:
- Leases (IAS 17 or IFRS 16)
- Financial instruments and other rights and obligations within the scope of IFRS 9 (IAS 39), IFRS 10, IFRS 11, IAS 27, IAS 28;
- Insurance contracts (IFRS 4) and

- Non-monetary exchanges between entities within the same business to facilitate sales.

5 steps to recognize revenue under IFRS 15

The main aim of IFRS 15 is to recognize revenue in a way that shows the transfer of goods/services promised to customers in an amount reflecting the expected consideration in return for those goods or services.

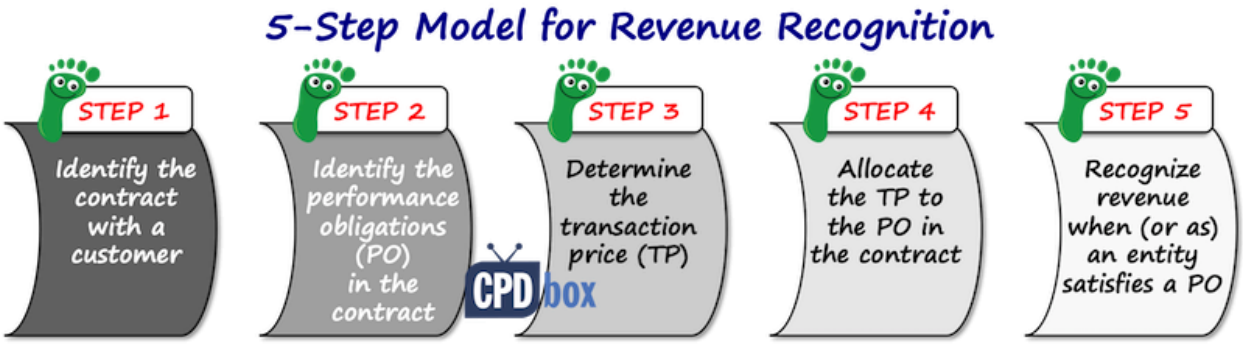
It seems understandable and very easy at first sight, and it truly is in many cases. So why is IFRS 15 so extensive?

Well, because many situations are not straightforward and entities recognize revenues differently in these cases, for example:

- Buy 1+get 1 free;
- Buy monthly prepaid plan + get handset for free;
- Earn loyalty points and cash them out/receive free goods later on;
- Get bonuses for delivery on time; etc.

To make it systematic, IFRS 15 requires application of 5 step model for revenue recognition.

The 5 steps are shown in the following picture:



Step 1: Identify the contract with the customer

A ***contract*** is an agreement between 2 parties that creates enforceable rights and obligations (IFRS 15, Appendix A).

You need to apply IFRS 15 to all contracts that have the following ***5 attributes*** (IFRS 15.9):

1. Parties to the contract has approved it and are committed to perform;
2. Each party's rights to the goods/services transferred are identified;
3. The payment terms are identified;
4. The contract has a commercial substance; and
5. It is probable that an entity will collect the consideration – here, you need to evaluate the customer's ability and intention to pay.

So, if the contract does not meet all 5 criteria, then you don't apply IFRS 15, but some other standard.

Therefore, be careful about intragroup transactions, as they often lack a commercial substance (as these companies often transfer inventories and other items at prices different than the market).

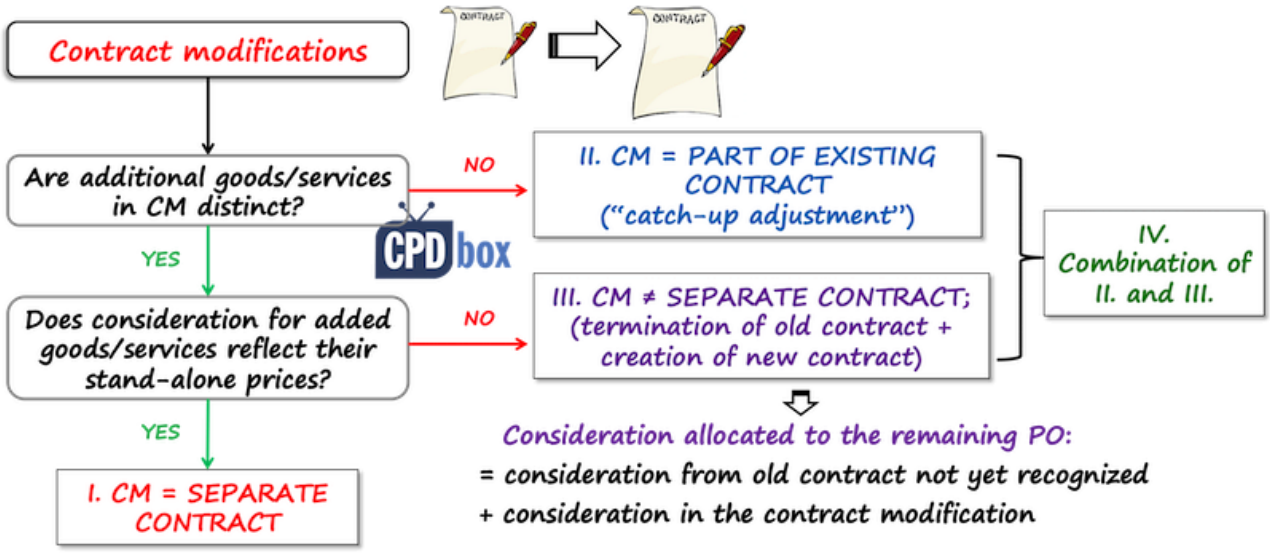
IFRS 15 provides a guidance about contract combinations and contract

modifications, too.

Contract combination happens when you need to account for two or more contract as for 1 contract and not separately. IFRS 15 sets the criteria for combined accounting.

Contract modification is the change in the contract's scope, price or both. In other words, when you add certain goods or services, or you provide some additional discount, you are effectively dealing with the contract modification.

IFRS 15 sets different accounting methods for individual contract modification, depending on certain conditions.



Step 2: Identify the performance obligations in the contract

Performance obligation is any good or service that contract promises to transfer to the customer.

It can be either (IFRS 15 App. A)

- A single good or service, or their bundle that is distinct; or
- A series of distinct goods or services that are substantially the same and have the same pattern of transfer.

An essential characteristic of a performance obligation is the word ***"distinct"***. Simply said, distinct means separable, or separately identifiable, and IFRS 15 sets criteria that you must assess in order to determine whether the performance obligation is distinct or not.

Let me say that this is extremely important and you must do it right.

The reason is that in further steps, you will account for distinct performance obligations and their revenues separately, in line with their allocated transaction price, and if you fail in the correct identification of distinct performance obligations, then the whole contract accounting will be wrong.

Let me also add that the performance obligations can be both ***explicit*** (e.g. written in the contract) and ***implicit*** (e.g. implied by some customary practices).

Also, if there's no transfer to customer, then there's no performance obligation. For example, imagine you construct a building for your client. Before you actually start, you build a small mobile toilet for your workers. As this will not

be delivered to your customer, it is not a separate performance obligation.

Step 3: Determine the transaction price

The ***transaction price*** is the amount of consideration than 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 (IFRS 15 Appendix A).

That't the definition from the standard and in other words, it's what you expect to receive from your customer in return for your supplies.

Attention – it's NOT always the price set in the contract. It is you expectation of what your receive.

It means that you need to ***estimate the transaction price***.

How?

First, you need to take the price stated in the contract as some basis (if applicable).

Then, you need to take some items into account, such as:

- ***Variable consideration*** – are there some bonuses or discounts, for example, performance bonus?
- ***Constraining estimates in variable consideration*** – you should include variable consideration (e.g. bonus) in the transaction price only when it's highly probable that you can keep it (this is a big simplification);
- ***Significant financing component*** – if your clients will pay you with delay, do the payments reflect the time value of money?
- ***Non-cash consideration*** – do you receive some non-cash items from your customer in return for your goods or services?
- ***Consideration payable to a customer*** – do you provide some vouchers or coupons to your customers?
- And other factors.

Step 4: Allocate the transaction price to the performance obligations

Once you have identified the contract's performace obligations and determined the transaction price, you need to split the transaction price and allocate it to the individual performance obligations.

The general rule is to do it ***based on their relative stand-alone selling prices***, but there are 2 exceptions when you allocate in a different way:

1. When allocating discounts, and
2. When allocating considerations with variable amounts.

A ***stand-alone selling price*** is a price at which an entity would sell a promised good or a service separately to the customer (not in the bundle).

The best way to determine a stand-alone selling price is simply to ***take observable selling prices*** and if these are not available, then you need to ***estimate them***. IFRS 15 suggest a few methods for estimating stand-alone selling prices, such as adjusted market assessment approach, etc.

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

A performance obligation is satisfied (and revenue is recognized) when a ***promised good or service is transferred to a customer***. This happens when ***control*** is passed.

A performance obligation can be satisfied either:

- ***Over time*** – in this case, control is passed to the customer over some period of time (e.g. contract term); or
- ***At the point of time*** – in this case, control is retained by the supplier until it is transferred at some moment.

IFRS 15 sets a few criteria when you should recognize revenue over time. In all other cases, revenue is recognized at the point of time.

Except for these 5 steps, IFRS 15 arranges a few other areas, such as…

Contract costs

IFRS 15 provides a guidance about two types of costs related to the contract:

1. ***Costs to obtain a contract*** Those are the incremental costs to obtain a contract. In other words, these costs would not have been incurred without an effort to obtain a contract – for example, legal fees, sales commissions and similar.These costs are not expensed in profit or loss, but instead, they are ***recognized as an asset*** if they are expected to be recovered (the exception is the contract costs related to the contracts for less then 12 months).
2. ***Costs to fulfill a contract*** If these costs are within the scope of IAS 2, IAS 16, IAS 38, then you should treat them in line with the appropriate standard.If not, then you should capitalize them only if certain criteria are met.

