IFRS standards:

IFRS 1 - **First-time Adoption of International Financial Reporting Standards**

IFRS 2 - **Share-based Payment**

IFRS 3 - **Business Combinations**

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

IFRS 6 - **Exploration for and Evaluation of Mineral Resources**

IFRS 7 - **Financial Instruments: Disclosures**

IFRS 8 - **Operating Segments**

IFRS 9 - **Financial Instruments**

IFRS 10 - **Consolidated Financial Statements**

IFRS 11 - **Joint Arrangements**

IFRS 13 - **Fair Value Measurement**

IFRS 15 - **Revenue from Contracts with Customers**

IFRS 16 - **Leases**

IAS Standards

IAS 1 - Presentation of Financial Statements

IAS 2 - Inventories

IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors

IAS 10 - Events after the Reporting Period

IAS 12 - Income Taxes

IAS 16 - Property, Plant and Equipment

IAS 19 - Employee Benefits

IAS 20 - Accounting for Government Grants and Disclosure of Government Assistance

IAS 21 - The Effects of Changes in Foreign Exchange Rates

IAS 23 - Borrowing Costs

IAS 24 - Related Party Disclosures

IAS 28 - Investments in Associates and Joint Ventures

IAS 32 - Financial Instruments: Presentation

IAS 33 - Earnings per Share

IAS 36 - Impairment of Assets

IAS 37 - Provisions Contingent Liabilities and Contingent Assets

IAS 38 - Intangible Assets

IAS 40 - Investment Property

IAS 41 - Agriculture

IAS 1 – Presentation of financial statements

IAS1 covers the form and content of financial statements. The main components are:

- Statement of financial position 'SOFP'
- Statement of profit or loss and other comprehensive income 'P&L and OCI'

(Statements of financial performance)

- Statement of changes in equity
- Statement of cash flows
- Notes to the financial statements

The entity should identify each financial statement and the notes very clearly. IAS1 also requires the entity to display the following information:

1. The name of the reporting entity
2. Whether the financial statements are of an individual entity or a group of entities
3. the date of the end of the reporting period or the period covered
4. the presentation currency
5. the level of rounding used

there are 8 overall considerations to present the financial statements:

(1) Fair presentation and compliance with IFRS
(2) Going-concern
(3) Accrual basis
(4) Materiality and aggregation
(5) Frequency of reporting
(6) Offsetting
(7) Comparability
(8) consistency

statement of financial position:

an entity must present current and non-current assets as separate classifications in the statement of financial position. A presentation based on liquidity should only be used where it provides more relevant and reliable information, in which case all assets and liabilities must be presented broadly in order of liquidity.

IAS1 distinguish between current and non- current assets(liabilities) by identifying the term current asset (liability):

1) Current Assets:
    I. Assets expected to be realized in or is intended for sale and consumption in the entity's normal operating cycle
    II. Held primarily for trading
    III. Due to be realized within 12 months
    IV. Cash or cash equivalent that are not subject to exchange restriction
2) Current liabilities:
    I. Expected to be settled in the entity's normal operating cycle
    II. Held primarily for trading
    III. Due to be settled within 12 months
    IV. The entity does not have the right at end of the reporting period to defer settlement of the liability for at least 12 months

All other assets (liabilities) are classified as non-current.

Statement of profit or loss:

IAS1 allows income and expense items to be presented either:

- in a single statement of profit or loss and other comprehensive income, or
- in two statements: a separate statement of profit or loss and a separate statement of other comprehensive income

"Memorize"

"The principals underpinning the overall presentation of financial statements are set out in IAS 1 – presentation of financial statements.

IAS 1 requires that all income and expenses are presented in a statement of profit or loss and other comprehensive income.

IAS 1 does not allow entities to choose whether to present income and expense in the P&L section or the OCI section of the statement.

IAS 1 states that unless required or permitted by a specific IFRS standard, all items of income and expense recognized in a period shall be included in profit or loss section.

The key implication of an item being presented in OCI other than P&L is that the item would not be taken into account when measuring the earnings per share."

"IAS1 states that tax related to OCI is either shown as a separate line in the OCI section of the statement or netted off against each component of other comprehensive income and disclosed in the notes to the financial statements."

Circumstances where items may be excluded from profit or loss for the current year include the correction of errors and the effect of changes in accounting policies (IAS8)

*An analysis of expenses must be shown either in the profit or loss section or by note, using a classification based on either the nature of the expenses or their function. This sub classification of expenses indicates a range of components of financial performance; these may differ in terms of stability, potential for gain or loss and predictability

Disclosures:

IAS1 specifies disclosures of certain items in certain ways.

- Some items must appear as line items in the statement of financial position or statement of profit or loss and other comprehensive income
- Other items can appear in a note to the financial statements instead

Disclosures in both IAS1 and other IFRS standards must be made either as separate line items in the statement or in the notes unless otherwise stated, disclosures cannot be made in an accompanying commentary or report.

~IAS1 also requires the disclosure of the amount of dividends paid during the period covered by the financial statements. This is shown either in the statement of changes of equity or in the notes.

~An entity must disclose the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognized in the financial statements.

~An entity must disclose in the notes: information regarding key assumptions about the future, and sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Statement of changes in equity

IAS1 requires entities to present statement of changes in equity. The statement must show:

- Total comprehensive income for the period, showing amounts attributable to the parent and NCI

- The effects of any retrospective application of accounting policies or restatements in accordance with IAS8
- A reconciliation of the opening to closing carrying amount for each component of equity
- An analysis of other comprehensive income

Notes to the financial statements

IFRS 13 Fair value

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

That price would be described as the 'exit price'. The market-based current exit price implies an exchange between unrelated, knowledgeable and willing parties.

Fair value is a market-based measurement, not an entity- specific measurement. It focuses on exit prices of assets and liabilities and takes into account market conditions at the measurement date. Because it's a market-based measurement, fair value is measured using the assumptions that market participants would use when pricing the asset, taking into account any relevant characteristics of the asset. The transactions take place either at the principal market for the asset or liability or in the absence of the principal market, in the most advantageous market for the asset or liability.

The principal market is the market which is the most liquid for that asset or liability. In most cases the principal market and the most advantageous market are the same

Fair value is not adjusted for transaction costs as these are not a feature of the asset or liability, but may be take into account when determining the most advantageous market.

*For *non-financial assets* the fair value measurement looks at how the asset can be used. It takes into account the ability of a market participant to generate economic benefits by using the asset in its highest and best use.

*Fair value measurement of a *liability* assumes that the liability is transferred at the measurement date to a market participant, who is then obliged to fulfill the obligation.

Valuation techniques:

The standard establishes three-level hierarchy for the inputs that valuation techniques used to measure fair value:

Level one: Quoted prices in active markets for identical assets or liabilities that the reportion entity can access at the measurement date.

Level two: Inputs, other than quoted prices included in level 1, that are observable for the asset or liability.

Level three: Unobservable inputs for the asset or liability

Valuation approaches:

There are three valuation approaches:

(A) Income approach: Valuation techniques that convert future amounts to a single current amount.
(B) Market approach: Valuation technique that uses prices and other relevant information generated by market transactions.
(C) Cost approach: Valuation technique that reflect the amount that would be required currently to replace the service capacity of an asset.

Entities may use more than one valuation technique to measure fair value in a given situation

IFRS 15: Revenue from contracts with customers

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

Under IFRS15 revenue is recognized when the promised goods and services are transferred to a customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Under IFRS 15 the transfer of goods and services are based upon the transfer of control. Control of an asset is the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.

Note: Revenue does not include taxes which are only collected for third parties, because these do not represent an economic benefit flowing to the entity.

Revenue recognition:

There are five steps to recognize revenue, which are:

1- Identify the contract with customer
2- Identify the separate performance obligation
3- Determine the transaction price
4- Allocate the transaction price to performance obligation
5- Recognize revenue when or as a performance obligation is satisfied

» **Identify the contract with customer:**

A contract is within the scope of IFRS15 if all the following criteria have been met:

(a) The parties have approved and are committed to fulfilling the terms of the contract
(b) Each party's right can be identified
(c) Clear identification of the payment terms
(d) The contract has commercial substance
(e) It is probable that the entity will collect the consideration to which it will be entitled
(f) The contract can be written, verbal or implied

» **Identify separate performance obligations:**

Performance obligations are the promises to provide goods and services to a customer.

If the goods and services are distinct (they can be sold or used separately or the customer can benefit from them on their own) then the company would account for the performance obligation separately.

» **Determine the transaction price:**

The transaction price is the amount of consideration a company expects to be entitled to from the customer in exchange for transferring goods or services.

Could be either variable or fixed

- ✓ In determining the transaction price, Variable considerations are only included where it is highly probable that there will not be a reversal of revenue when any uncertainty associated with the variable consideration is resolved

- » **Allocate the transaction price to the performance obligations:**

Where a contract contains more than one distinct performance obligation a company allocates the transaction price to all separate performance obligations in proportion to the stand-alone selling price of the goods and services underlying each performance obligation.

Recognize revenue when or as a performance obligation is satisfied

The entity satisfies performance obligation by transferring control of a promised good or services to the customer. A performance obligation can be satisfied at a point in time, such as when goods are delivered to the customer or over time and the amount of revenue recognized is the amount allocated to the performance obligation (the outcome if it can be reasonably measured or the cost incurred if outcome cannot be reasonably measured)

IMP: Timing and measurement of revenue summary:

"The timing of the recognition of revenue under IFRS15 depends on the type of PO the entity has under the contract. A PO is a distinct promise to transfer goods and services to the customer. IFRS15 requires that revenue should be recognized when (or as) a particular PO is satisfied.

- » In many cases, PO is satisfied at a point in time.
  In such cases, revenue is recognized at the point control of goods is transferred to the customer.
- » In some cases, PO is satisfied over a period of time.
  In such cases, the proportion of revenue recognized is the proportion of PO which has been satisfied at the reporting date.

The measurement of revenue is based on the TP. TP is the amount of consideration to which an entity expects to be entitled in exchange for transferring the promised goods and services to the customer.

- » In many cases, where the consideration for the transaction is fixed and payable immediately after the revenue has been recognized
  The TP is the invoice amount Less any sales taxes collected on behalf of third parties.
- » In other cases, where the due date for payment of invoiced price is significantly different from the date of revenue recognition (more than 12 months).
  Then the time value of money should be taken into consideration when measuring the TP. This means that revenue recognized on the sale of goods with deferred payment will be split into cost of goods sold component and a financing component.
- » In other cases, where consideration due contains variable elements.
  The TP should be based on the best estimate of total amount receivable from the customer as a result of the contract."

Contract costs:

- Recognized as an asset: [1]the incremental costs of obtaining a contract if they are expected to be recovered, [2] costs incurred in fulfilling the contract if they relate directly to an identifiable contract, are expected to be recovered and they generate or enhance resources of the entity that will be used in satisfying performance obligation in the future. *Costs recognized as an asset are amortized on a systematic basis consistent with the transfer to the customer of the goods or services to which the asset relates

- Recognized as expense: costs that would have been incurred regardless pf whether the contract was obtained

Common types of transactions:

Warranties

If a customer has the option to purchase a warranty separately from the product, it constitutes a distinct service and is accounted for as a separate performance obligation.

If the customer does not have the option to purchase the warranty separately, for instance if its required by law, that does not give rise to a performance obligation and the warranty is accounted for in accordance with IAS 37 provision, contingent liabilities and contingent assets.