When and how to implement IFRS 15

As I've written above, you have to apply IFRS 15 mandatorily for all periods starting ***on 1 January 2018 or later*** (earlier adoption is permitted).

Be careful, because you should present ***comparative figures***, too – so in practice, you need to present the results for the periods starting on 1 January 2017, too.

As the requirements of IFRS 15 are very extensive and demanding, IFRS 15 permits 2 methods of adoption:

1. ***Full retrospective adoption*** Under this approach, you need to apply IFRS 15 fully to all prior reporting periods, with some exceptions.
2. ***Modified retrospective adoption*** Under this approach, comparative figures remain as they were reported under the previous standards and you recognize the cumulative effect of IFRS 15 adoption as a one-off adjustment to the opening equity at the initial application date.

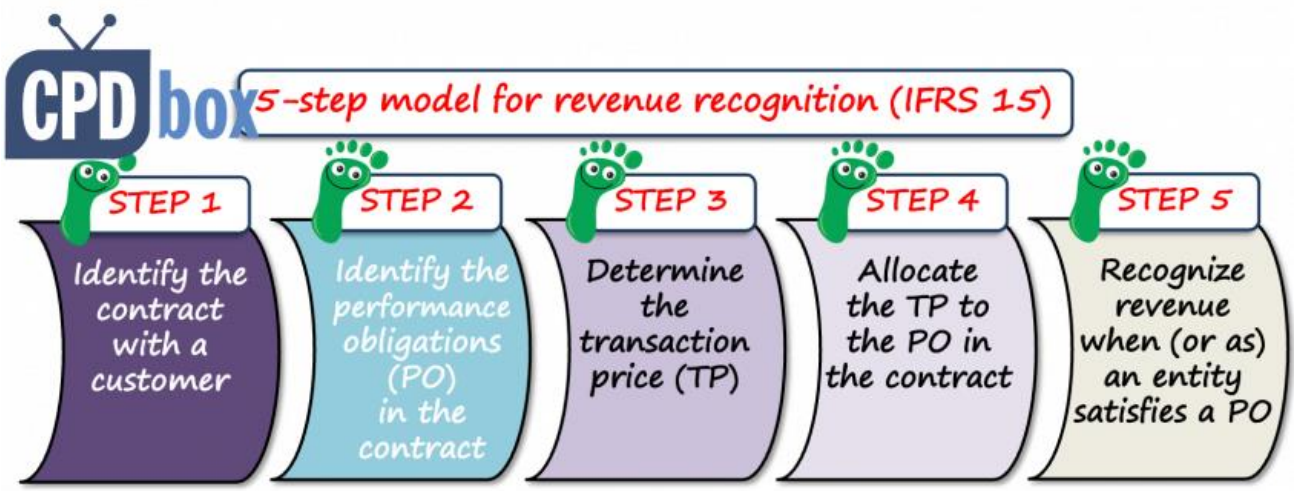
IFRS 15 also prescribes some presentation rules, necessary disclosures and provides further guidance in the specific circumstances in the implementation guidance.

3. Read the article and discuss

5-STEP MODEL FOR REVENUE RECOGNITION UNDER IFRS 15 + JOURNAL ENTRIES

The standard IFRS 15 has been with us for a while now, yet I still receive the same question:

What precisely is 5-step model and should we really apply it to even the simple shop sales to the customer?



The short answer is ***YES***, you should, because 5-step model represents five steps that you should apply to ALL contracts with customers.

However, if the transaction is very simple, then the 5-step model is easy to apply, without thinking too much about it.

Note: If you don't want to read and just want the video, then scroll down and watch.

Short simple example: Simple shop purchase

The customer just walks into the shop, buys newspapers for 3 CU and chocolate bar for 1 CU, pays you and walks out.

Strictly applying this model:

1. ***The contract:*** It is the customer's acceptance of shop's terms in line with the applicable laws;
2. ***The performance obligations:*** The newspapers and chocolate bar.
3. ***The transaction price:*** 4 CU (3+1)
4. ***The allocation of transaction price to the individual performance obligations:*** CU 3 to newspapers and CU 1 to chocolate bar.
5. ***Recognition of revenue AT the point of time:*** At the time of purchase, because the customers takes newspapers and chocolate bar.

That's it.

Easy, right?

Well, of course, the complications arise when there are some rules or terms attached to the contract.

In such a case, my recommendation is to go through each step carefully.

Let me illustrate on an example.

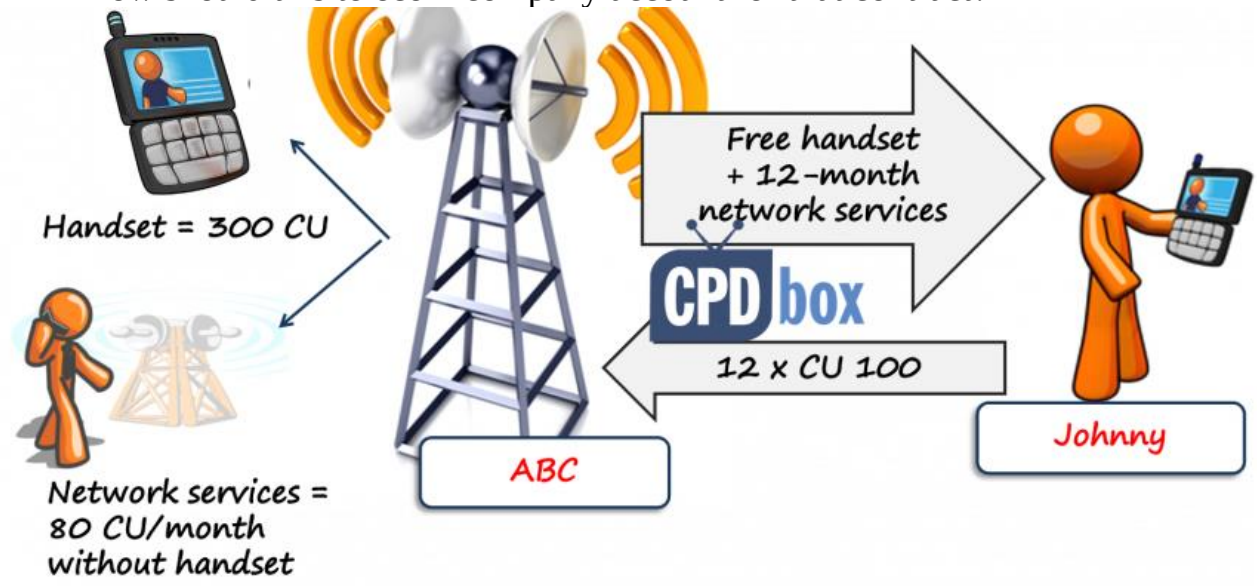
More complex example: Telecom contracts

ABC, a telecom company, entered into a contract with Johnny:

- Johnny subscribes for ABC's monthly plan for 12 months, and
- as a bonus he receives free handset from ABC Corp. immediately after contract signature,
- Johnny will pay a monthly fee of CU 100.

ABC sells the same handsets for CU 300 and the same monthly plans for CU 80/month without handset.

How should this telecom company account for that contract?



Warning before we start applying the 5-step model:

You just cannot treat the mobile phone as a marketing cost. That's wrong and that's what changed by IFRS 15.

Now, let's start with 5-step model.

Step #1: Identify the contract with the customer

Here, it is very straightforward, because ABC has a written contract with Johnny.

Step #2: Identify the performance obligations in that contract

Performance obligations are simply the promises that the telecom company gave to Johnny in that contract. Here, we have two in fact:

1. Network services or connection for 12 months
2. Phone that the company gives to Johnny right away after signing the contract.

Step #3: Determine the transaction price

It means to determine how much in total will Johnny pay to ABC.

He should pay 100 CU per month over 12 months, so that's 1 200 CU in total.

Step #4: Allocate the transaction price to the individual performance

This is where it becomes interesting.

We know that total transaction price is 1 200 CU (see step #3) and we need to allocate it based on the relative stand-alone selling prices.

The stand-alone selling price is simply the price at which ABC would sell the handset and network services separately.

From the information in the example, we know that:

- ABC sells similar phones at CU 300, and
- ABC offers similar monthly plans for CU 80 per month if purchased without handset.

Therefore, the total of stand-alone selling prices is CU 1 260 (being CU 300 + CU 80*12).

Now, we can do the allocation in the table:

Performance obligations	Stand-alone selling price	Allocated transaction price	Revenue
Handset / phone			
Network services			
Total			

So, you can see, that we allocated CU 285.70 to "free" mobile phone and CU 914,30 to the network services (CU 76.20 per month).

Step #5: Recognize revenue when or as the entity satisfies a performance obligations

There are two basic ways of satisfying the performance obligations:

1. Over time: this would apply to the network services; and
2. At the point of time: this applies to the mobile phone delivered at the time of contract start.

This step is important to determine WHEN to recognize revenue in your journal entries.

Journal entries

Let's wrap it up and draft the journal entries which ABC passes in connection with the Johnny's contract.

At the start of the contract when the phone is delivered:

- Debit Contract asset: CU 285.70;
- Credit Revenues from sale of a phone: CU 285.70;

As you might notice, the amount of CU 285.70 comes from our table in the Step #4. It is the amount allocated to the phone.

Also, why contract asset and not receivable?

Well, in short, because ABC does not have any right to issue invoice to Johnny in the amount of CU 285.70, as the phone is given for "free".

At the end of each month when ABC issues monthly invoice for the network services:

- Debit Receivables: CU 100;
- Credit Revenues from network services: CU 76.20;

- Credit Contract asset: CU 23.80;

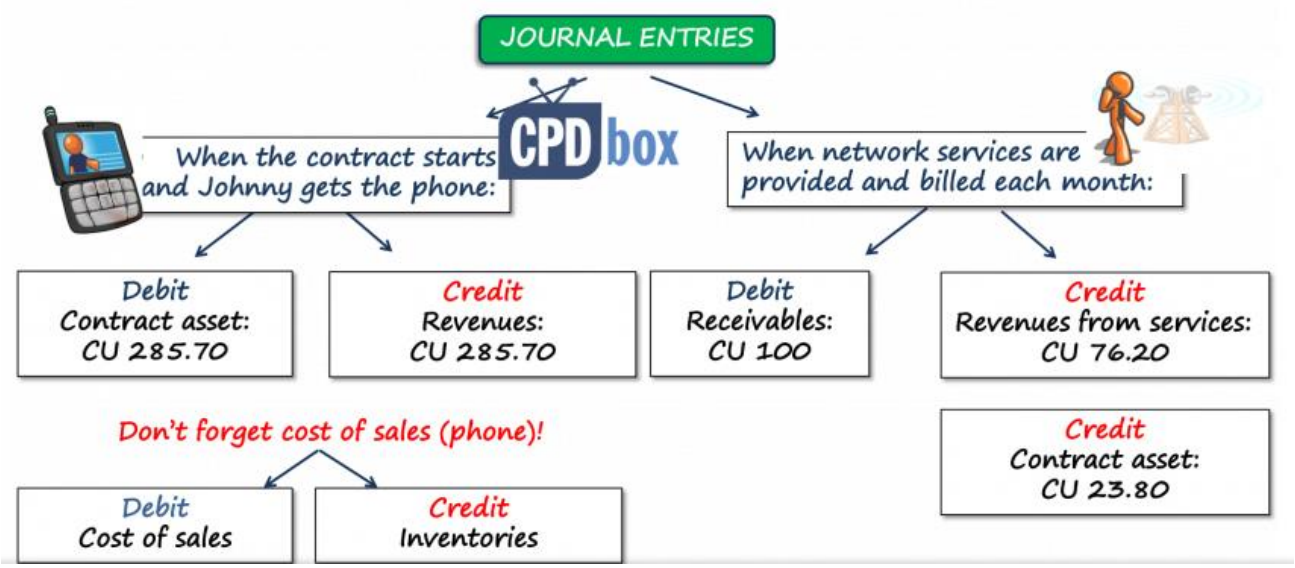
The amount of CU 76.20 for the revenue from network services comes from the allocation table in step #4. Again.

And, the amount of CU 23.80 is just the balancing amount between the receivable of CU 100 (invoicing to Johnny) and revenues recognized (CU 76.20).

Over 12 months of services, the contract asset gradually decreases to zero.

CU 23.80 * 12 = CU 285.60

OK, OK. The initial contract asset was CU 285.70, so sorry for my rounding here.



Finally…

That's the whole point of IFRS 15.

Instead of recognizing zero revenues for phone and CU 100 per network services, you should recognize some revenue for mobile, too, based on relative stand-alone selling prices.

The mobile phone is NOT a marketing cost.

4. Read the article and discuss

IFRS 15 EXAMPLES: HOW IFRS 15 AFFECTS YOUR COMPANY

IFRS 15 Contracts with Customers introduced a huge change and a very difficult challenge for almost every single company.

After I wrote a couple of articles about IFRS 15 here and here, and after I discussed with some of my friends CFOs or auditors, there are two types of reactions:

1. Either people feel that this is ***A CHALLENGE*** and they ask me how IFRS 15 can possibly affect them; OR
2. People even don't realize this is a challenge and as a result, they do literally nothing in order to prepare themselves. As we say – sweet ignorance. Or as English says: ignorance is a bliss.

Please, be the exception and stand out from the crowd.

What industries will be the most affected?

For some companies, the impact of the new rules for revenue recognition will be minimal and they will simply continue recognizing revenue just as before. No headaches.

However, some companies might face difficult challenges in order to apply the new rules. The biggest challenges will be mainly in the areas that are not very precisely arranged by IAS 18 and other related standards.

As opposed to existing guidance, ***IFRS 15 gives you much less room for your own accounting decisions*** and specifies a lot more things.

The biggest areas of impact are probably:

- Is the revenue recognized ***over time*** (spread between the periods during contract duration) or ***at the point of time*** (upon completion)?
- If the revenue is to be recognized over time, how should the company ***measure the progress towards completion*** (previously "stage of completion")?
- How shall companies account for ***revenue from bundled offers*** (with multiple deliverables)? Should they ***split the contract*** into several components?
- How shall companies deal with ***contract modifications***?
- How shall companies treat the ***contract costs***, including cost of obtaining the contract? Shall they expense these costs in profit or loss, or capitalize and defer?
- Are there any ***financing components*** in the contract? If yes, how to deal with the ***time value of money***?
- What ***disclosures*** do companies need to make? Do they have all the appropriate and relevant information?

Different sectors or industries are affected in many different ways along the 5-step model. Here, I selected ***4 important industries*** that will face probably the biggest challenges:

1. **Telecommunications** (with link to example: Identifying individual performance obligations and allocating transaction price)
2. **Manufacturers** (example included below: Contract modifications)
3. **Real estate and property development** (example included below: Revenue over time/at the point of time)
4. **Software development and technology** (example included below: Splitting the contract into 2 separate obligations)

Little disclaimer: It is really impossible to write about everything here as that would be enough to write a book. Analyzed sectors can face different challenges too. And if you don't find your sector here, just go through these 4 as there's a lot of analogy.

#1 Telecommunications

Telecom industry is typical for dealing with huge number of clients, typified contracts and various multiple offerings (e.g. sign up for annual plan and get handset for free).

Therefore, the main challenge will be to ***split bundled offers into individual performance obligations and allocate the transaction price***.

Also, the revenue for the individual performance obligations might be recognized over time (e.g. 2 years subscription plan), or at the point of time (e.g. delivery of handset).

Short example of a similar situation:

Under IAS 18, many telecom operators provided free handsets to customers and treated them as "marketing costs", or costs to obtain a client.

Under IFRS 15, this is not permitted, as IFRS 15 requires allocating the transaction price to individual performance obligations.

In this case, telecom operators must allocate total contract price between the revenue from the sale of handset and sale of monthly plan.

As a result, the ***timing of revenue recognition changes***, because under IFRS 15, the revenue is recognized earlier than under IAS 18.

Another implication of this treatment is that the ***revenue recognition does not correspond with monthly billing*** to customers, as there will be some deferral accounts involved.

This is really challenging because implementation will require significant changes in the IT systems, so that IT systems can automatically calculate and book the amount of revenue recognized each month.

Further challenges in telecom industry are:

- ***Contract modifications:***

what happens when customers modify their contracts with operators, for example – change the amount of prepaid minutes or add new services?

Here, it will be necessary to assess whether such a change shall be accounted for ***retrospectively*** (one-off adjustment) or ***prospectively*** (as a "catch-up" adjustment to future revenues), or even as ***for a separate contract***. As IFRS 15 contains more precise rules than IAS 18, it can trigger the change in the accounting systems.

- ***Time value of money and discounting:*** IFRS 15 strictly defines the ***"financing component"*** and requires accounting for such a component separately from revenue.

As a result, maybe you would need to carefully incorporate time value of money into some long-term advances received or paid, or contracts settled after more than 12 months.

- ***Costs related to obtaining a customer:*** Any industry, not only telecom industry, pays so-called "success fees" or commissions for obtaining a client. Before, these costs were normally expensed and recognized in profit or loss.

However, IFRS 15 requires capitalizing them and recognizing them in profit or loss in line with revenue recognition. How are telecom operators going to do that? What will be the pattern of expensing these costs in P/L?

#2 Manufacturer Companies

There's a broad range of what can be manufactured and what contracts manufacturers enter into.

If you manufacture similar items in large amounts that are basically typified and not too specific, then you can still be affected by IFRS 15 – just look to

example below.

However, manufacturers of specific equipment or goods in general with long period of a production can be affected painfully.

What you should watch out:

- Should you recognize revenue ***over time or at the point of time***? If over time, how are you going to ***measure the progress*** towards completion?
- How should you account for ***contract modifications***, e.g. for delivering additional items of goods?
- Do you provide ***post-delivery rebates? Volume discounts? Year-end bonuses*** to customers based on total volume ordered during the year? Then you are probably affected by IFRS 15.
- Should you ***split*** your contract into more performance obligations? This could be the case when you provide some ***warranty period*** for your products – should the warranty be accounted for separately? Are you providing any other services for your products?
- Do you incur certain costs for obtaining the contract, like ***bonuses to sales team***? Maybe you should capitalize them, and not expense them immediately as before.

To illustrate the potential impact of IFRS 15, let me give you one example dealing with contract modification. In this case, we'll take a look at subsequent order for the same goods with the same customer.

Example: Manufacturers and contract modifications

Ball PC, computer manufacturer, enters into contract with Forward University to deliver ***300 computers for total price of CU 600 000 (CU 2 000 per computer).***

Due to necessary preparation works, Forward University agrees to deliver computers in ***3 separate deliveries*** during the forthcoming 3 months (100 computers in each delivery). Forward University takes control over the computers at delivery.

After the first delivery is made, Forward University and Ball PC ***amend the contract.*** Ball PC will supply ***200 additional computers*** (500 in total).

How should Ball PC account for the revenue from this contract for the year ended 31 December 20X1 if:

- **Scenario 1:** The price for additional 200 computers was agreed at ***CU 388 000***, being CU 1 940 per computer. Ball PC provided a ***volume discount of 3%*** for additional delivery which reflects the normal volume discounts provided in similar contracts with other customers.
- **Scenario 2:** The price for additional 200 computers was agreed at ***CU 280 000***, being CU 1 400 per computer. Ball PC provided a ***discount of 30%*** for additional delivery because it hopes for the future cooperation with Forward University (nothing even discussed yet).

As of ***31 December 20X1, Ball PC delivered 400 computers*** (300 as agreed initially and 100 under the contract amendment).

Revenue under previous rules (IAS 18)

Well, here, nothing much to say. By definition of revenue in line with IAS 18, the revenue for the delivery is simply accounted at the time of delivery, in the ***fair value of consideration received*** for the computers – which is whatever amount under 2 above scenarios.