Principal versus agent

An entity must establish in any transaction whether it is acting as a principle or agent

It is a principle if it controls the promised goods and services before it is transferred to the customer and some other indications which are:

(a) It is primarily responsible for fulfilling the contract
(b) It has inventory risk before or after the transfer of control to the customer
(c) It has discretion in establishing prices for the specified goods or services

When the performance obligation is satisfied, the entity recognizes revenue in the gross amount of the consideration to which it expects to be entitled for those goods or services

It is an agent if its performance obligation is to arrange for the provision of goods and services by another party. In this case the agent's revenue is measured at the fee or commission that it expects to be entitled to for arranging the provision of goods or services by the other party

Repurchase agreements

Under a repurchase agreement an entity sells an asset and promises, or has the option, to repurchase it. Repurchase agreements generally come in 3 forms:

1- Forward contract: where an entity has an obligation to repurchase the asset } control is with the seller
2- Call option: where an entity has the right to repurchase the asset } Same accounting treatment for both
   ~IF Original price > Repurchase piece, then it is accounted for as a lease
   ~IF Repurchase Price> Original price, it is a financial arrangement
3- Put option: where an entity must repurchase the asset if requested to do so by the customer
   Control is with the buyer
   ~IF original price > Repurchase price> Market price, i.e., the customer has incentive to exercise the option, then it is accounted for as a lease.
   ~IF Original price > Market price > Repurchase price, it is considered as a sale with the right to return
   ~IF Repurchase price > Original price, then it is a financial arrangement

Consignment arrangements

When a product is delivered to a customer under a consignment arrangement, the customer (dealer) does not obtain control of the product at that point in time, so no revenue is recognized upon delivery.

Indicator of a consignment arrangement include:

(a) The product controlled by the entity until a specified event occurs, such as the product is sold on, or a specified period expires
(b) The entity can require the return of the product, or transfer it to another party
(c) The customer does not have an unconditional obligation to pay for the product.

If the control of the inventory has been transferred to the dealer

- The inventory should be recognized in the dealer's SOFP, together with a corresponding liability to the manufacturer and any deposit should be deducted from this liability and the access classified as trade payable

If the control of the inventory has not been transferred to the dealer

- The inventory should not be included in the dealer's SOFP until the transfer of control has taken place and any deposit should be included under 'other receivables'

Bill and hold arrangement

Under a bill and hold arrangement goods are sold but remain in the possession of the seller for a specified period, perhaps because the customer lacks storage facilities.

For a customer to have obtained control of a product in a bill and hold arrangements, the following criteria must all be met:

1- The reason for the bill and hold must be substantive
2- The product must be separately identified as belonging to the customer
3- The product must be ready for physical transfer to the customer
4- The entity cannot have the ability to use the product or to transfer it to another customer

Sale with a right to return

When goods are sold with a right to return, an entity should not recognize revenue for goods that is expects to be returned. This will be shown as a refund liability and a deduction from revenue.

The entity also recognizes an asset for its right to recover products from customers on settlement of the refund liability

With estimation:

Dr	Accounts receivable/Cash	XXX
Cr	Revenue	XX
Cr	Refund liability "Contra-account to AR"	X

Dr	Cost of goods sold	XX
Dr	Right to recover asset	X
Cr	inventory	XXX

With no estimation: *No revenue recognition*

Dr	Right to recover asset	XXX
Cr	Inventory	XXX

Presentation

Contract with customers will be presented in an entity SOFP as a contract liability, a contract asset or a receivable, depending on the relationship between the entity's performance and the customer's payment.

A contract liability: where a customer has paid an amount pf consideration prior to the entity performing by transferring control of related goods or services to the customer.

A contract asset: where the entity has performed but the customer has not yet paid the related consideration and the entity's right to consideration is conditional on something other than the passage of time, e.g., future performance

Receivable: where the entity has performed but the customer has not yet paid the related consideration and the entity's right to consideration is unconditional except for the passage of time.

Where revenue has been invoiced a receivable is recognized. Where revenue has been earned but not invoiced, it is recognized as a contract asset.

ASSETS

IAS 36 Impairment of assets

Impairment is determined by comparing the carrying amount of the asset with its recoverable amount. This is the higher of its fair value less costs of disposal and its value in use.

Carrying amount: the amount at which an asset is recognized after deducting any accumulated depreciation (or amortization) and accumulated impairment losses.

Impairment loss: is the amount by which the carrying amount of an asset or a cash generating unit exceeds its recoverable amount

IAS 36 impairment applies to all tangible, intangible and financial assets except IAS2, IAS 12, IAS19, IFRS9, IAS40, IFRS5.

This is because those standards already have rules or recognizing and measuring impairment (except for ifrs5: no impairment).

The basic principle of IAS36 is if an asset's carrying amount in the financial statements is higher than its net recoverable value (NRV), the asset has suffered an impairment loss and should therefore be reduced in value, by the amount of the impairment loss. This amount is written off against profit immediately.

Impairment loss indicators:

External indicators (4):

- A fall in the assets market value that is more significant than what would normally be expected from passage of time over normal use.
- A significant change in the technological, legal, market or economic environment of the business in which the asset is employed
- An increase in market interest rates or market's rates of ROI likely to affect the discount rate used in calculating value in use
- Carrying amount of entity's net assets are more that its market capitalization.

Internal indicators (2):

- Evidence of obsolescence or physical damage
- Adverse changes in the use to which the asset is put or the asset's economic performance

Even if there are no indications of impairment, the following assets must always be tested for impairment annually:

(a) an intangible asset with an indefinite useful life. (B) goodwill acquired in a business combination.

The net recoverable amount/value of an asset (NRV):

It is measured as the higher of the asset's fair value less costs of disposal and its value in use

An asset's fair value less costs of disposal is the price that would be received to sell the asset in an orderly transaction between market participants at the measurement date, less direct disposal costs (restructuring and reorganizing expenses or any costs that have already been recognized in the financial statements as liabilities are not included)

The value in use is the present value of the future cash flows expected to be derived from an assets or cash-generating units

Cash generating unit is the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or group of assets. Cash generating units should be identified consistently from period to period for the same type of asset unless a change is justified. If it is not possible to calculate the recoverable amount for an individual asset, the recoverable amount of the asset's cash-generating unit should be measured instead.

Accounting treatment of an impairment loss:

If the NRV of an asset is less than its carrying amount in the SOFP, an impairment loss has occurred and should be recognized immediately.

- The carrying amount should be reduced to its recoverable amount in the SOFP
- The impairment loss should be recognized immediately in P&L

Cost model:

Dr	Impairment loss	XX
Cr	Asset	XX

Revaluation model:

Dr	Revaluation surplus (OCI)	XX
Dr	Impairment loss	X
Cr	Asset	XXX

After reducing an asset to its recoverable amount, the depreciation charge on the asset should then be based on its new carrying amount, its estimated residual value (if any) and its estimated remaining useful life.

An impairment loss should be recognized for a cash generating unit If its recoverable amount is less than the carrying amount for all assets in the unit. The loss is then allocated between the assets in the unit in the following order

1- Any asset damaged or specifically identified as impaired
2- Goodwill
3- Non-current assets (Pro-rata basis)

Reversal of an impairment loss:

An annual impairment test should be applied to all assets. Including assets that have been impaired in the past.

In some cases, the NRV of a previously impaired asset becomes higher than its current carrying amount. In other words, there might have been a reversal of some of the previous impairment loss.

In which case, the carrying amount of the asset should be increased to its new recoverable amount. The asset cannot be revalued to a carrying amount that is higher than its value would have been if the asset had not been impaired originally. (i.e.: original carrying amount- accumulated depreciation).

An exception to this rule is goodwill. An impairment loss of goodwill should not be reversed in a subsequent period.

Cost model:

Dr	Asset	XX
Cr	Recovery of impairment loss	XX

Revaluation model:

Dr	Asset	XX
Cr	Revaluation surplus (OCI)	XX

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IAS 16 – Property, plant and equipment

Property, plant and equipment are tangible assets that:

- Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. And
- Are expected to be used during more than one period

Bearer plants are within the scope of IAS 16 and they are living plants that is

- used in the production or supply of agriculture produce and
- are expected to bear produce for more than one period and
- have a remote likelihood of being sold as agricultural produce

Recognition: PPE are recognized as non-current assets if they meet two criteria:

1- it is probable that future economic benefits associated with the asset will flow to the entity
2- the cost of the asset can be measured reliably

and the asset should be initially measured at cost

Cost of the asset include its [1]purchase price, [2]import duties, [3]directly attributable costs of bringing the asset to the location and working conditions necessary for its intended use and [4]unavoidable costs of dismantling the asset

* For very large and specialized items, an apparently single asset should be broken down into its composite parts. this occurs where the different parts have different useful lives and different depreciation rates are applied to each part.

*Major components or separate parts should be recognized as PPE

*Smaller items sometimes classified as inventory or written down as expenses.

*Safety and environmental equipment that are necessary for the entity to obtain future economic benefits from its other assets should be recognized as assets and reviewed for impairment along with the original assets.

*Parts of some items of PPE may require replacement at regular intervals. This cost and expenditure incurred in replacing or renewing it are recognized in full when incurred and added to the carrying amount of the asset. It will be depreciated over its useful life which may be different from the useful life of other components of the asset. The carrying amount of the item being replaced is derecognized when the replacement takes place.

* When an asset requires regular overhauls in order to continue to operate, the cost of the overhaul is treated as an additional component and depreciated over the period to the next overhaul.

Subsequent measurement: The standard offers two choices, either keeping the asset recorded at cost or revaluing it to fair value

- Cost model: initial cost less any accumulated depreciation and impairment loss
- Revaluation model: the fair value of the asset at the date of revaluation less any subsequent accumulated depreciation and impairment losses. Revaluation model is only available if the fair value of the item can be measured reliably.

The frequency of revaluation depends on the volatility of the fair values of individual items of PPE. The more volatile the fair value, the more frequently the revaluation should be carried out.

When an item of PPE is revalued, the whole class of assets to which it belongs should be revalued.

Accounting for revaluation method:

When an increase in value takes place, IAS 16 requires the increase to be credited to 'other comprehensive income' and accumulated in "revaluation surplus"

Dr	Asset	XX
Cr	Revaluation surplus (OCI)	XX

When a decrease in value takes place, IAS 16 requires the decrease to be recognized in 'other comprehensive income' up to the balance of any revaluation surplus in relation to the asset.

Dr	Revaluation surplus (OCI)	XX
Dr	Profit or loss	X
Cr	Asset	XXX

The decrease recognized in OCI reduces the amount accumulated in the revaluation surplus. If no revaluation surplus available, the decrease in value should be charged to profit or loss.

IF the asset has recently suffered a decrease in value that was charged to profit or loss, any increase in value in subsequent revaluation should be recognized in profit or loss up to the net amount of the previously recognized decrease. Any excess should be recognized in OCI and accumulated in revaluation surplus:

Dr	Asset	XXX
Cr	Profit or loss	X
Cr	Revaluation surplus (OCI)	XX

The amount of surplus realized, when an asset has an upward revaluation, is the difference between depreciation charged on the revalued amount and the previous depreciation which would have been charged on the asset's original cost. This amount can be transferred to RE but not through P&L.

Note: When a revaluation takes place, the depreciation for the period up to the date of revaluation should be deducted from the carrying amount before calculating the revaluation surplus.

*When an asset is permanently withdrawn from use, or sold or scrapped, and no future economic benefits are expected from its use or disposal, it should be withdrawn from the statement of financial position. Gains or losses are the difference between the net disposal proceeds and the carrying amount of the asset. They should be recognized as income or expense in P&L.

IAS 38- Intangible assets

Intangible assets are identifiable non-monetary assets without physical substance. The assets must be:

a. Controlled by the entity as a result of past events

b. Something from which the entity expects future economic benefits to flow

*An Item should not be recognized as an intangible asset unless it fully meets the definition in the standard.