You are not required by IAS 18 to examine whether this additional delivery reflects stand-alone selling prices or not. Also, let's not complicate the things with issues such as "commercial substance", "transfer pricing", "dumping prices" – this is just an example.

The revenue for the year ended 31 December 20X1:

- **Scenario 1:** CU 600 000 (the first 300 computers) + CU 194 000 (additional 100 computers delivered) = ***CU 794 000*** (for all 400 computers already delivered).
- **Scenario 2:** CU 600 000 (the first 300 computers) + CU 140 000 (additional 100 computers) = ***CU 740 000*** (for all 400 computers already delivered)

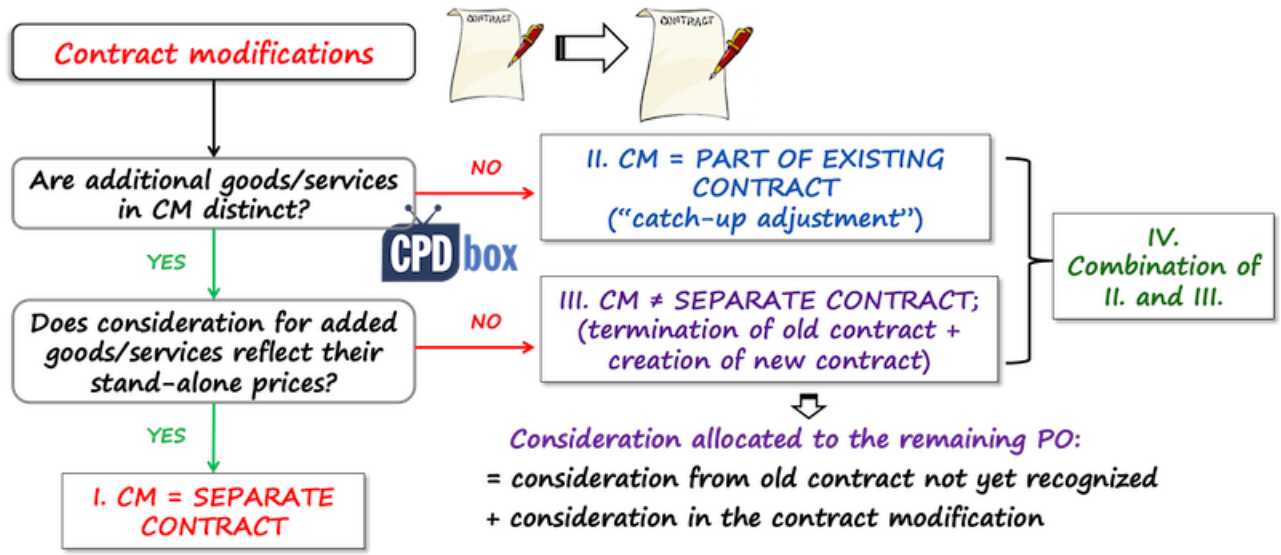
Is it the same under IFRS 15?

You bet it is NOT!

Revenue under IFRS 15

Here, the additional contract represents ***typical contract modification***, as the amount of computers changes and the total transaction price changes, too.

IFRS 15 precisely specifies ***how to account for contract modifications***, based on the terms of modification. There are 2 basic types of contract modification:



1. **Contract modification is a separate contract**

Contract modification is accounted for as for a separate contract (meaning that the original contract is left as it is), when ***2 criteria are fulfilled***:

- Additional goods and services in the modification must be ***distinct*** from the goods or services in the original contract.

In both scenarios, this is met, as additional computers are quite distinct from the original computers.

- Amount of consideration expected for the additional goods/services must ***reflect the stand-alone selling price*** of these goods/services.

2. **Contract modification is not a separate contract**

If the above criteria are not fulfilled (or one of them is not met), then the contract modification is ***not a separate contract*** and the accounting depends on further analysis.

Let's take a look at our situation. Here, as we concluded that additional goods are distinct, the main question is ***whether the additional consideration reflects their stand-alone selling prices***.

Scenario 1: 3% discount agreed on additional delivery

The price for additional computers indeed ***reflects their stand-alone selling prices***, because Ball PC normally provides 3% volume discount.

Therefore, this contract modification is accounted for ***as a separate contract*** and revenue for the year 20X1 (400 computers delivered) is:

- CU 600 000 from the original contract for 300 computers;

CU 194 000 from the contract modification for additional 100 computers delivered.

Total revenue in the year 20X1 is therefore ***CU 794 000*** – exactly as under IAS 18.

Scenario 2: 30% discount agreed on additional delivery

Here, it's clear that the price for additional computers ***does not reflect their stand-alone selling prices***, because 30% discount is exceptional and tied to the overall contract with the Forward University.

It means that the second criterion is not met.

As a result, the contract modification is ***NOT a separate contract, but it is bundled*** with the original contract.

How?

In this case, as additional goods are distinct, you need to account as ***you would terminate the original contract and start the new one***.

Still unclear?

You simply recognize the revenue from the delivery already made before contract modification under the original contract.

For the remaining goods from the original contract and additional goods, you recognize total revenue amounting to:

- That part of consideration in the original contract that hasn't been recognized as revenue yet (in other words, price for goods yet to be delivered); PLUS
- The consideration agreed in the contract modification.

You need to allocate this amount to individual performance obligations, or individual computers in this case.

In the scenario 2, contract modification was ***made after the first delivery***, so Ball PC needs to recognize revenue for the first 100 computers in line with the original contract:

100 computers x CU 2 000 per computer = CU 200 000

Total transaction price to allocate ***after the contract modification*** is:

- ***CU 400 000***, being the part of original consideration related to undelivered 200 computers (300 per contract less 100 delivered; times 2 000 per unit);
- ***CU 280 000***, being total consideration for additional 200 computers;
- Total: ***CU 680 000***

We need to ***allocate CU 680 000 to 400 computers*** in total (200 undelivered before contract modification + 200 additional computers), which means that Ball PC allocates ***CU 1 700 to one computer*** (680 000/400).

So what's the ***total revenue recognized in 20X1*** during which 400 computers were delivered? Let's calculate:

- Revenue for 100 computers delivered before contract modification: ***CU 200 000*** (CU 2 000/computer)
- Revenue for 300 computers delivered after contract modification: ***CU 510 000*** (CU 1 700/computer);
- Total: ***CU 710 000.***

Here you can clearly see that in this second scenario (additional delivery with 30% discount):

- ***Under IAS 18***, revenue for the year 20X1 is ***CU 740 000***.

  The revenue to be recognized in the next period is remaining 100 computers at CU 1 400 = 140 000; that gives us total CU 880 000 per contract.
- ***Under IFRS 15***, revenue for the year 20X1 is ***CU 710 000***.

  The revenue to be recognized in the next period is remaining 100 computers at CU 1 700 = 170 000; that gives us total CU 880 000 per contract.

Hmm, but the totals are the same!

Yes, sure. But ***the timing of revenue is different***. And exactly this timing can impact your taxes, dividends, financial rations and everything. Just think it out carefully!

#3 Real Estate – Construction Companies and Property Developers

Property developers and construction companies are typical for their contracts with customers of a ***long-term nature.***

The biggest challenge is to decide whether the company should recognize revenue ***over time*** (spread during individual years of construction) or ***at the point of time*** (one-time at the completion of a contract).

IFRS 15 lists ***3 situations*** when an entity needs to recognize revenue over time:

For property developers and construction companies, especially one situation is crucial:

When the entity's performance ***does not create an asset with alternative use*** to the entity and the entity has an ***enforceable right to payment*** for performance completed to date, then the revenue is recognized ***over time***.

For example, when a company constructs or develops an asset so specific for the customer that it would be very costly or impracticable to transfer to other

customer (e.g. building with highly customized specification). At the same time, customer is obliged to pay for work completed to date in the reasonable amount.

Alternatively, "no alternative use" can be achieved contractually, meaning that the contract prevents directing the asset to another customer.

For real estate companies it will be crucial to assess whether the property developer has an enforceable right to payment for performance completed to date or not.

This is not the only criterion to decide, but it is prevailing for real estate.

If the specific contract does not meet this criterion (and also the other two), then the revenue is recognized at the point of time; that is, when an asset is delivered to customer.

Only slight change in the provisions of the specific contract may trigger the necessity to recognize revenue at the point of time rather than over time – or vice versa.

Let's take a look at the example illustrating exactly this point.

Example: Property developer and revenue over time/at the point of time

RE Construct, property developer, builds a residential complex consisting of 50 apartments. Apartments have a similar size and proportions – however, they can be customized to clients' needs.

RE Construct enters into 2 contracts with 2 different clients (A and B). Both clients want to buy almost identical apartments and agree with total price of ***CU 100 000*** per apartment. The payment schedule is as follows:

- Upon the signature of a contract, clients pay deposit of CU 10 000 each.
- Milestone: 1 year prior planned completion, RE Construct will deliver progress reports to clients and clients need to pay CU 50 000 each.
- Completion: Upon the completion of the construction, the legal ownership to apartments is transferred to clients and they pay the remaining amount of CU 40 000 each.

Assumed period of construction is ***2 years*** from the date of contract. RE Construct has the right to retain the payments from any client in the situation when that client defaults on the contract before its completion.

The contracts with clients A and B are NOT identical. Further contractual terms specify that:

- No other specific terms in the contract with client A.
- The contract with client B specifies that ***RE Construct cannot transfer or direct*** the apartment to another client and in return, the ***client B cannot terminate*** the contract.

If the client B defaults on the contract before its completion (in other words, does not make payments in line with the schedule), RE Construct has the ***right for all contractual price if RE Construct decides to complete the contract.***

What's the difference here?

In the case of client A, the revenue would be recognized at the point of time and revenue from contract B over time.

Why?

We need to assess 3 criteria for recognizing revenue over time. As I have mentioned above, we will not deal with the first 2 here (let's say they are not met), but let's focus on the third criterion (no alternative use and enforceable right to payments).

Revenue from contract with client A – at the point of time

The contract with client A ***does NOT meet*** the third criterion.

The reason is that RE Construct builds an apartment that can be ***easily sold or transferred to another client*** in case of default.

Even when this would be prevented (by writing specifically in the contract), RE Construct has ***NO enforceable right to payment*** for performance completed to date.

RE Construct will keep ***ONLY the progress payments*** in the case of client's default and they may not cover entity's cost for work completed to date.

As a result, RE Construct would recognize ***revenue at the point of time*** – that is when the apartment is transferred to the client A (upon the completion in the year 2).

Revenue from contract with client B – over time

The contract with client B ***MEETS the third criterion***.

The reason is that RE Construct cannot direct the constructed asset for the alternative use, because the contract with client B ***does not permit transfer of the apartment to another client***.

Also, RE Construct ***has enforceable right to payment for performance completed to date.***

Therefore in this case, RE Construct recognizes ***revenue over time*** – that is, over 2 years of construction of apartment based on some output or input method.

Let's not go into any details of output or input methods right now. To make it simple, let's say that 1 year prior completion, RE Construct ***incurred 45% of total cost*** for building an apartment and another 55% is incurred in the second year of construction.

As a result, RE Construct recognizes the revenue:

- In the ***year 1: CU 45 000*** (45% of CU 100 000)
- In the ***year 2: CU 55 000*** (55% of CU 100 000)

This example illustrates how the change in the contractual terms can drastically affect the company's revenues.

The comparison of the revenue profiles for contract A and contract B under IFRS 15 is in the following table:

When	***Revenue for Contract A***	***Revenue for Contract B***
Year 1	0	45 000
Year 2	100 000	55 000
Total	**100 000**	**100 000**

Why does it matter?

Timing of revenues matters due to your tax payments, dividends, financial rations, etc. Also note, that under IAS 11, you would probably account for both

contracts in the same way (as for contract B), but NOT under IFRS 15.

Maybe you should revise your contracts now and see whether you need to make some changes in order to prevent this situation.

#4 Technology and Software development

Technology sector, especially companies involved in a development of software, selling software licenses and providing various related services is famous for the ***diversity of its operations and long-term contracts***.

The main challenges are therefore:

- Identification of the ***individual performance obligations*** (e.g. sale of license + customization + post-delivery support) and ***allocating transaction price*** to them
- Assessment of the ***progress*** towards meeting the contract
- Assessment of the ***licenses*** for the products sold by software vendors or developers.

IFRS 15 recognizes ***2 types of licenses: license to use and license to access.*** The accounting treatment is different for both of them and you should be able to identify which license is in question.

Other difficulties arise in areas common for every industry: dealing with ***contract modifications***, how to account for ***contract costs*** (e.g. commissions for getting the client), etc.

Let's take a look at example in which software company needs to split the contract and treat performance obligations separately.

Example: Software development and Splitting the contract into 2 separate obligations

ManyBits is a software company who entered into contract with a client C on 1 July 20X1. Under the contract, ManyBits is obliged to:

- Provide ***professional services*** consisting of implementation, customization and testing of software. Client C has bought software license from the third party.
- Provide ***post-implementation support*** for 1 after the customized software is delivered.

Total contract price is CU 55 000.

ManyBits assessed its total cost for fulfilling the contract as follows:

- Cost of developers and consultants for implementing and testing the existing software: CU 43 000;
- Cost of consultants for post-delivery support: CU 2 000;
- Total estimated cost of fulfilling the contract: ***CU 45 000***.

As of ***31 December 20X1***, ManyBits incurred the following costs of fulfilling the contract:

- Cost of developers and consultants for development, implementation and testing the customized modules: CU 13 000.

How should ManyBits recognize revenue from this contract under IAS 18 and IFRS 15?

Revenue under previous rules (IAS 18)

Here, ManyBits clearly provides professional services and the related revenue falls under the scope of IAS 18. IAS 18 requires recognizing revenue from similar services using the ***stage of completion including post-delivery services.***

It means that ManyBits treats software development and post-delivery services as ***one big service*** for the purpose of accounting the revenue.

Let's say that ManyBits calculates the stage of completion based on costs incurred for fulfilling the contract.

At the end of 20X1, total incurred cost was CU 13 000, which is ***29%*** of total estimated cost of CU 45 000.

Therefore, under IAS 18, ManyBits' revenue from this particular contract in the year 20X1 is 29% (stage of completion) x CU 55 000 (total contract price) = ***CU 15 950***. Sure, I used some rounding, but you get the picture.

Is it the same under IFRS 15?

Revenue under the new rules (IFRS 15)

IFRS 15 states very precise and detailed guidance on ***whether the goods or services promised under the contract are distinct*** and whether they can be considered ***separate performance obligations or not***.

Of course, you need to perform your analysis and I tell you – your conclusion might be pretty different from this example, based on specifics in the contract.

But here, let's say that software customization services and post-delivery support meet the definition of distinct performance obligations and as a result, they need to be treated separately.

How?

We need to look at them as at separate components, and allocate total transaction price of CU 55 000 to them ***based on their relative stand-alone selling prices***.

Note: contract price is not necessarily the same as transaction price, but let's not complicate it now.

Let's say that ManyBits' normal charge for the support services is 10% of the package price, no matter what the "package" is – whether some ready-made license or customized software.

That would imply that the relative split between customization service and post-delivery service is 100:10, which is:

- CU 50 000 (CU 55 000/(100+10)*100) for software development or customization service, and
- CU 5 000 (CU 5 000/(100+10)*10) for post-delivery support.

Again, this is just an example and some different approach might fit your own situation better.

In the year 20X1, ManyBits ***measures the progress towards the completion of the performance obligation separately***, based on inputs for the fulfilling the contract (costs in this case).

Internal cost estimations show that ManyBits estimated total cost for the contract of ***CU 45 000***, thereof CU 43 000 for the salaries of software developers and CU 2 000 for the salaries of consultants providing post-delivery support (based on man-days).

Let's measure the progress towards the completion of both individual performance obligations ***as of 31 December 20X1***:

- Software development services: CU 13 000 (incurred cost)/CU 43 000 (total estimated cost) = 30%
- Post-delivery services: CU 0 (incurred cost)/CU 2 000 (total estimated cost) = 0%

As a result, ***revenue recognized from this contract in the year 20X1*** is:

- Software development services: 30% (progress %) * CU 50 000 (revenue allocated to software development) = ***CU 15 000;***
- Post-delivery services: 0% (progress %) * CU 5 000 (revenue allocated to post-delivery service) = ***CU 0.***

Total revenue from the same contract under IFRS 15: ***CU 15 000***.

For the simplicity, you can revise the calculations in the following table:

Performance obligation	Estimated total cost (A)	Incurred cost to 31-Dec-X1 (B)	Progress % (C)=(B)/(A)	Allocated transaction price (D)	Revenue recognized in 20X1 (D)*(C)
Professional services	43 000	13 000	30%	50 000	15 000
Post-delivery support	2 000	0	0%	5 000	0
Total	45 000	13 000	n/a	55 000	15 000

Again, this is just one way of how new IFRS 15 can influence software developers, but also other companies performing long-term contracts.

Also, the specific calculation will strongly depend on what you have in your own contracts and how your own calculations, systems and estimates work. There is no one solution applicable for all.

THEME 10. LIABILITIES AND EMPLOYEE BENEFITS

1. Read the article and discuss

EMPLOYEE BENEFITS (IAS 19)

Employee benefits encompass all forms of compensation offered by a company in exchange for services performed by employees, or upon the termination of employment. These benefits can arise from formal agreements between the company and the employee, be mandated by local laws (such as state pension plans), or stem from implied commitments. The benefits can be paid either in cash or in kind and may extend to an employee's family members as well (IAS 19.4-7).

According to IAS 19.5, employee benefits are categorised into four main types:

- Short-term employee benefits.
- Post-employment benefits.
- Other long-term employee benefits.
- Termination benefits.

It's worth noting that all types of employee benefits fall under the scope of IAS 19, with the exception of share-based payments.

Short-term employee benefits

Definition of short-term employee benefits

Short-term employee benefits are those expected to be fully settled within 12 months after the end of the year in which the employee performed the service. As specified in IAS 19.9, these benefits include:

- Wages, salaries, bonuses (including profit-sharing) and social security contributions,
- Paid absences,
- Free or subsidised non-monetary benefits, such as medical care and housing.

The term 'fully settled' is important to note, as it distinguishes these benefits from long-term benefits. Therefore, even if certain arrangements, like bonuses, appear similar to short-term benefits, they should be accounted for as other long-term benefits if they are not fully settled within the 12-month time frame.

Recognition of short-term employee benefits

According to IAS 19.11, a short-term employee benefit is recognised when an employee provides a service. This is typically recognised as an expense, unless it can be capitalised as part of an asset's cost (e.g., inventories or property, plant, and equipment).

Short-term paid absences

Paid absences commonly include holidays, sick leave, and maternity leave. IAS 19 differentiates between accumulating and non-accumulating paid absences. Accumulating absences are those which can be carried over for future use if not fully utilised in the current period (IAS 19.15). Holidays usually fall under this

category, although this may vary between countries. Non-accumulating paid absences, like sick or maternity leave, do not carry forward and expire if not used within the current period. Additionally, they don't result in a cash payment upon an employee's departure from the company (IAS 19.18).

For accumulating paid absences, entities should recognise the employee benefit expense as the employee earns their entitlement to a paid absence (IAS 19.13(a)). If these benefits are non-vesting—meaning an employee won't receive a cash payment for unused leave upon departure—the expense should still be recognised, but adjusted for the expected unused absences (IAS 19.15).

In contrast, for non-accumulating paid absences, the expense should only be recognised when the absence actually occurs (IAS 19.13(a)).