Identifiable: - acquired separately through purchase or it could be rented or sold separately "In order to distinguish it from goodwill"

Controlled by the entity: - entity must be able to enjoy the future economic benefits from the asset and prevent access to others from those benefits.

Initial measurement:

When recognized initially, intangible assets should be measured at cost. It should be recognized only if the recognition criteria were met:

1) It is probable that future economic benefits that are attributable to the asset will flow to the entity
2) The cost of the asset can be measured reliably

~~If an intangible asset is:

- acquired separately → its cost can usually be measured reliably as its purchase price
- A part of business combination → the cost of the intangible asset is its fair value at the date of acquisition
- Acquired by way of government grant (IAS20) → it may be recorded initially either at cost or fair value
- Is in exchange of another intangible asset → the cost of the intangible asset is measured at fair value unless:
  - The exchange transaction lacks commercial substance, or
  - The fair value of neither assets can be measured reliably

  Otherwise, its cost is measured at the carrying amount of the asset given up.

Internally generated intangible assets:

- Internally generated goodwill may not be recognized as an asset. IAS 38 specifically prohibits recognitions of internally generated goodwill because its cost cannot be measured reliably and it is not identifiable and controlled.

- Research and development costs:

  Research activities by definition do not meet the criteria for recognition under IAS 38. This is because, at the research stage of a project, it cannot be certain that future economic benefits will flow to the entity from the project. Research costs should therefore be written off as an expense as they are incurred.

  Development costs may qualify by definition as intangible assets provided that the following strict criteria can be demonstrated:

  - The technical feasibility of completing the intangible asset so that it will be available for use or sale
  - The entity's intention to complete the intangible asset and use or sell it
  - The entity's ability to use or sell the intangible asset
  - How the intangible asset will generate future economic benefits
  - The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset
  - The entity's ability to reliably measure the expenditure of the intangible asset during the development

Once these criteria are met, IAS 38 requires development expenditure to be capitalized. Its cost is the sum of the expenditure that are directly attributable to the asset and incurred from the date where the intangible asset first met the recognition criteria. The earlier expenditure should not be retrospectively recognized at a later date as part of the intangible asset cost.

*If the entity cannot distinguish between research and development, it treats the expenses from the project as if it were incurred in the research phase

- Other internally generated intangible assets:
  The standard prohibits the recognition if internally generated brands, customer lists, titles…etc. these all fail to meet one or more the definition and recognition criteria and, in some cases, indistinguishable from internally generated goodwill.
  All expenditures related to other intangibles that do not meet the recognition criteria of an identifiable intangible asset or goodwill should be expensed when incurred. Examples training and advertising costs, IAS 38 specifically prohibits the capitalization of advertising and promotion expenses as the economic benefits are uncertain and it is beyond the control of the entity

Subsequent measurement of intangible assets:

The standard allows two methods

1. The cost model: Cost less accumulated amortization and impairment losses
2. Revaluation model: measured at fair value at the date of revaluation same accounting treatment as IAS16. Can only be used if there is an active market in that type of asset and fair value can be measured reliably. If there is no active market then the cost model must be used.
   Revaluation must be made to the entire class of intangible assets at the same time and with such regularity that the carrying amount does not differ from its fair value at the end of the reporting period.

Amortization:

An entity should assess the useful life of an intangible asset for amortization purposes. Which may be finite or indefinite. An intangible asset with a finite useful life should be amortized over its expected useful life and residual value is assumed to be zero. Amortization starts when the asset is available for use and is recognized in profit or loss. Amortization period and method should be reviewed at each financial year end.

- No amortization for held for sale assets in accordance with IFRS5 at the earlier date of when the asset is derecognized or classified as held for sale.
- Residual value of an intangible asset with a finite useful life is assumed to be zero unless a third-party id committed to buying it at the end of the useful life or there is an active market for that type at the end of the useful life

An intangible asset with an indefinite useful life should not be amortized. IAS36 requires this asset to be tested for impairment at least annually.

The useful life should be reviewed each year to determine if it is still appropriate to assess its useful life as indefinite. Reassessing the useful life as finite is an indicator that the asset may be impaired and should be tested for impairment

Disposal/retirements of intangible assets:

An intangible asset should be eliminated from the statement of financial position when it is disposed of or when there is no further expected economic benefit from its future use. On disposal the gain or loss arising from the difference between the net proceeds and the carrying amount of the asset should be taken to profit or loss as a gain or loss on disposal

Goodwill "IFRS 3-business combination":

Usually, goodwill is not valued in the financial statements of a business at all, and is not normally present in its statement of financial position. There is one exception to the general rule that goodwill has no objective valuation. This is when a business is sold. Purchased goodwill is shown in the statement of financial position because it has been paid for. It has no tangible substance, so it is an intangible non-current asset. The purchased goodwill is the difference between the price agreed on and the value of the identifiable net assets in the books of the new business.

IFRS 3 requires that assets and liabilities acquired to constitute a business. Otherwise, it's not a business combination, and investors need to account for the transaction in line with other IFRS.

Goodwill acquired in a business combination is recognized as an asset and initially measured at cost.

Subsequent measurement is cost less any accumulated impairment losses. It is not amortized. Instead, tested for impairment at least annually, in accordance with IAS36.

~ a gain on a bargain purchase "negative goodwill" is recognized when the acquirer's interest in the net fair value of identifiable assets, liabilities and contingent liabilities of the acquired business exceeds the cost of the business combination. it can also arise as a result of errors in measurement so, before recognizing a gain on bargain purchase, an entity should first reassess the measurement of the acquiree's identifiable net assets. Any gain on bargain purchase remaining should be recognized immediately in profit or loss.

Note: all costs associated with the acquisition must be expensed (P&L) except for costs of issuing debt or equity instruments (OCE)

IAS 40 – Investment property

It is property held to earn rentals or for capital appreciation or both rather than for sale in the ordinary course of business (IAS2) or use in the production or supply of goods and services or for administrative purposes (IAS16)

*An asset held by an entity as a right-of-use asset under IFRS16 and leased out under an operating lease is treated as investment property.

'If the entity has not determined the use of its PPE, it is considered held for capital appreciation.

^some properties may be partly owner-occupied partly held for investment purposes. Under IAS40, if they can be sold separately, an entity should account for the portions separately. If the portions cannot be sold separately, the property is investment property only if an insignificant portion is owner-occupied.

Memorize: "IAS 40 states that where a property is held for mixed-use, the portions should be accounted for separately if they could be sold separately. This apply/doesn't apply here"

~ Investment property should be recognized as an asset when two conditions are met:

1. It is probable that future economic benefits associated with it will flow to the entity
2. the cost of the asset can be reliably measured

Initial measurement: investment properties should be measured initially at cost, including transaction costs

Subsequent measurement: IAS40 requires an entity to choose between two models and whichever one it chooses should be applied to all its investment properties.

(i) Cost model
It is the same as the cost model in IAS16. Investment properties should be measured at cost, less any accumulated depreciation and impairment losses. An entity that chooses the cost model should disclose the fair value of its investment property.

(ii) Fair value model
After initial recognition, an entity that chooses the fair value model should measure all of its investment properties at fair value, except those that their fair value cannot be measured reliably. In such cases it should apply the IAS16 cost model.

A gain or loss arising from a change in the fair value of an investment property should be recognized in net profit or loss for the period in which it arises.

Once the entity has chosen the fair value or cost model, it should apply it to all its investment property. It should noy change from one model to another unless the change will provide more reliable or relevant information.

Transfer to or from investment property should only be made when there is a change in use. When the transfer is:

From	to	
Investment property	Owner-occupied or inventory	Property's cost for subsequent accounting is Its fair value at the date of change of use
Owner occupied	Investment property	Treat the difference between carrying amount and fair value at the date with revaluation model under IAS16

Disposal: Derecognize an investment property on disposal or when it is permanently withdrawn from use and no future economic benefits are expected from its disposal.

Any gain or loss on disposal is the difference between the net disposal proceeds and the carrying amount of the asset. It should generally be recognized as income or expense in profit or loss.

Compensation from third parties for investment property that was impaired, lost or given up shall be recognized I profit or loss when the compensation becomes receivable.

IFRS 5- Non-current assets held for sale and discontinued operations

IFRS 5 requires [1]assets or a group of assets that are 'held for sale' to be presented separately in the statement of financial position and [2]the result of discontinued operations to be presented separately in the statement of profit or loss and other comprehensive income. This is required so that users of financial statements will be better able to make projections about the financial position, profits and cash flows of the entity.

Disposal group: A group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction and liabilities directly associated with those assets that will be transferred in the transaction.

A non-current asset (or disposal group) should be classified as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. and:

a) The asset must be available for immediate sale in its present condition
b) The sale must be highly probable

For the sale to be highly probable, the following must apply:

1. Management must be committed to a plan to sell the asset
2. There must be an active program to locate a buyer
3. The asset must be marketed for sale at a reasonable price in relation to its current fair value
4. The sale is expected to take place within one year from the date of classification
5. It is unlikely that significant changes to the plan will be made or that the plan is withdrawn

*An asset or disposal group can still be classified as held for sale, even if the sale has not actually taken place within one year. However, the sale's delay must have been caused by events or circumstances beyond the entity's control and there must be sufficient evidence that the entity is still committed to sell the asset or disposal group. Otherwise, the entity must cease to classify the asset as held for sale

*If an entity acquires a disposal group with the intention of selling it, it can classify the asset as held for sale only if the sale is expected to take place within a year and it is highly probable that the other criteria will be met within a short time (3 months)

*An asset that is to be abandoned should not classify as held for sale. Because the carrying amount will be recovered principally through continuing use.

A disposal group that is to be abandoned may meet the definition of a discontinued operation and therefore separate disclosure may be required

*Non-current assets classified as held for sale should be presented separately from other assets in the statement of financial positions. The liabilities of a disposed group should be presented separately from other liabilities in the statement of financial position.

* Assets and liabilities held for sale should not be offset and major classes of them should be separately disclosed either in the face of the statement of financial position or in the notes

Measurement:

~ A non-current asset (or disposal group) that is held for sale should be measured at the lower of its carrying amount and fair value less costs to sell. Fair value less costs to sell is equivalent to net realizable value (as the is no value in use for assets held for sale). And it should de remeasured at the lower of its carrying amount and fair value less costs to sell at each reporting date at which it is still classified as held for sale.

~ An impairment loss should be recognized where fair value less costs to sell is lower than the carrying amount. The impairment loss is charged to profit or loss unless the asset has been previously revalued in which case impairment should be treated as a decrease in value and accounted for by applying the relevant accounting standard (IAS16 or IAS38). IAS36 does not apply to assets held for sale. Impairment losses of assets held for sale are dealt with under IFRS5. If the fair value less costs to sell increases, then the carrying amount of the asset can be increased and the resulting gain should not be in excess of impairment losses previously recognized (under IFRS5 or IAS36 before the asset was classified as held for sale)

~ Non-current assets held for sale should not be depreciated, even if they are still being used by the entity

~ A non-current asset held for sale that is no longer classified as held for sale is measured at the lower of:

(a) Its carrying amount before it was classified as held for sale, adjusted to any depreciation, amortization or revaluations that would have been recognized had the asset not been recognized as held for sale.
(b) Its recoverable amount at the date of the decision not to sell

Disclosures:

- **Non-current assets held for sale (or disposal group):**

  In the period in which it has been classified as held for sale the following should be disclosed:

  - A description of the non-current asset or disposal group
  - A description of the facts and circumstances of the disposal
  - Any gain or loss recognized when the item was classified as held for sale

  When the asset previously classified as held for sale is no longer held for sale, the entity should disclose a description of the facts and circumstances leading to the decision and its effect on results

- **Discontinued operations:**

  Discontinued operation is a component of the entity that has either been disposed of, or is classified as held for sale, and:

a) Represents a separate major line of business or geographical area of operations
b) Is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations, or
c) Is a subsidiary acquired exclusively with a view to resale

An entity should present and disclose information that enables users of the financial statements to evaluate the financial effects of the discontinued operations and disposals of non-current assets or disposal groups.

This allows users to distinguish between operations which will continue in the future and those which will not, and make it more possible to predict future results.

1- <u>An entity should disclose *a single amount* in the statement of profit or loss comprising the total of:</u>
    - The post-tax profit or loss of discontinued operations
    - The post-tax gain or loss recognized on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group constituting the discontinued operation

2- An entity should also disclose an analysis of this single amount into:
    - The revenue, expenses and pre-tax profit or loss of discontinued operations
    - The related income tax expense
    - The gain or loss recognized on the measurement to fair value less costs to sell or on the disposal of the assets of the discontinued operations
    - The related income tax expense

This may be presented either in the statement of profit or loss or in the notes. If it is presented in the statement of profit or loss it should be presented in a section identified as relating to discontinued operations, i.e., separately from continued operations. *This analysis is not required where the discontinued operation is a newly acquired subsidiary that has been classified as held for sale

3- An entity should disclose the net cash flows attributable to the operating, investing and financing activities of discontinued operations.
These disclosers may be presented as separate line items in statement of cash flows or in the notes.

IAS 20 – Accounting for government grands and disclosure for government assistance

Government assistance: action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria.

** the forms of government assistance which are excluded from the definition of government grants should be disclosed because of its significance.

Government grants: assistance by government in the form of transfer of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

An entity should only recognize government grants when it has reasonable assurance that

- The entity will comply with any conditions attached to the grant
- The entity will actually receive the grant

Even if grants have been received, this does not prove that the conditions have or will be fulfilled. The manner of receipt is irrelevant.

In the case of a forgivable loan from government, it should be treated in the same way as a government grant when it is reasonably assured that the entity will meet the relevant terms for forgiveness.

Accounting treatment:

IAS20 requires grants to be recognized as income over the relevant periods to match them with related costs which they have been received to compensate. This should be done on a systematic basis. Grands should not, therefore, be credited directly to equity as that would be against the accruals concept. It would only be accepted if no other basis was available.

Where grants are received in relation to a [1]**depreciating asset**, the grant will be recognized over the periods in which the asset is depreciated and in the same proportions. In the case of grants for [2]**non-depreciable assets,** the grant should be recognized as income over the periods in which the cost of meeting the obligation is incurred. An entity may receive a grant [3]**as compensation for expenses or losses which it has already incurred or with no future related costs expected**. In cases such as these, the grant received should be recognized as income of the period in which it becomes receivable.

A non-monetary asset may be transferred by the government to the entity as a grant. The fair value of such asset is usually assessed and this is used to account for both the assets and the grant.

1) **Grants related to assets:**
There are two choices of how government grants related to assets should be shown in the SOFP

(A) Set up the grant as deferred income

Dr	Cash	XX
Cr	Deferred income	XX

At the end of the year (deferred income/ useful years)

Dr	Deferred income	X
Cr	Other income	X

(B) Deduct the grant in arriving at the carrying amount of the asset.

Dr	Cash	XX
Cr	Asset	XX

2) **Grants related to income:**
There are two choices of how they are presented in the profit or loss statement:

(A) Present as a separate credit or under a general heading ("other income")

Dr	Cash	XX
Cr	Other income	XX

(B) Deduct from the related expense

Dr	Cash	XX
Cr	Related expense	XX

Repayment of the grant:

If a grant must be repaid it should be accounted for as a revision of an accounting estimate (IAS8)

- Repayment of grant related to an asset: increase the carrying amount of the asset or reduce the deferred income balance by the amount repayable. The cumulative additional depreciation that would have been recognized to date in the absence of the grant should be immediately recognized as an expense

Repayment of grant related to income: apply first against unamortized deferred income set up in respect of the grant and any excess should be immediately recognized as an expense

IAS 41- agriculture

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

A biological asset is a living animal or plant

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

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

*Bearer plants (IAS16) and agricultural land (IAS16/IAS41) and intangible assets related to agricultural activity (IAS38) are specifically excluded from the scope of IAS41.

Recognition criteria of biological assets:

- ✓ The entity controls the assets as a result of past events
- ✓ It is probable that the future economic benefits associated with the asset will flow to the entity
- ✓ The fair value or cost of the asset to the entity can be measured reliably

Measurement and presentation of biological assets:

IAS 41 requires that each year end all biological assets should be measured at fair value less costs to sell

If the fair value cannot be determined and is not available, then the biological asset can be measured at cost less accumulated depreciation and impairment losses. This alternative is only allowed on initial recognition.

*IFRS 13 fair value measurement – requires the fair value of a biological asset to be determined by reference to the principal market for the asset. This may or may not be the most favorable market. Changes to fair value can arise due to both physical changes in the asset and price changes in the market.

Biological assets are recognized in the statement of financial position as a separate class of assets falling under neither current nor non-current at fair value less costs to sell, incorporating the consequences of all biological transformations.

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

Measurement and presentation of agriculture produce:

It is recognized at the point of harvest. It should be measured at each reporting date at fair value less costs to sell. The change in the carrying amount of the agriculture produce held at two reporting dates should be recognized as income or expense in profit or loss. This will be rare as such produce are usually sold or processed within a short time.

Agricultural produce that is harvested for trading and processing activities should be measured at fair value at the date of harvest and this amount is deemed cost for application of IAS2 to consequential inventories.

Agricultural produce should be classified as inventory in the statement of financial position and disclosed separately either in the statement of financial position or in the notes.

<u>Measurement and presentation of government grants:</u>

Measured at fair value less costs to sell.

If the government grant related to a biological asset is unconditional it should be recognized as income when the grant is receivable. If it is conditional then it should be recognized as income only when the conditions are met.

IAS 20 does not apply to a government grant on biological assets measured at fair value less costs to sell. However, if a biological asset is measured at cost less accumulated depreciation and impairment losses then IAS 20 does apply.

IAS 2- inventories

Inventories are assets:

~ Held for sale in the ordinary course of business,
~ In the process of production for such sale, or
~ In the form of materials or supplies to be consumed in the production process or in the rendering of services.

Inventories can include:

- Goods purchased and held for resale
- Finished goods produced
- Work in progress being produced
- Materials and supplies awaiting use in the production process (Raw materials)

The cost of inventories consists of all costs of:

* Purchase (Purchase price, import duties, transport and directly attributable costs of acquisition of finished goods less trade discounts, rebates and other similar amounts)
* Costs of conversion (directly related to units of production and fixed and variable production overheads)
* Other costs incurred in bringing the inventories to their present location and conditions

Costs that would *not* be included in costs of inventories are:

a) Abnormal amounts of wasted materials, labors or other production costs
b) Storage costs
c) Selling costs
d) Administrative overheads not incurred to bring inventories to their present location and conditions

*Costs of inventories should be assigned by using the ***<u>FIFO</u>*** or ***<u>weighted average</u>*** cost formulas. The LIFO formula is not permitted by IAS 2.

Inventories should be measured at **the lower of *<u>cost</u>* and *<u>net realizable value (NRV)</u>***

NRV could be less than cost when items are damaged or become obsolete, or where costs to completion have increased in order to make the sale or where:

i. An increase in costs or fall in selling price
ii. A physical deterioration in the condition of inventory
iii. Obsolescence of products
iv. Errors in production or purchasing
v. A decision to sell the product at a loss

Fluctuations of price or cost should be taken into account if they relate directly to events after the reporting period, which confirm conditions existing at the end of the reporting period.

NRV must be reassessed at the end of each period and compared again with cost. If the NRV has risen for inventories held over the end of more than one period, then the previous write down must be reversed to the extent that the inventory is then valued at the lower of cost and the new NRV. This may be possible when selling prices have fallen in the past and risen again.

- When inventories are sold The carrying amount is recognized as an expense in the period in which the related revenue is recognized

Dr	P&L (Cost of goods sold)	XX
Cr	Inventory	XX

- The amount of any write-down of inventories to NRV (impairment) and all losses of inventories are recognized as an expense in the period the write-down or loss occurs

Dr	P&L	XX
Cr	inventory	XX

- The amount of any reversal of any write-down of inventories, arising from an increase in NRV, is recognized as a reduction in the amount of inventory recognized as an expense in the period in which the reversal occurs.

Dr	Inventory	XX
Cr	P&L	XX

IAS 23- Borrowing costs

Borrowing costs are interest and other costs incurred by the entity in connection with the borrowing of funds.

Only borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset can be capitalized as part of the cost of that asset. These are the borrowing costs that would have been avoided had the expenditure on the qualifying asset not been made.

Dr	Asset	XX
Cr	Borrowing costs	XX

Qualifying asset is an asset that necessarily takes a substantial period of time (normally more than one year) to get ready for its intended use or sale.

Financial assets and inventories that are manufactured, or produced over a short period of time are not qualifying assets. Assets that are ready for their use or sale when purchased are not qualifying assets.

Where the entity uses a range of debt instruments to finance a wide range of assets; once the relevant borrowings are identified which relates to a specific asset, then the amount of borrowing costs available for capitalization will be the actual borrowing costs incurred on those borrowings during the period less any investment income on the temporary investment of those borrowings.

~ A situation may arise where the carrying amount of the qualifying asset exceeds its recoverable amount or net realizable value. In these cases, the carrying amount must be written down and they may be written back in the future.

=== **<u>Commencement of capitalization:</u>**

Three events must be taking place for capitalization of borrowing costs to be started

a. Expenditure on the asset is being incurred
b. Borrowing costs are being incurred

c. Activities are in progress that are necessary to prepare the asset for its intended use or sale

=== **Suspension of capitalization:**

If active development is interrupted for any extended periods, capitalization of borrowing costs should stop for those periods.

=== **Cessation of capitalization:**
once substantially all the activities necessary to prepare the asset for its intended use or sale are completed, the capitalization of borrowing costs should cease.

Memorize:

"IAS 23 looks at the treatment of borrowing costs, particularly where the related borrowings are applied to the construction of certain assets. These are usually called 'self-constructed assets', where an entity builds its own inventory of non-current assets over a substantial period of time."

"Under the principle of IAS 23, Borrowing costs which are directly attributable to the acquisition of an asset should be included as a part of the carrying amount of the asset"

"Borrowing costs would have been avoided if it weren't for manufacturing the asset. Therefore, interest expense should be capitalized"

IFRS 6 – Exploration for and evaluation of mineral resources

The scope of IFRS6 is intentionally very narrow. Entities must apply IFRS 6 to all exploration and evaluation expenditure incurred, after the entity has obtained legal rights to explore in a specific area, but before extraction has been demonstrated to be both technically feasible and commercially viable.

Exploration and evaluation expenditures are expenditures incurred in connection with the exploration for and evaluation of mineral resources before the technical feasibility and commercial viability of extracting and mineral resource and demonstrable.

Exploration and evaluation assets are exploration and evaluation expenditures recognized as assets in accordance with the entity's accounting policy.

An entity may choose its accounting policy as long as it's in line with IAS 8. Specifically, where it states that management should use its judgement in developing an accounting policy that result in information that is relevant and reliable. After choosing their policy, entities must then apply it consistently.

*Expenditure related to development of mineral resources must not be recognized as exploration and evaluation assets under IFRS6, as they come under IAS38

At recognition, exploration and evaluation assets must be measured at cost. Examples of costs included:

- Acquisition of rights to explore
- Topographical geological, geometrical and geophysical studies
- Exploratory drilling
- Trenching
- Sampling
- Activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource
- Costs of any obligations for removal and restoration

In Subsequent measurement, entities must apply cost model or revaluation model (IAS16 or IAS38)

Exploration and evaluation assets are classified as tangible or intangible according to the nature of the assets acquired. For example, drilling rights would be intangible, vehicles or drilling rigs would be tangible. The classification must be applied consistently.