Example: Holiday pay accrual (accumulating paid absence)

Employees at Entity A are entitled to 20 days of paid leave annually. Unused holidays can be carried over indefinitely but are non-vesting, meaning employees do not receive cash for unused days. Entity A uses software to track unused holidays for each employee.

For instance, as of 31 December 20X1, John Smith has 15 unused holiday days. His total annual remuneration is $60,000, comprising a salary of $50,000 and $10,000 in state-imposed levies paid by the employer. Given an average working year has 250 working days, one working day for John costs $240 ($60,000/250). Based on past experience, Entity A estimates that an average employee leaves the company with 2 unused holiday days. Hence, Entity A recognises a holiday pay accrual of $3,120 [$240 x (15 days – 2 days)]. This calculation is performed for each employee. If the holiday pay were vesting, the accrual would be for all 15 days.

Profit sharing and bonuses

Entities should recognise the expected costs of profit-sharing and bonuses when there's either a legal or constructive obligation to make such payments, and the amount can be reliably estimated.

Profit-sharing plans where employees receive a share of the profits only if they stay with the entity for a specified period create a constructive obligation. This obligation arises as employees provide service that increases the payable amount, contingent on their continued employment until the end of the specified period. The measurement of such obligations must consider the likelihood of some employees leaving without receiving their profit-sharing payments.

Even in the absence of a legal obligation to pay bonuses, an entity may have a constructive obligation if it has a history or practice of paying bonuses, thereby leaving it with no realistic alternative but to make these payments. The measurement of this constructive obligation similarly reflects the possibility of employees departing without receiving a bonus. An entity can reliably estimate its legal or constructive obligations under a profit-sharing or bonus plan when there is a formula in the plan's formal terms, when amounts are determined before the financial statements are authorised, or when past practices provide clear evidence of the obligation's amount (IAS 19.19-22).

Under some national GAAP, profit-sharing payments are directly deducted from equity rather than being expensed. However, IAS 19 prohibits this practice, stating that employee profit-sharing plans do not constitute transactions with owners acting in their capacity as owners (IAS 19.23).

Post-employment benefits

Definition of post-employment benefits

Post-employment benefits are benefits provided to employees after their period of employment has ended. Examples include:

- Pensions,
- One-off payments upon retirement,
- Certain severance payments (note the distinction from termination benefits),
- Post-employment medical care.

Distinguishing between defined contribution and defined benefit plans

Post-employment benefit plans are classified as either defined contribution or defined benefit plans. The accounting treatment for each differs significantly, as detailed in IAS 19.26-49.

In a defined contribution plan, an entity contributes a fixed sum to a fund on behalf of the employee. The entity has no legal or constructive obligation to make additional payments, even if the fund lacks sufficient money to meet future benefits. A common example is a retirement plan where the employer contributes to an employee's individual account, which is then invested. The eventual payouts to the employee depend on both the employer's contributions and the investment returns. If the investments perform poorly, the employer is not required to contribute further.

Conversely, a defined benefit plan obliges the employer to provide a predetermined level of benefits to employees, irrespective of the contributions made. A classic example is a pension plan where the employer promises a monthly pension amount, bearing any actuarial or investment risks. For instance, a pension equalling 50% of the employee's final salary is a defined benefit plan.

State-managed plans are usually funded on a pay-as-you-go basis. Future benefits for current employees are generally financed by future contributions from younger workers. Therefore, the entity has no obligation for these future payments, classifying most state plans as defined contribution plans (IAS 19.45).

Other long-term employee benefits

According to IAS 19.8, other long-term employee benefits are those that are neither short-term, post-employment, nor termination benefits. While these benefits might appear similar to short-term ones, they aren't expected to be settled within 12 months following the end of the service year (e.g., multi-year bonuses or profit-sharing plans). For these, the accounting principles related to short-term benefits should be applied, including any necessary discounting.

However, accounting for certain other long-term employee benefits, like jubilee / anniversary bonuses, can be as complex as that for post-employment

benefits. For these benefits, it's vital to differentiate between defined benefit and defined contribution plans, and then follow the IAS 19 guidelines accordingly (IAS 19.153-158). Notably, actuarial gains or losses (remeasurements) for other long-term benefits are recognised in profit or loss, as opposed to OCI for post-employment benefits (IAS 19.156). Furthermore, IAS 19 doesn't mandate specific disclosures for other long-term benefits.

Constructive obligation

IAS 19 specifies that an entity should account not just for the legal obligations stipulated in the terms of a defined benefit plan, but also for any constructive obligations arising from informal practices (IAS 19.61-62). A constructive obligation arises from the company's informal practices that aren't legally binding. Nevertheless, the standard assumes that if a company currently offers certain benefits, it will continue to do so throughout the employees' remaining working lives, unless evidence suggests otherwise.

Defined contribution plans

Accounting for defined contribution plans is outlined in IAS 19.50-54 and is generally straightforward: the employee benefit is recognised when a service is rendered by the employee, much like regular wages. Typically, there is no need for actuarial valuations or discounting of future payments.

Entities are required to disclose the expense recognised for defined contribution plans. This requirement also applies to state-operated schemes that mandate additional contributions on top of an employee's gross salary. However, it's worth noting that entities seldom provide this disclosure.

Defined benefit plans

Accounting for defined benefit plans is considerably more complex, often requiring actuarial valuation through the projected unit credit method. This entails attributing benefits to specific service periods and making relevant actuarial assumptions. The rules governing defined benefit plans are covered in paragraphs IAS 19.55-152.

Example: Calculating defined benefit plan costs and obligations for a single employee

Let's consider the case of John Smith, who joins a company on 31 December 20X0. All employees in this company are entitled to a one-off retirement payment equal to three months of their final monthly salary. The following facts and assumptions apply to this example:

- John Smith joins the company on 31 December 20X0.
- He will be eligible for retirement on 31 December 20X6.
- His starting salary is $10,000.
- The estimated annual salary increase rate is 2%.
- The projected salary at the retirement date is $11,262 ($10,000 x $1.02^{\wedge 6}$).
- The estimated retirement payment totals $33,785 (3 x $11,262).
- The discount rate is 5%.

	20X1	20X2	20X3	20X4	20X5	20X6
Opening obligation	–	4,412	9,265	14,592	20,429	26,813
Current service cost	4,412	4,632	4,864	5,107	5,363	5,631
Discounting expense	–	221	463	730	1,021	1,341
Closing obligation	4,412	9,265	14,592	20,429	26,813	33,785

The current service cost represents the portion of the retirement payment earned by John Smith in a given year, discounted to its present value. Let's examine the year 20X3 in greater detail.

John will be eligible for his retirement payment in six years (from 20X1 to 20X6). Consequently, he earns 1/6 of his retirement payment each year. Given the anticipated salary increase, John's estimated salary at retirement will be $11,262, making his projected retirement payment $33,785. For the year 20X3, John earns 1/6 of this amount, which is $5,631. However, this sum will only be paid out on 31 December 20X6, so it needs to be discounted to its present value. After applying a 5% discount rate, the discounted value for the year 20X3 stands at $4,864.

Besides the current service cost, entities also recognise a discounting expense. This is similar to the discounting of other liabilities and represents the unwinding of the discount applied to the liability recognised in previous periods. This expense is generally presented as financing or interest expenses, although IAS 19 doesn't specify where these should appear in financial statements.

Current service cost and attributing benefit to periods of service

General attribution criteria

The term 'current service cost' refers to the growth in the present value of the defined benefit obligation due to an employee's service in the current period. This cost is generally recognised as an expense, except when it is considered part of the cost of another asset (IAS 19.120(a),121).

The criteria for attributing benefits to specific periods of service are detailed in paragraphs IAS 19.70-74. The general rule instructs entities to allocate benefits according to the plan's benefit formula. However, if applying the benefit formula would disproportionately allocate a higher level of benefit to future years, a straight-line attribution should be used instead. In this approach, benefits are attributed from the point at which an employee's service first entitles them to receive plan benefits—regardless of whether these benefits are conditional on future service—until the point where additional service will not materially increase those benefits, aside from potential salary increases. Refer also to this agenda decision.

Example: Attributing benefit to periods of service

Consider a company that offers a retirement benefit equivalent to a month's salary for employees who have worked for at least five years. In this scenario, the benefits are attributed to the initial five years of employment. This is because serving additional years won't increase the benefit amount, aside from adjustments due to salary increases.

Impact of vesting conditions

It's important to note that an employee benefit obligation and its associated expense are recognised even if they are subject to vesting conditions. The likelihood that some employees may not meet these conditions is factored into the benefit measurement. For example, adjustments may be made based on the expected employee turnover rate (IAS 19.72).

Immediate vesting of benefits

Immediate vesting of benefits, wherein employees become eligible for specific benefits from their first day of employment without changes in value due to seniority (except for potential salary increases), presents several practical challenges. For instance, if an employee is entitled to receive an equivalent of three months' salary upon leaving the company for any reason, traditional attribution of benefits to specific periods of service becomes problematic. This is because the benefit vests immediately and is not dependent on the duration of employment. Likewise, additional years of service do not lead to significant increases in the level of the benefit.

Some guidance can be gleaned from IAS 19.157, which discusses disability benefits. According to this paragraph, if the benefit level is consistent for any disabled employee regardless of years of service, the expected cost should be recognised when an event occurs that leads to long-term disability. Therefore, the most pragmatic approach for benefits that vest immediately is to recognise the obligation when the triggering event for payment occurs.

The exposure draft of IAS 19 also examined a similar issue concerning death-in-service benefits. The IASB proposed the following guidelines for recognising these benefits:

- When benefits are insured or re-insured with third parties, the cost should be recognised in the period when the related insurance premiums are due.
- For non-insured benefits, recognition occurs to the extent that deaths have taken place before the end of the reporting period.
- For death-in-service benefits provided through a post-employment benefit plan, their present value should be included in the post-employment benefit obligation.
- If the entity provides these benefits directly and not via a post-employment plan, this future commitment is not considered a present obligation and does not warrant liability recognition. A liability arises only if a death has occurred by the end of the reporting period.