They should no longer be classified as exploration and evaluation assets when the technical feasibility and commercial viability of extracting a mineral resource is demonstrable. Any impairment loss on the assets must be recognized before classification

exploration and evaluation assets must be assessed for impairment when facts and circumstances suggest that the carrying amount of an asset may exceed its recoverable amount. Any resulting impairment loss must be measured, presented and disclosed in accordance with IAS36.

*For impairment purposes, each cash generating unit or group of units to which an exploration and evaluation assets is allocated must not be larger than a segment as determined by IFRS8- operating segments.

Memorize:

“IFRS6 states that, in making this determination, entities should consider the degree to which the expenditure can be associated with finding the specific mineral resources it is seeking”

“IFRS 6 specifically prohibits the inclusion of the cost of development of mineral resources in the exploration and evaluation asset figure. Such expenditure should be accounted for in accordance with IAS 38- intangible assets”

LIABILITIES

IAS37 – Provisions, contingent liabilities and contingent assets

A provision is a liability of uncertain timing or amount

A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

IAS37 states that a provision should be recognized as a liability in the financial statements when:

- An entity has present obligation as a result of past events (legal or constructive)
- It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation (more likely than not to occur, more than 50%)
- A reliable estimate can be made of the amount of the obligation

Provision should be capitalized as an asset, if the expenditure provides access to future economic benefits. Otherwise, it should immediately be charged to the statement of profit or loss.

The amount recognized as a provision should be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. The estimate is determined by the judgement of the entity’s management.

*Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities, i.e., expected value

Where the provision involves a single item, such as the outcome of a legal case, provision is made in full for the most likely outcome.

The amount of a provision should be the present value of the expenditure required to settle the obligation, where the effect of time value of money is material. An appropriate discount rate should be used.

* Future events which are reasonably expected to occur may affect the measurement of the provision and should be taken into account.

* Gains from the expected disposal of assets should not be taken into account in the measurement of a provision

At the end of each reporting period, a provision should be adjusted to reflect the current best estimate of the expected expenditure. A provision should be derecognized if the expenditure required to settle the related obligation is no longer probable.

Only expenditure related to the provision should be offset against it. Setting expenditures against a provision that was originally recognized for another purpose would conceal the impact of two events.

Some or all of the expenditure needed to settle the provision may be expected to be recovered from a third party. If so, the reimbursement should be recognized only when it is virtually certain that reimbursement will be received if the entity settles the obligation.

- It should be treated as a separate asset, the amount recognized not greater than the provision itself
- The provision and the amount recognized for reimbursement may be netted of in profit or loss

Some types of provisions:

- **Warranties:** these are argued to be genuine provisions as on past experience it is probable that some claims will emerge. The nature of the warranty granted will determine whether it should be accounted for under IAS37b or IFRS15.

- **Major repairs:** under IAS37 it is no longer possible to recognize a provision for major repairs, as it is a mere intention to carry out repairs, **not** an obligation.

- **Self-insurance:** under IAS37, this kind of provision is no longer justifiable as the entity has no obligation until a fire or accident occurs. **No** obligation exists until that time

- **Environmental contamination**: if the company has an environmental policy or if the company has broken current environmental legislation, then a provision for environmental damage must be made

- **Decommissioning or abandonment costs:** a legal obligation exist on initial expenditure therefore a liability exists immediately. However, the cost of purchasing the field in the first place is not only the cost of the field itself but also the cost of putting it right again. Thus, all costs of decommissioning may be capitalized

Dr	PPE	XX
Cr	Provision	XX

- **Future operating losses:** provisions are **not** recognized for future operating losses. They do not meet the definition of a liability and the general recognition criteria set out in the standard

- **Onerous contracts:** it is a contract in which the unavoidable costs of meeting the obligation under the contract exceed the economic benefits expected to be received under it. IAS37 requires a provision to be recognized for this contract after the recognizing if any impairment losses for assets related to the contract. The provision should be measured at the lower of the cost of fulfilling the contract and the cost of penalties from failure to fulfil the contract.

- **Restructuring:**

  It is a program that is planned and controlled by the management, and materially changes either the scope of a business undertaken by the entity or the manner in which a business is conducted.

  For the entity to have an obligation at the end of the reporting date, it must:

  - Have a detailed formal plant for the restructuring
  - Have raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announce its main features to those affected by it.

    A mere management decision is not normally sufficient

Where the restructuring involves the sale of an operation then IAS37 states that no obligation arises until the entity has entered into a binding agreement. This is because until this has occurred the entity will be able to change its mind and withdraw from the sale even if its intentions have been announced publicly.

A restructuring provision should include only direct expenditures arising from the restructuring. Direct expenditure are those which it has been necessary to incur because of the restructuring and which are *not related to the ongoing activities of the business.*

Costs relating to marketing and new systems/distributions networks as well as costs relating to retraining or relocating existing staff should not be included in a restructuring provision.

Contingent liabilities and contingent assets:

~ An entity should not recognize a contingent asset or liability, but they should be disclosed.

A contingent liability is:

a) A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity, or
b) A present obligation that arises from past events but is not recognized because:
   I. It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation, or
   II. The amount of the obligation cannot be measured with sufficient reliability

They should not be recognized in the financial statements but they should be disclosed. The required disclosures are:

- Description of the nature of the contingent liability
- Estimate of its financial effect
- Indication of the existing uncertainties
- The possibility of any reimbursement

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

A contingent asset must not be recognized. Only when the realization of the related economic benefits is virtually certain should recognition take place. At that point, the asset is no longer a contingent asset.

IAS 19 – Employee Benefits

Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment

The standard recognizes four categories for employee benefits, and proposes a different accounting treatment for each.

(a) ***Short-term benefits:*** they are employee benefits (other than termination benefits) that are expected to be settled wholly before 12 months after the end of the annual reporting period in which the employee render the related service.

e.g., wages and salaries, social security contributions, paid annual leave, paid sick leave, paid military service, profit shares and bonuses, non-monetary benefits, etc.

(b) ***Post-employment benefits:*** they are employee benefits (other than termination and short-term employee benefits) that are payable after the completion of employment.
e.g., pensions and post-employment medical care and post-employment insurance

(c) ***Other long-term benefits:*** they are all employee benefits other than short-term employee benefits, post-employment benefits and termination benefits
e.g., profit shares, bonuses or deferred compensation payable later than 12 months after the year end, sabbatical leave, long-service benefits and long-term disability benefits

(d) ***Termination benefits:*** they are employee benefits provided in exchange for the termination of an employee's employment.
e.g., early retirement payments and redundancy payments

Short-term employee benefits:

Accounting for short-term employee benefits is fairly straightforward, because there are no actuarial assumptions to be made, and there is no requirement to discount future benefits.

- **Unpaid** short-term employee benefits as at the end of an accounting period should be recognized as an **accrued expense**. Any short-term benefits **paid in advance** should be recognized as a **prepayment.**

  The cost should be recognized as an expense in the period when the economic benefit is given, as employment costs.

- Paid short-term employee benefits can be accumulating, such as a paid holiday leave, or non-accumulated paid absences, such as maternity/paternity pay.
  The cost of accumulating paid absence should be measured as the additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period.

*Profit shares or bonuses payable within 12 months after the end of the accounting period should be recognized as an expected cost when the entity has a present obligation to pay it.

The short-term accumulating paid benefits should be recognized as a cost and a related liability in the year when the entitlement arises. The liability should be released as the carried forward benefits are used up or after 12 months if they are not used.

Post-employment benefits:

There are two types of post-employment benefit plan: "Memorize"

1- **Defined contribution plan**: is one where the value of the retirement benefits paid out depends on the value of the plan. Which itself depends on the value of the contribution made.
The party who makes contributions and receive benefits bears the risk here, since if the value of the plan falls then so do the benefits paid out.
Payments are expenses in the year of employment, and are accounted for in the same way as e.g., salaries.

2- **Defined benefit plan**: the value of retirement benefits paid out is defined in advance, and is not affected by the value of the plan.
The risk here is with the plan operator because if the plan does not have sufficient funds to pay out the defined benefits, then these must be made up for.

It requires an entity to set up a separate plan, and to record the plan's assets, liabilities, income and expense. It is common to have a net liability, meaning that the obligation to pay the pension in the future is bigger than the value of the assets owned by the fund.

Defined contribution plans:

- The obligation is measured by the amounts to be contributed for the period
- There is no actuarial assumption to make
- No requirement for discounting if the obligation is settled in the current period (less than 12 months)

- Contributions to the plan should be recognized as an expense in the period they are payable
- Any unpaid contributions that are due as the end of the period should be recognized as a liability
- Any excess contributions paid should be recognized as an asset (prepaid expense), but only to the extent that the prepayment will lead to, for example a reduction in future payments or a cash refund

**IF the contributions of a defined contribution plan do not fall due entirely within 12 months after the end of the period in which the employees performed the related service, then these should be discounted.

Defined benefits plan:

	Defined benefit obligation	Plan asset
PV of defined benefit obligation / FV of plan asset	+	+
Interest (market yield)	+	+
Service cost (current and past)	+	…..
Contributions received	…..	+
Benefits paid	-	-
Actuarial remeasurement	+/-	+/-

Accounting for defined benefit plans is much more complex. The complexity stems largely from the following factors:

- The future benefits cannot be measured exactly, but the employer will have to pay them, and the liability should therefore be recognized now. To measure these future obligations, it is necessary to use actuarial assumptions.
- If actuarial assumption change, the amount of required contribution to the fund will change, and there may be actuarial gains or losses. A contribution into a fund in any period will not equal the expenses for that period, due to actuarial gains or losses
- The obligations payable in future years should be valued, by discounting, on a present value basis

There is a four-step method for recognizing and measuring the expenses and liability of a defined benefit pension plan

1) Measure the deficit or surplus

   *The deficit or surplus is: the present value of the defined benefit obligation less the fair value of the plant asset

   a) An actuarial technique should be used to make a reliable estimate of the amount of future benefits employees have earned from service in relation to current and prior periods
   b) The benefits should be discounted to arrive at the present value of the defined benefit obligation and the current service cost
   c) The fair value of any plant assets should be deducted from the present value of the defined benefit obligation.
2) the surplus or deficit measured in step 1 may have to be adjusted if a net benefit asset has to be restricted by the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan

3) Determine the amounts to be recognized in profit or loss:
    a. Current service cost
    b. Any past service cost and gain or loss on settlement
    c. Net interest on the net defined benefit liability
4) Determine the re-measurements of the net defined liability (asset), to be recognized in OCI "items to be reclassified to profit or loss":
    a. Actuarial gains or losses
    b. Return on plan assets (excluding amounts included in the net interest)
    c. Any change in the effect of the asset ceiling (excluding amounts included in the net interest)

The statement of financial position:

In the statement of financial position, the amount recognized as a defined benefit liability (may be negative, i.e., an asset) should be the following:

- ~ The present value of the defined obligation at the year end, minus
- ~ The fair value of the assets of the plan at the year end

The statement of profit or loss and other comprehensive income:

All of the gains or losses that affect the plan obligation and plan asset must be recognized. The components of defined benefit cost must be recognized as follows in the statement of profit or loss and other comprehensive income:

- Service cost—P/L
- Net interest on the net defined benefit liability—P/L
- Re-measurement if the net defined benefit liability -- OCI "not reclassified to p/l"

**Contributions and benefits paid other than at the end of the period: if benefits or contributions are paid in two equal payments, on dates other that at the end of the period, we must pro-rate the interest cost calculation to take amount of the timing of the payment made during the period, benefits paid on the last day of the year do not impact on the interest cost

<u>Other long-term benefits:</u>

The accounting treatment for other long-term benefit plans follows the treatment for defined benefit pension plan, but with a simplification: remeasurements are not recognized in OCI. Instead, the net total of the following amounts should be recognized in profit or loss.