This issue was also considered by the Interpretations Committee, but they were unable to agree on a conclusive wording for their agenda decision.

Given the complexities, the most straightforward recommendation is to recognise the liability relating to such immediate-vesting benefits when the event triggering the payment occurs. However, if these benefits can be integrated with other defined benefit plans, they should be accounted for concurrently. For example, in the case of death-in-service benefits, if an entity also offers a pension scheme, the estimated deaths during employment would reduce the value of the

overall defined benefit obligation relating to pensions.

Actuarial assumptions

Definition and types of actuarial assumptions

Paragraphs IAS 19.75-98 outline actuarial assumptions as estimates of the variables used to calculate the ultimate cost of providing post-employment benefits. These assumptions are categorised into two main groups:

Demographic assumptions, including:

- Mortality rates (refer to IAS 19.81-82),
- Employee turnover rates, disability rates, and early retirement rates,
- The proportion of plan members eligible for benefits,
- Claim rates.

Financial assumptions, including:

- Discount rate,
- Benefit costs.

According to IAS 19.77-78, actuarial assumptions should be both unbiased, meaning neither imprudent nor excessively conservative, and mutually compatible.

Discount rate

The discount rate is determined by referring to the market yields on high-quality corporate bonds (HQCB) as of the end of the reporting period. In the absence of a deep market for HQCB in a particular currency, government bond yields should be utilised. The bonds' currency and term should align with those of the post-employment benefit obligations. This alignment can be achieved through a single weighted average discount rate, which reflects the estimated timing and amount of benefit payments (IAS 19.83-86).

IAS 19 doesn't explicitly define what constitutes HQCB. However, bonds issued by entities with the two highest investment ratings (AAA, AA) are generally considered as HQCB. Furthermore, this agenda decision confirmed that a pre-tax discount rate should be used.

Actuarial gains and losses

Actuarial gains or losses arise when actual outcomes differ from actuarial assumptions ('experience adjustments'), or when actuarial assumptions themselves change (see IAS 19.128 for more examples). These gains or losses are different from past service cost or gains or losses on settlement (IAS 19.129).

Actuarial gains or losses impact the value of the defined benefit obligation recognised in previous periods. For post-employment benefits, actuarial gains and losses are recognised in OCI (IAS 19.120(c)), and for other long-term benefits, they are included in P/L (IAS 19.156). Note that these actuarial gains or losses are never recycled back into P/L, even if the benefit plan is amended or curtailed (IAS 19.122).

Past service cost

Past service cost refers to changes in the present value of the defined benefit obligation resulting from either a plan amendment or a curtailment. A curtailment significantly reduces the number of employees covered by the plan, whereas a plan

amendment alters the value of benefits payable or introduces/withdraws a plan (IAS 19.102-105).

Past service cost is always recognised in P/L. Under certain conditions, it can be a credit to the P/L, for instance, when an entity reduces the value of benefits payable (IAS 19.106). This recognition happens at the earlier of two dates: when the plan amendment or curtailment occurs, or when the entity recognises related restructuring costs as per IAS 37 (IAS 19.103).

Past service cost excludes the effect of actuarial gains or losses (see IAS 19.108 for examples).

Gains and losses on settlement

A settlement takes place when an entity undertakes a transaction that eliminates all further legal or constructive obligations for part or all benefits provided under a defined benefit plan, such as making a lump sum cash payment to employees (IAS 19.111). Any gain or loss on settlement—calculated as the difference between the present value of the defined benefit obligation being settled and the settlement price—is immediately recognised in P/L (IAS 19.109).

It's worth noting that entities are not required to distinguish between past service cost due to a plan amendment, past service cost due to a curtailment, and gains or losses on settlement if these transactions happen concurrently (IAS 19.100).

Plan assets

Plan assets refer to financial resources managed by a legally separate entity (often referred to as a 'fund') whose sole purpose is to pay or fund employee benefits. These assets are earmarked specifically for employee benefits and cannot be used for other purposes. A qualifying insurance policy may also be considered a plan asset, as stated in IAS 19.115. For a comprehensive set of definitions, refer to IAS 19.8.

If assets meet the criteria laid out in IAS 19, their fair value is deducted from the present value of the defined benefit obligation in the statement of financial position. For further discussion on this, refer to IAS 19.113-119. Any changes in the fair value of plan assets, including the costs associated with managing these assets, are treated in a manner similar to actuarial gains or losses. Specifically, they are included in OCI for post-employment benefits and in P/L for other long-term benefits.

Typically, if plan assets are present, entities include a line in their financial statements referred to as 'remeasurements of the net defined benefit liability (asset)'. This line consolidates both actuarial gains or losses and changes in the fair value of plan assets.

The discount expense associated with the defined benefit obligation is offset by interest income earned on the plan assets. The same discount rate used for calculating the obligation is applied to determine this interest income, which is based on the fair value of the plan assets.

Disclosure

IAS 19 mandates that entities disclose various aspects of defined benefit plans, including their characteristics and associated risks. The standard also stipulates specific requirements for disclosing any estimation uncertainties. For a comprehensive list of disclosure requirements related to defined benefit plans, consult paragraphs IAS 19.135-152.

Termination benefits

Definition of termination benefits

Termination benefits, as outlined in IAS 19.159-171, form a unique category of employee benefits that arise upon the termination of employment, rather than accruing during an employee's ongoing service. However, it's crucial to note that not all payments made at the end of employment qualify as termination benefits. According to IAS 19, termination benefits are specific to situations where:

- The entity decides to end an employee's employment before the standard retirement age; or
- The employee chooses to accept a benefits package in return for voluntarily leaving the company.

In contrast, if a benefit is due to an employee upon ending their employment, regardless of the reason or manner of termination, it falls under the category of post-employment benefits, not termination benefits. Additionally, benefits aren't considered termination benefits if they result from an employee's unilateral decision to leave without an offer from the employer.

The line between termination benefits and post-employment benefits can sometimes blur. This is because many benefits granted at termination may legally be described as 'termination benefits'. However, IAS 19 classifies them based on specific criteria, as discussed above.

Recognition and measurement

Entities should recognise termination benefits at the earliest of the following dates, according to IAS 19.165:

- When the entity can no longer withdraw the offer of those benefits (refer to IAS 19.166-167 for more details);
- When the entity recognises costs for a restructuring that is within the scope of IAS 37 and involves the payment of termination benefits.

Typically, measuring termination benefits is straightforward since they are often paid as a lump sum. Since these benefits are not for the future service of an employee, they should be recognised immediately in P/L, even if the actual payments are spread over time. In complex scenarios, such as when the termination benefit resembles a pension plan, an actuarial valuation may be required.

On occasion, the termination benefit might be the difference between what an employee would have received upon leaving without a formal offer and a higher amount offered because the entity initiated the termination (IAS 19.160). An example is provided in IAS 19.170.

Disclosure

IAS 19 does not prescribe any specific disclosure requirements in relation to termination benefits, as indicated in IAS 19.171.

THEME 11. INCOME TAXES

1. Read the article and discuss

Deferred tax is accounted for in accordance with IAS 12, *Income Taxes*. It is important to note that references to 'income tax' here are to tax on company profits or losses rather than tax on an individual's income. Tax related to companies may be referred to as 'corporation tax' or 'corporate income tax' in some jurisdictions.

In FR, deferred tax normally results in a liability being recognised within the statement of financial position. IAS 12 defines a deferred tax liability as being the amount of income tax payable in future periods in respect of taxable temporary differences. So, in simple terms, deferred tax is tax that is payable in the future. However, to understand this definition more fully, it is necessary to explain the term 'temporary differences'.

Temporary differences are defined as being differences between the carrying amount of an asset or liability in the statement of financial position and its tax base (ie the amount attributed to that asset or liability for tax purposes).

Temporary differences may be either 'taxable temporary differences' or 'deductible temporary differences'.

Taxable temporary differences are those on which tax will be charged in the future when the asset (or liability) is recovered (or settled).

Deductible temporary differences are those which will result in tax deductions or savings in the future when the asset (or liability) is recovered (or settled).

IAS 12 requires that a deferred tax liability is recorded in respect of all taxable temporary differences that exist at the year-end.

All of this terminology can be rather overwhelming and difficult to understand, so consider it alongside an example. Depreciable non-current assets are a typical deferred tax example used in FR to examine knowledge and understanding.

Within financial statements, non-current assets with a limited useful life are subject to depreciation. However, within the corresponding tax computations, non-current assets are subject to tax depreciation (sometimes known as 'capital allowances') at rates set within the relevant tax legislation. Where at the year-end the accumulated depreciation and the cumulative tax depreciation claimed are different, the carrying amount of the asset (cost less accumulated depreciation) will then be different to its tax base (cost less accumulated tax depreciation) and hence a temporary difference arises.

Example 1

A non-current asset with a cost of $2,000 was acquired at the start of year 1. It is being depreciated on a straight-line basis over four years, resulting in annual depreciation charges of $500. Therefore, a total of $2,000 of depreciation will be charged over the life of the asset. The tax depreciation granted by the tax authorities on this asset are:

	$
Year 1	800
Year 2	600
Year 3	360
Year 4	240
Total tax depreciation	2,000

The table below shows the carrying amount of the asset, the tax base of the asset and therefore the temporary difference at the end of each year:

Year	Carrying value (Cost less accumulated depreciation) $	Tax base (Cost less accumulated tax depreciation) $	Temporary difference $
1	1,500	1,200	300
2	1,000	600	400
3	500	240	260
4	-	-	-

As stated above, deferred tax liabilities arise on taxable temporary differences (i.e. those temporary differences that result in tax being payable in the future as the temporary difference reverses). So, how does the above example result in tax being payable in the future?

Entities pay income tax on their taxable profits. When determining taxable profits, the tax authorities start by taking the profit before tax (accounting profits) of an entity from their financial statements and then make various adjustments. For example, depreciation is considered a disallowable expense for taxation purposes but instead tax relief on asset expenditure (capital expenditure) is granted in the form of tax depreciation.