- o Service cost, net interest on and remeasurement of the defined benefits liability/asset.

<u>Termination benefits:</u>

Termination benefits are employee benefits provided in exchange for the termination of an employee's employment as a result of either:

1- An entity's decision to terminate an employee's employment before the normal retirement date, or
2- An employee's decision to accept an offer of benefits in exchange for the termination of employment.

Termination benefits are accounted for differently from other employee benefits because the event that gives rise to the obligation to pay termination benefits is the termination of employee rather than rendering of services.

*Termination benefits are only those benefits paid when employment is terminated at the request of the employer. Benefits paid on retirement or on resignation are not termination benefits.

*Employee benefits that are conditional on future service being provided by the employee are not termination benefits

Termination benefits should be recognized as an expense and a corresponding liability at the earlier of the date at which the entity:

- Can no longer withdraw the offer of the termination benefit (it depends on whether the employee is accepting an offer of termination or whether the employee's termination is the entity's decision)

- Recognize costs for a restructuring provision (IAS37) and the restructuring involves the payment of termination benefits

The initial and subsequent measurement of termination benefits depends on when those benefits are expected to be settled:

- ✓ Expected to be settled wholly before 12 months after the end of the reporting period→ apply requirements of short-term employee benefits
- ✓ All other termination benefits→ apply requirements of other long-term employee benefits

*In measuring termination benefits, an entity must take care to distinguish between termination benefits (resulting from termination of employment) and enhancement of post-employment benefits (resulting from service provided). If the benefits are an enhancement of post-employment benefits, they are accounted for as such.

ASSETS/ LIABILITIES

IFRS 16 – Accounting for leases

IFRS 16 requires a lessee to recognize assets and liabilities for all leases, unless the lease is for short term (less than 12 months) or the underlying asset is of low value. For short-term leases or low value assets, the lease payments are simply charged to profit or loss as an expense (exempted from IFRS16 recognition).

For all other leases, the lessee recognizes a right-of-use asset, representing the right to use the underlying asset and a lease liability representing its obligation to make payments. Lessors are required to classify leases into finance and operating leases.

A lease is a contract, or a part of a contract, that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.

Underlying asset is an asset that is the subject of a lease, for which the right to use that asset has been provided by a lessor to a lessee.

The right to control the use of the asset depends on the lessee having:

a) The right to obtain substantially all of the economic benefits from use of the identified asset, and
b) The right to direct the use of the identified asset

An underlying asset qualifies as low value only if two conditions apply:

(i) The lessee can benefit from using the underlying asset
(ii) The underlying asset is not highly dependent on, or highly interrelated with, other assets

If the entity elects to take the exemption of short-term leases or low value assets, lease payments are recognized as expense on straight-line basis over the lease term or another systematic basis, if more representative of the pattern of the lessee's benefits.

<u>Lessee accounting:</u>

~ At commencement date of the lease, which is the date the lessor makes the underlying asset available for use by the lessee, the lessee recognizes a right-of-use asset and a lease liability

Right-of-use asset is an asset that represents a lessee's right to use an underlying asset for the lease term.

Lease term is the non-cancellable period for which a lessee has the right to use an underlying asset, together with both:

- Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise the option; and
- Periods covered by an option to terminate the lease if the lessee is reasonably certain to exercise the option.

Lease liability is initially measured at the present value of lease payments not paid at the commencement date, discounted at the interest rate implicit in the lease.

The lease liability includes:

➢ Fixed payments, less any lease incentives (payments made by the lessor to the lessee)
➢ Variable payments that depend on an index or rate
➢ Amounts expected to be payable under residual value guarantees
➢ Purchase options if reasonably certain to be exercised

After commencement date, the carrying amount of the lease liability is increased by interest charges on the outstanding liability and reduced by lease payments made.

Dr	Interest expense	XX
Cr	Lease liability	XX

Dr	Lease liability	XX
Cr	Cash (lease payments)	XX

Lease liability should be either presented [1]separately from other liabilities or [2]disclosed in the notes.

IFRS16 does not specify that lease liability should be split between current and non-current liabilities, but this should be done as best practice.

** Consequently, at the start of the lease the finance charges will be large as the outstanding lease liability is large. Towards the end of the lease's life, the finance charge will be smaller as the outstanding lease liability is smaller.

Right-of-use asset

The right-of-use asset is initially measured at cost, which includes:

* The initial measurement of lease liability (the present value of lease payments not paid on commencement date)
* Any lease payments made at/before the commencement date, less any incentives received
* Any initial direct costs incurred by the lessee
* Any dismantling or removing or restoring costs that will be incurred by the lessee

Subsequently, after the commencement date, the right-of-use asset is normally measured at cost less accumulated depreciation and impairment losses in accordance with the cost model of IAS 16.

The right-of-use asset is depreciated from the commencement date to the earlier of the end of its useful life or the end of the lease term. However, if the ownership of the underlying asset is expected to be transferred to the lessee at the end of the lease, the right-of-use asset should be depreciated over the useful life of the underlying asset.

It is presented in the statement of financial position on [1]a separate line under non-current assets or they can be included in [2]the total of corresponding underlying assets and disclosed in the notes.

Alternative models of measurements:

If the right-of-use asset relates to a class of property, plant and equipment which is measured under the revaluation model then it is optional to measure the right-of-use asset under the revaluation model of IAS16 as well.

If the right-of-use asset meets the definition of investment property and the lessee uses fair value model for its investment properties, then it is compulsory to measure the right-of-use asset using the fair value model of IAS40

Sale and lease back:

A. Transfer is a sale
   If the transfer satisfies the IFRS15 requirements to be accounted for as a sale:
   - Step1: The seller/lessee measures the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount of the asset that relates to the right of use retained by the seller/lessee.

     Carrying amount * (PV of lease payments/FV)

   - Step2: the seller/lessee only recognizes the amount any gain or loss on the sale that relates to the rights transferred to the buyer:
     (FV – Carrying amount) * (1-PV/FV)

     The right of use asset continues to be depreciated as normal, a revision of the remaining useful life may be necessary

     ~ If the fair value of the consideration for the sale does not equal the fair value of the asset, or if the lease payments are not at market terms, the following adjustments should be made:
     - Any below-market terms: should be accounted for as a prepayment of lease payments
     - Any above-market terms: should be accounted for as additional financing provided by the buyer/lessor

B. Transfer is not a sale
   If the transfer does not satisfy the IFRS15 requirements to be accounted for as a sale, the seller continues to recognize the transferred asset, and the transfer proceeds are treated as a financial liability, accounted for in accordance with IFRS9 -financial instruments. The transaction is more in the nature of a secured loan.

Lessor accounting:

For lessor accounting, IFRS16 distinguishes between ***finance leases*** and ***operating leases***

Finance lease is a lease that transfers substantially all the risks and rewards incidental to ownership of an underlying asset.

Operating lease is a lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset.

Accounting treatment of finance lease:

IFRS16 requires the amount due from the lessee under a *finance lease* to be recorded in the statement of financial position of a lessor as a receivable at the amount of the net investment in the lease.

Dr	Lease receivable	XX
Cr	Asset	X
Cr	Unearned finance income	X

The lease payments relating to the accounting period should be applied against the gross investment in the lease, so as to reduce both the principal and the unearned finance income.

Gross investment in the lease is the sum of:

(a) The lease payments receivable by the lessor under a finance lease, and
(b) Any unguaranteed residual value accruing to the lessor

Net investment in the lease is the gross investment in the lease discounted at the interest rate implicit in the lease

Unearned finance income is the difference between the gross and net investment in the lease

Unguaranteed residual value is that portion of the residual value of the underlying asset, the realization of which by the lessor is not assured.

Guaranteed residual value is:

- For a lessee, that part of the residual value which is guaranteed by the lessee or by a party related to the lessee
- For a lessor, that part of the residual value which is guaranteed by the lessee or by a third party unrelated to the lessor who is financially capable of discharging obligations under the guarantee.

The estimated unguaranteed residual values used to calculate the lessor's gross investment in a lease should be reviewed regularly. If there is a reduction in the value, then the income allocation over the lease term must be revised.

Initial direct costs incurred by the lessors are included in the initial measurement of the net investment in the lease. The interest rate implicit in the lease is defined in such a way that initial direct costs are included automatically in the net investment in the lease; there is no need to add them separately

❖ IF manufacturers or dealers offered customers the choice of either buying or leasing an asset, there will be two types of income under such a lease
    1. Profit/loss equal to that from an outright sale (normal selling price less any discount)
    2. Finance income over the lease term

IFRS 16 requires the following treatment:

(i) Recognize the selling profit/loss in income for the period as if it was an outright sake
(ii) If interest rates are low, restrict the selling profit to that which would apply had a commercial rate been applied
(iii) Recognize costs incurred in connection with negotiating and arranging a lease as an expense when the selling profit is recognized (at the start of the lease term)

Accounting treatment for operating leases:

An asset held for use in an operating lease by a lessor should be recorded as a long-term asset and depreciated over its useful life consistent with the lessor's policy on similar non-lease assets under IAS16.

Income from operating lease should be recognized on a straight-line basis over the period of the lease, unless another systematic and rational basis is more representative of the time pattern in which the benefit from the leased asset is receivable.

Initial direct costs incurred by the lessor in negotiating and arranging an operating lease should be added to the carrying amount of the leased asset and recognized as an expense over the lease term on the same basis as lease income, i.e., Capitalized and amortized over the lease term.

Lessors should refer to IAS36 in order to determine whether the leased asset is impaired

A lessor who is a manufacturer or dealer should not recognize any selling profit on entering into an operating lease because it is not equivalent of a sale.

Subleases:

A lessee (L) may sublease an asset which it in turn leases from another lessor (H). In this situation, H is the 'head lessor' who ultimately owns the asset from a legal perspective. L then becomes an 'intermediate lessor'. An intermediate lessor must assess whether the sublease is a finance or operating lease in the context of the right-of-use asset being leased, not the actual underlying asset.

IAS12 – Income taxes

Current tax is the amount of income taxes payable in respect to the taxable profit for a period

Taxable profit is the profit (or loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable if it's a loss)

Accounting profit is the net profit or loss for a period before deducting tax expense

Tax expense (tax income) is the aggregate amount included in the determination of net profit or loss for a period in respect of current tax and deferred tax.

Current tax:

IAS 12 requires any unpaid tax in respect of the current or prior periods to be recognized as a liability → tax liability

Conversely, any excess tax paid in respect of the current or prior periods to be recognized as an asset → tax asset

*IAS12 also requires recognition as an asset of the benefit relating to any tax loss that can be carried back to recover current tax of a previous period. This is acceptable because it is probable that the benefit will flow to the entity and it can be measured reliably.

Current tax liabilities (assets) are measured at the amount expected to be paid to (recover from) the tax authorities. The tax rates used should be those enacted by the year end

Current tax is recognized as income or expense and included in the net profit or loss for the period, except in two cases:

a. Tax arising from a business combination which is an acquisition is treated differently
b. A transaction or event which is recognized, in the same or a different period, outside profit or loss, either in other comprehensive income or directly in equity.

Current tax assets and liabilities can be offset, but this should only happen when

- The entity has a legally enforceable right to set off the recognition amounts
- The entity intends to settle the amounts on a net basis, or to realize the asset and settle the liability at the same time

The tax expense (Income) related to the profit or loss for the year should be shown in the profit or loss section of the statement of profit or loss and other comprehensive income

Deferred tax:

Deferred tax is an accounting adjustment. It is not a tax which is currently payable to the tax authorities. it is an accounting measure used to match the tax effects of transactions with their accounting impact. It is the tax attributable to temporary differences

*The tax base of an asset or liability is the value of that asset or liability for tax purposes. The tax rules determine the tax base.

Memorize:

"The tax base of an asset is the future tax deductions which will be available when the asset generates taxable economic benefits"

"The tax base of a liability is its carrying amount, less the future tax deductions which will be available when the liability is settled"

The difference between current and deferred tax:

- ***Current tax:*** is the amount **actually payable to the tax authorities** in relation to the trading activities of the entity during the period
- ***Deferred tax***: is an **accounting measure**, used to match the tax effects of transactions with their accounting impact and thereby produce less distorted results.

Deferred tax liability →The amount of income taxes payable in future periods in respect of taxable temporary differences

Deferred tax assets→ The amount of income taxes recoverable in future periods in respect of:

- Deductible temporary differences
- Carry forward of unused tax losses
- Carry forward of unused tax credits

Temporary difference is the difference between the carrying amount of an asset or liability in the statement of financial position and its tax base. Temporary difference may be either:

- Taxable temporary differences: they are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled. "Tax to pay in the future, deferred tax liability"

- Deductible temporary differences: they are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled "Tax saving in the future, deferred tax asset"

Recognition of deferred tax:

Under IAS 12, a deferred tax liability or asset is recognized for all taxable and deductible temporary differences, unless they arise from:

- The initial recognition of goodwill
- The initial recognition of an asset or liability in a transaction which is not a business combination and affects neither accounting profit nor taxable profit

Deferred tax is recognized in the same section of the statement of profit or loss and other comprehensive income as the transaction was recognized

Revaluation, impairment losses and inventory losses

Under IAS16 assets may be revalued. If the revaluation does not affect current taxable profits, the tax base of the asset is not adjusted. Consequently, the taxable flow of economic benefits to the entity as the carrying amount of the asset is recovered will defer from the amount that will be deductible for tax purposes. The gain (or loss) between the carrying amount of a revalued asset and its tax base is a temporary difference and gives rise to a deferred tax liability (or deferred tax asset) which is accounted for in other comprehensive income (and the revaluation surplus) for consistency with the presentation of the revaluation surplus that arises on the revaluation.

If an item of property, plant and equipment suffered an impairment loss, the carrying amount of that asset is reduced. If tax relief on the loss is only granted when the asset is sold, the reduction in value of the asset is ignored for tax purposes until the sale. The tax base of the asset does not change, resulting in a deductible temporary difference and a deferred tax liability.

Similarly, losses on inventory that are not tax deductible until the inventory is sold generate a deferred tax asset.

Deferred tax assets are only recognized to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized.

It is assumed that enough taxable profit will be available if there are sufficient taxable temporary differences which can be offset, in accordance with tax regulation, against the available deductible temporary difference.

An entity may have unused tax losses or credit at the end of a period. IAS12 states that a deferred tax asset may be recognized in such circumstances to the extent that it is probable future taxable profit will be available against which the unused tax losses/credits can be utilized

For all unrecognized deferred tax assets, at each year end an entity should reassess the availability of future taxable profits and whether part or all of any unrecognized deferred tax assets should now be recognized. This may be due to an improvement in trading conditions which is expected to continue.

Deferred tax assets and liabilities can only be offset if:

- The entity has a legally enforceable right to set off current tax assets against current tax liabilities
- The deferred tax assets and liabilities relate to income taxes levied by the same taxation authority

Deferred tax assets and liabilities are measured at the tax rates expected to apply to the period when the asset is realized or liability is settled, based on tax rates that have been enacted by the end of the reporting period.

Deferred tax assets and liabilities should not be discounted because the complexities and difficulties involved will affect reliability

Deferred tax and business combinations:

There are some temporary differences that only arises in business combinations. This is because on consolidation, adjustments are made to the carrying amount of assets and liabilities that are not always reflected in the tax base of those assets and liabilities.

* Fair value adjustments on consolidation:

  IFRS 3-Business combination, requires assets acquired and liabilities assumed on acquisition of a subsidiary to be brought into the consolidated financial statements at their fair value rather than their carrying value. This change is not usually reflected in the tax base and so a temporary difference arises
  The accounting entries to record deferred tax are:

  ~ Deferred tax liability: Reduces FV of net assets and Increase goodwill:

Dr	Goodwill	XX
Cr	Deferred tax liability	XX

  ~ Deferred tax asset: Increases FV of net assets and reduces goodwill:

Dr	Deferred tax liability	XX
Cr	Goodwill	XX

* Undistributed profits pf subsidiaries, branches, associates and joint ventures:

  A subsidiary's profits are recognized in the consolidated financial statements. If they are not taxable in the parent's tax regime until they are remitted to the parent as dividend income, a temporary difference arises. Under IAS 12, a resulting deferred tax liability is recognized unless:
  (a) The parent is able to control the timing of the reversal of the temporary difference, and
  (b) It is probable that the temporary difference will not reverse in the foreseeable future.

* Unrealized profits on intragroup trading:
  When a group entity sells goods to another group entity, the selling entity recognizes the profit made in its individual financial statements.
  If the related inventories are still held by the group at the year end, the profit is unrealized from the group perspective and adjustments are made in the group accounts to eliminate it.
  The same adjustment is not usually made to the tax base of inventories and a temporary difference arises.

Financial instruments:

There are three accounting standards on financial instruments:

(A) IAS 32-Financial instruments: presentation, which deals with:
  i. The classification of financial instruments between liabilities and equities
  ii. Presentation of certain compound instruments
(B) IFRS 7- Financial instruments: Disclosures, which revised, simplified and incorporated disclosure requirements previously in IAS 32.
(C) IFRS 9 – financial instruments, which covers:
  I. Recognition and derecognition
  II. The measurement of financial instruments
  III. Impairment
  IV. General hedge accounting

Definitions:

- ***Financial instrument:*** is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument in another entity

- ***Financial asset:*** any asset that is
  1)cash, or
  2)an equity instrument of another entity, or
  3)a contractual right to receive cash or another financial instrument from another entity, or to exchange financial instruments with another entity under conditions that are potentially favorable to the entity

- ***Financial liability:*** any liability that is:
  A contractual obligation to deliver cash or another financial asset to another entity, or to exchange financial instruments with another entity under conditions that are potentially unfavorable to the entity.

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

- ***Derivative:*** a financial instrument or other contract with all three of the following characteristics:

        - Its value changes in response to the change in a specific underlying variable. E.g., interest rate, financial instrument price, commodity price, foreign exchange rate, index of price rates, credit ratings or credit index
        - It requires no initial net investment or a net investment that is smaller that would be required for similar types of contracts
        - It is settled at a future date

    Common examples of derivatives are: forward contracts, future contracts, options, swaps.

*As we have already noted, financial instruments include both the following

- Primary instruments: e.g., receivables, payables and equity securities
- Derivative instruments: e.g., financial options, futures and forwards, interest rate swaps and currency swaps

*IAS 32 makes it clear that the following are **not** financial instruments

- ***Physical assets:*** as the control of these creates an opportunity to generate an inflow of cash or other assets, but it does not give rise to a present right to receive cash or other financial assets (e.g., inventories, property, plant and equipment, leased assets and intangible assets)
- ***Prepaid expense:*** as the future economic benefit is the receipt of goods or services rather than the right to receive cash or other financial assets
- ***Deferred revenues and most warranty obligations:*** as the probable outflow of economic benefits is the delivery of goods/services rather than cash or another financial asset.
- ***Liabilities or assets that are not contractual in nature***
- ***Contractual rights/obligations that do not involve transfer of a financial asset.***

IAS 32-Financial instruments: presentation

Financial instruments should be presented according to their substance, not merely their legal form. In particular, entities which issue financial instruments should classify them (or their component parts) as either financial liabilities, or equity.

The critical feature of a liability is an obligation to transfer economic benefit. Therefore, a financial instrument is a financial liability if there is a contractual obligation on the issuer either to deliver cash or another financial asset to the holder or to exchange another financial instrument with the holder under potentially unfavorable conditions to the issuer.

Where the above feature is not met, then the financial instrument is an equity instrument. IAS 32 explains that although the holder of an equity instrument may be entitled to a share of any distributions out of equity, the issuer does not have a contractual obligation to make such distribution.

A financial instrument may have the legal form of equity, but in substance it is in fact a liability. Other instruments may combine features of both equity instruments and financial liabilities. For example, preference shares which must be redeemed by the issuer for a fixed amount at a fixed future date. In such cases, the issuer has an obligation. Therefore, the instrument is a financial liability and should be classified as such.

Another example is cumulative irredeemable preference shares. While the issuer does not redeem the preference shares, there is an obligation on the issuer to pay fixed dividends. If the entity has insufficient retained earnings in a given year, the dividends still must be paid in future years. Again, because the issuer has an obligation, the instrument should be classified as financial liability.

The classification of the financial instrument is made when it is first recognized and this classification will continue until the financial instrument is removed from the entity's statement of financial position.

*Contingent settlement provisions: an entity may issue a financial instrument where the way in which it I settled depends on: - the occurrence or non-occurrence of uncertain future events or the outcome of uncertain circumstances that are beyond the control of both the holder and the issuer of the instrument. Such financial instruments should be classified as financial liabilities unless the possibility of settlement is remote.

*When a derivative financial instrument gives one party a choice over how it is settled. The instrument is a financial asset or a financial liability unless all the alternative choices would result in it being an equity instrument.

*Compound financial instruments: they are financial instruments that contain both a liability and an equity element. In such cases, the component parts of the instrument can be classified separately, according to the substance of the contractual arrangement and the definition of a financial liability and an equity instrument. (e.g., Convertible bonds)

Memorize:

"under IFRS9, convertible bonds need to be split into their liability and equity component.

The liability component is computed by discounting the future amounts payable, assuming that loan is repaid, using the discount rate equivalent to the return that would be required by a lender without any conversion option—the market rate.

The resulting equity element will be uncharged and will be presented in the statement of financial position in the equity section of OCE."

*If an entity reacquires its own equity instruments, those instruments ('treasury shares') shall be deducted from equity. No gain or loss shall be recognized in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instruments. Consideration paid or received shall be recognized directly in equity.

~IAS32 considers how financial instruments affect the profit or loss and movement of equity. The treatment varies according to whether interest, dividends, losses or gains relate to a financial liability or equity instrument

- interest, dividends, losses and gains relating to a financial instrument (or compound part) classified as financial liability should be recognized as income or expense in profit or loss
- distributions to holder of a financial instrument classified as an equity instrument should be debited directly to equity of the issuer
- transaction costs of an equity transaction shall be accounted for as a deduction from equity (unless they are directly attributable to the acquisition of a business, IFRS3)

#A financial asset and a financial liability should only be offset, with the net amount reported in the statement of financial position, when an entity:

- has a legally enforceable right to set off, and
- intends to settle on a net basis, or to realize the asset and settle the liability simultaneously.

This will reflect the expected future cash flows of the entity in these specific circumstances. In all other cases, financial assets and financial liabilities are presented separately

*IAS32 requires that if the holder of a financial instrument can require the issuer to redeem it for cash it should be classified as a liability. Some ordinary shares and partnership interests allow the holder to 'put' the instrument. IAS32 requires the entities to classify such instruments as equity, so long as they meet certain conditions. IAS32 further requires that instruments imposing an obligation on an entity to deliver to another party a pro rata share of the net assets only on liquidation should be classified as equity.