Therefore, taxable profits are arrived at by adding back depreciation and deducting tax depreciation from the accounting profits. Entities are then charged tax at the appropriate tax rate on these taxable profits.

In the above example, when the tax depreciation is greater than the depreciation expense in years 1 and 2, the entity has received tax relief early. This is good for cash flow in that it delays (i.e. defers) the payment of tax. However, the difference is only a temporary difference and so the tax will have to be paid in the future. In years 3 and 4, when the tax depreciation for the year is less than the depreciation charged, the entity is being charged additional tax and the temporary difference is reversing. Hence the temporary differences can be said to be taxable temporary differences.

Notice that overall, the accumulated depreciation and accumulated tax depreciation both equal $2,000 – the cost of the asset – so over the four-year period, there is no difference between the taxable profits and the profits per the financial statements. Where local tax legislation requires that tax depreciation is calculated on a reducing (diminishing) balance basis, then the asset may be fully depreciated before the full amount of tax depreciation has been claimed. This does not make a difference to the accounting required for deferred tax.

In this example, at the end of year 1 the entity has a temporary difference of

$300, which will result in tax being payable in the future (in years 3 and 4). In accordance with the accruals concept, a liability is therefore recorded equal to the expected tax payable.

Assuming that the tax rate applicable to the company is 25%, the deferred tax liability that will be recognised at the end of year 1 is 25% x $300 = $75. This will be recorded by crediting (increasing) a deferred tax liability in the statement of financial position and debiting (increasing) the income tax expense in the statement of profit or loss.

By the end of year 2, the entity has a taxable temporary difference of $400 (i.e. the $300 bought forward from year 1, plus the additional difference of $100 arising in year 2). A liability is therefore now recorded equal to 25% x $400 = $100. Since there was a liability of $75 recorded at the end of year 1, the double entry that is recorded in year 2 is to credit (increase) the liability and debit (increase) the income tax expense by $25.

At the end of year 3, the entity's taxable temporary differences have decreased to $260 since the company has now been charged tax on the difference of $140 ($500 depreciation - $360 tax depreciation). In other words, they are now adding back more depreciation in their tax computation than they are able to deduct in tax depreciation. Therefore, in the future, the tax payable will be 25% x $260 = $65. The deferred tax liability now needs to be reduced from $100 to $65 and so is debited (a decrease) by $35. Consequently, there is now a credit (a decrease) to the income tax expense of $35.

At the end of year 4, there are no taxable temporary differences since now the carrying amount of the asset is equal to its tax base. Therefore, the opening liability of $65 needs to be removed by a debit entry (a decrease) and hence there is a credit entry (a decrease) of $65 to the income tax expense. This can all be summarised in the following working:

Year	1 $	2 $	3 $	4 $
Opening deferred tax liability	0	75	100	65
Increase/(decrease) in the year	75	25	(35)	(65)
Closing deferred tax liability	75	100	65	0

The movements in the liability are recorded in the **statement of profit or loss** as part of the income tax charge.

The closing figures are reported in the **statement of financial position** as part of the deferred tax liability.

The statement of profit or loss

As IAS 12 considers deferred tax from the perspective of temporary differences between the carrying amount and tax base of assets and liabilities, the standard can be said to focus on the statement of financial position. However, it is helpful to consider the effect on the statement of profit or loss.

Continuing with the previous example, suppose that the profit before tax of the entity for each of years 1 to 4 is $10,000 (after charging depreciation). Since

the tax rate is 25%, it would then be logical to expect the income tax expense for each year to be $2,500. However, income tax is based on taxable profits, not on the accounting profits.

The taxable profits and current tax liability for each year could be calculated as in the table below:

	Year 1 $	Year 2 $	Year 3 $	Year 4 $
Profit before tax	10,000	10,000	10,000	10,000
Add back depreciation	500	500	500	500
Less tax depreciation	(800)	(600)	(360)	(240)
Taxable profits	9,700	9,900	10,140	10,260
Tax liability @ 25% of taxable profits	2,425	2,475	2,535	2,565

The current tax liability is recorded as part of the income tax expense. As we have seen in the example, accounting for deferred tax then results in a further increase or decrease in the income tax expense. Therefore, the final income tax expense for each year reported in the statement of profit or loss would be as follows:

	Year 1 $	Year 2 $	Year 3 $	Year 4 $
Income tax expense related to current tax payable	2,425	2,475	2,535	2,565
Increase/(decrease) due to deferred tax	75	25	(35)	(65)
Total income tax expense	(2,500)	(2,500)	(2,500)	(2,500)

It can therefore be said that accounting for deferred tax is ensuring that the matching principle is applied. The income tax expense reported in each period is the tax consequences (i.e. tax charges less tax relief) of the items reported within profit in that period.

However, it should be noted that the tax consequences of transactions should be accounted for in the same way that the underlying transaction is accounted for. Therefore, if a transaction is accounted for outside of the statement of profit or loss (either in other comprehensive income or directly in equity), then the tax effect should also be recognised either in other comprehensive income or directly in equity as appropriate. See Example 2 for further details.

The FR exam

Here are some hints on how to deal with questions about deferred tax when preparing financial statements in the exam:

- Any deferred tax liability given within the trial balance or draft financial statements is likely to be the opening liability.
- In the notes to the question, there will be information to enable you to calculate the closing liability for the statement of financial position or the increase/decrease in the liability.

It is important that you read the information carefully. You will need to ascertain exactly what you are being told within the notes to the question and therefore how this relates to the working that you can use to calculate the figures for the answer.

Consider the following sets of information – all of which will achieve the same ultimate answer in the financial statements.

Example 2

The trial balance shows a credit balance of $1,500 in respect of a deferred tax liability.

The notes to the question could contain one of the following sets of information:

1. At the year-end, the required deferred tax liability is $2,500.
2. At the year-end, it was determined that an increase in the deferred tax liability of $1,000 was required.
3. At the year-end, there are taxable temporary differences of $10,000. Tax is charged at a rate of 25%.
4. During the year, taxable temporary differences increased by $4,000. Tax is charged at a rate of 25%

	$	
Situation 1		
Opening deferred tax liability	1,500	*Provided in trial balance*
Increase in the year (income tax expense)	1,000	*Balancing figure*
Closing deferred tax liability	2,500	*Provided in information*
Situation 2		
Opening deferred tax liability	1,500	*Provided in trial balance*
Increase in the year (income tax expense)	1,000	*Provided in information*
Closing deferred tax liability	2,500	*Balancing figure*
Situation 3		
Opening deferred tax liability	1,500	*Provided in trial balance*
Increase in the year (income tax expense)	1,000	*Balancing figure*
Closing deferred tax liability	2,500	*Calculated from information (25% x $10,000)*
Situation 4		
Opening deferred tax liability	1,500	*Provided in trial balance*
Increase in the year (income tax expense)	1,000	*Calculated from information ($4,000 x 25%)*
Closing deferred tax liability	2,500	*Balancing figure*

Situations 1 and 2 are both giving a figure that can be included in the deferred tax working. In situations 3 and 4 however, the temporary differences are being given. These are then used to calculate a figure which can be included in the working. In all situations, the missing figure is calculated as a balancing figure.

Revaluations of non-current assets

Revaluations of non-current assets are a further example of a taxable temporary difference. When a non-current asset is revalued to its fair value within

the financial statements, the revaluation gain is recorded in equity (revaluation surplus) and reported as other comprehensive income. While the carrying amount of the asset has increased, the tax base of the asset remains the same and so a temporary difference arises.

Tax will become payable on the gain when the asset is sold and so the temporary difference is taxable. Since the revaluation gain has been recognised within other comprehensive income and included as part of equity, the tax charge on the surplus is also recorded in other comprehensive income and reflected in the revaluation surplus balance in equity. Suppose that in Example 1, the asset is revalued to $2,500 at the end of year 2, as shown below:

Year 2	Carrying value (Cost less accumulated depreciation) $	Tax base (Cost less accumulated tax depreciation) $	Temporary difference $
Opening balance	1,500	1,200	300
Depreciation charge / tax depreciation	(500)	(600)	100
Revaluation	1,500	-	1,500
Closing balance	2,500	600	1,900

The carrying amount will now be $2,500 while the tax base remains at $600. This results in a temporary difference of $1,900, of which $1,500 relates to the revaluation gain. This gives rise to a deferred tax liability of $475 (25% x $1,900) at the year-end to report in the statement of financial position. The liability was $75 at the end of the prior year (Example 1) and thus there is an increase of $400 to record.

However, the increase in relation to the revaluation gain of $375 (25% x $1,500) will therefore reduce the total recorded in the revaluation surplus to $1,125 ($1,500 - $375). The revaluation gain itself can be presented in other comprehensive income net of tax or can be shown gross (i.e. without netting off the tax). If the gross revaluation gain is presented then the tax effect should be shown as a separate line item, aggregated with the tax effect of any other items of other comprehensive income presented gross.

The remaining increase in deferred tax of $25 will be charged to the statement of profit or loss as before. The overall journal entry required would be:

- Dr Tax expense in Income Statement $25
- Dr Revaluation reserve in equity $375
- Cr Deferred tax liability in SFP $400

SUGGESTED READING

International Financial Reporting Standards (IFRS)

№	Name	Issued
IFRS 1	First-time Adoption of International Financial Reporting 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
IFRS 18	Presentation and Disclosures in Financial Statements	2024
IFRS 19	Subsidiaries without Public Accountability: Disclosures	2024

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

IFRS Foundation. *IFRS - Home*. URL: http://www.ifrs.org.

IAS Plus. *IAS*. URL*:* *https://www.iasplus.com/en*

Articles - CPDbox - Making IFRS Easy. *CPDbox - Making IFRS Easy*. URL: https://www.cpdbox.com/articles/

Knowledge Base - IFRScommunity.com. *IFRScommunity.com.* URL: https://ifrscommunity.com/knowledge-base/

Навчальне видання

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