IFRS 7 – Financial instruments: Disclosures

IFRS7 requires qualitative and quantitative disclosures about the exposure to risks arising from financial instruments, and specifies minimum disclosures about credit risk, liquidity risk and market risk.

Risk	Definition	Disclosures required

Credit risk	The risk that one party to a financial instrument will cause a financial loss to the other party by failing to discharge an obligation	The credit risk rating grades, the gross carrying amount of financial assets and the exposure to credit risk on loan commitments and financial guarantee contracts.
Liquidity risk	The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset	Maturity analysis for both derivative and non-derivative financial liabilities and a description of how it manages the liquidity risks in both categories
Market risk	The risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. It comprises three types of risk: currency, interest rate and other price risk	A sensitivity analysis for each type of market risk that the entity is exposed to. The analysis should show how profit or loss would have been affected by changes in the risk at the reporting date

For each type of risk arising from financial instruments, the entity should disclose the exposures to risk and how they arise as well as its objective, policies and processes for managing the risk and the methods used to measure the risk.

IFRS 9 -Financial instruments

IFRS9 establishes principles for recognizing and measuring financial assets and liabilities

Recognition:

Financial instruments should be recognized in the statement of financial position when the entity becomes a party to the contractual provisions of the instruments.

Derecognition of financial assets:

Derecognition is the removal of previously recognized financial instrument from an entity's statement of financial position. an entity should derecognize an asset when [1]the contractual rights to the cash flows from the financial asset expire, or [2]the entity transfers the financial asset or substantially all the risks and rewards of ownership of the financial asset to another party.

It is possible for only a part of a financial asset or liability to be derecognized. This is allowed if the part comprises:

a) only specifically identified cash flows, or
b) only a fully proportionate share of the total cash flows

for example, if an entity holds a bond, it has the right to two separate sets of cash inflows: those relating to the principal and those relating to the interest. It could sell the right to receive the interest to another party while retaining the right to receive the principal.

On derecognition, the amount to be included in net profit or loss for the period is calculated as follows:

Carrying amount allocated to the part derecognized- consideration received for the part derecognized= difference to profit or loss

Derecognition of financial liabilities:

A financial liability is derecognized when it is extinguished- i.e., when the obligation specified in the contract is discharged or cancelled or expires.

Any gains or losses on the derecognition of a financial liability (or part of a financial liability) is recognized in profit or loss

<u>Financial assets:</u>

<u>initial measurement:</u>

Financial assets are initially measured at transaction price, that is the fair value of the consideration given. In the case of financial assets or financial liability classified as measured at amortized cost or at fair value through other comprehensive income, transaction costs directly attributable to the acquisition are capitalized (added to the asset and deducted from the liability). If the asset or liability is held at fair value through profit or loss, the cost of acquisition is expensed. If an irrevocable election has been made to take gains and losses on the financial asset to other comprehensive income, cost of acquisition should be added to the purchase cost.

If transaction price is not equal to fair value. It should be measured initially at fair value, rather than transaction price.

<u>Classification of financial assets:</u> *"Memorize"*

On recognition, IFRS9 requires the financial assets to be classified as measured at either:

- **Amortized cost**
  where (a) the objective of the business model within which the asset is held is to hold assets in order to collect contractual cash flows,
  and (b) the contractual terms of the financial assets give rise on specific dates to cashflows that are solely payments of principles and interest on the principle outstanding

- **Fair value through other comprehensive income (FVTOCI)**
  where (a) the objective of the business model within which the asset is held is both collecting contractual cashflows and selling financial assets,
  and (b) the contractual terms of the financial asset gives rise on specific dates to cashflows that are solely payments of principle and interest on the principle outstanding.

- **Fair value through profit or loss (FVTPL)**
  all other financial assets must be measured at FVTPL (the default)

- Notwithstanding the above, IFRS9 allows financial assets meeting the criteria of FVTOCI, to be **designated, at initial recognition, as being measured at FVTPL** if a recognition or measurement inconsistently would otherwise arise from measuring assets or liabilities or recognizing the gain or loss on them on different bases.

<u>If the financial asset is an equity instrument:</u>

equity instruments must be measured at fair value because the contractual terms associated with the investment does not entitle the holder to specific payment of interest and principal.

equity instruments may not be classified as measured at amortized cost, must be measured at fair value. However, if an equity instrument is not held for trading, an entity can make an irrevocable election at initial recognition to measure it at FVTOCI with only dividends recognized in profit or loss.

Subsequent measurement of financial assets:

It depends on how they are classified at initial recognition

- at amortized cost→ using the effective interest method
- at fair value through other comprehensive income→ fair value established at each period end and any changes in fair value is recognized in other comprehensive income

- at fair value through profit or loss→ fair value established at each period end and any changes in fair value is recognized in profit or loss

*Investments whose fair value cannot be reliably measured should be measured at cost. This will only be the case in very rare circumstances.

Reclassification of financial assets:

Financial assets are classified under IFRS9 when, and only when, an entity changes its business model for managing financial assets. The reclassification should be applied prospectively from the reclassification date.

The rules only apply to investments in debt instruments as investments in equity instruments are always held at fair value and any election to measure them at fair value through other comprehensive income is an irrevocable one.

~If a financial asset is reclassified from amortized cost to fair value → gain or loss arising from the difference between the previous carrying amount and fair value is recognized in profit or loss.

~If a financial asset is reclassified from fair value to amortized cost → fair value at the date of reclassification becomes the new carrying amount.

Impairment of financial assets:

A financial asset is impaired when its carrying amount cannot be reasonably expected to be recovered through future generation of income or sale proceeds

IFRS9 classifies financial assets intro three types. One of these types is 'fair value through profit or loss'. Where financial assets are measured on this basis, any impairment of the asset is automatically reflected in the measurement basis, so no further action is required.

As far as other financial assets are concerned, the general rule is that we should recognize a loss allowance for "expected credit losses". The loss allowance should be recognized in profit or loss and deducted from the carrying amount of the financial asset in the statement of financial position.

A credit loss is the difference between the cashflows we are contractually entitled to receive in respect of a financial asset and the cash flows which are expected based on current circumstances.

Unless the credit risk attaching to the financial asset has increased significantly since initial recognition, the loss allowance should be based on expected credit losses in the next *12 months.*

Where the credit loss has increased significantly since initial recognition, the loss allowance should be based *on lifetime* expected credit losses.

As far as trade receivable are concerned, as a simplifying measure IFRS9 allows the loss allowance to always be measured based on lifetime credit losses.

Dr	Expected credit losses	XX
Cr	Allowance for receivables	XX

Doubts regarding the going concern status of a customer would normally be regarded as prime facie evidence that any trade receivable has suffered impairment. In such circumstances, any impairment loss allowance equal to the expected losses, at the reporting date, would be appropriate.

Financial liability

At initial recognition, financial liabilities must be measured at transaction price in the statement of financial position.

After initial recognition, all financial liabilities should be measured at amortized cost with the exception of financial liabilities measured at FVTPL (financial liability that is held for trading, or is a derivative, or acquired for the purpose of selling) these should be measured at fair value if it can be measured reliably.

Reclassification of financial liabilities is not permitted.

Derecognize the liability when the obligation specified in the contract is discharged or cancelled or expired.

Financial liabilities: **initial measurement:**

IFRS 9 requires that financial liabilities are initially measured at transaction price, i.e., the fair value of consideration received except where part of the consideration received is for something other than the financial liability. In this case the financial liability is initially measured at fair value measured as for financial assets mentioned above. Transaction costs are deducted from this amount for financial liabilities classified at amortized cost.

Subsequent measurement:

After initial recognition, all financial liabilities should be measured at amortized cost, with the exception of financial liabilities at fair value through profit or loss. These should be measured at fair value, but where the fair value is not capable of reliable measurement, they should be measured at cost.

***Credit risk:**

IFRS 9 requires that financial liabilities which are designated as measured at fair value through profit or loss are treated differently:

- any change in the fair value resulting from credit risk should be included in other comprehensive income
- the remaining amount of the change in fair value should be included in profit or loss

changes in a financial liability's credit risk affect the fair value of the financial liability. This means that when an entity's creditworthiness deteriorates, the fair value of its issued debt will decrease (and vice versa)

the exception is where such treatment creates or enlarges an accounting mismatch, in which case it is recognized in profit or loss

an accounting mismatch is a measurement or recognition inconsistency arising from measuring assets or liabilities or recognizing the gains or losses on them on different bases.

Embedded derivatives:

An embedded derivative is a derivative instrument that is combined with a non-derivative host contract to form a single hybrid instrument.

Where the host contract is an asset within the scope of IFRS 9 the hybrid contract is accounted for as one instrument. Otherwise, IFRS 9 requires that the embedded derivative is separated from the host contract where certain conditions are met and accounted for separately.

Example of embedded derivatives:

-A bond which is redeemable in five years' time with part of the redemption price being based on the increase in the FTSE 100 Index. The bond: host contract, amortized cost – the option on equities: embedded derivative, treated as derivative (FVTP&L)

-A construction contract priced in a foreign currency. The construction contract is a non-derivative contract, but the changes in foreign exchange rate is an embedded derivative.

Accounting treatment for embedded derivatives:

- **financial asset host contract:** where the host is a financial asset, the classification and measurement rules of the standard are applied to the entire hybrid contract.
- **Other host contract:** where the host contract is not a financial asset, the standard requires that an embedded derivative be separated from its host contract and accounted for as a derivative when the following conditions are met:
  - The economic characteristics and risks of the embedded derivative and the host contract are not closely related
  - A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative
  - The hybrid instrument is not measured at fair value through profit or loss (a derivative embedded in a financial liability need not to be separated out if the entity holds the combined instrument at fair value through profit or loss)

Hedge accounting:

The rules on hedge accounting are set up in IFRS9: Before a hedging relationship qualifies for hedge accounting, all of the following conditions must be met:

(a) The hedging relationship consists only of eligible hedging instruments and eligible hedged items
(b) There must be a formal documentation
(c) The hedging relationship meets all the following hedge effectiveness criteria:

- There is an economic relationship between the hedged items and hedging instrument
- The effect of credit risk does not dominate the value changes that result from the economic relationship
- The hedge ration of the hedging relationship is the same as that resulting from the actual quantity of the hedged items and hedging instruments that the entity has.

There are three types: fair value hedge, cash flow hedge, hedge of a net investment in a foreign operation

Fair value hedge: is a hedge of the exposure to changes in fair value of a recognized asset or liability, or an unrecognized firm commitment, or a component of any such item, that is attributable to a particular risk and could affect profit or loss.

The gain or loss from remeasuring the hedging instrument at fair value is recognized in profit or loss. The gain or loss on the hedged item attributable to the hedged risk should adjust the carrying amount of the hedged item and be recognized in profit or loss

Cash flow hedge: is a hedge of exposure to variability in cash flows

The gain or loss on the ***effective portion*** of the hedging instrument is recorded in other comprehensive income as an amount that can be recycled to profit or loss. Any gain or loss on the ineffective portion is recorded in profit or loss.

Hedge accounting summary:

under IFRS9, the forward exchange contract is a derivative financial instrument and so would be classified as fair value through profit or loss. This would normally mean that gains or losses on re-measurement to fair value would be recognized in profit or loss.

However, where the derivative contract is designated as cash flow hedge of a future firm commitment, IFRS9 allows the effective portion of the change in fair value to be recognized in OCI. They will be presented as gains which may subsequently be reclassified to profit or loss.

Under the principals of IFRS9, given that hedge accounting is used, the cumulative gains on remeasuring the derivative which have been recognized as OCE will be included in the carrying amount of PPE, this will be achieved by a direct transfer out of the cash flow hedge reserve. This transfer will not affect OCI.

The PPE is a non-monetary asset, so its carrying amount will not be affected by future exchange rate fluctuations.

REQUIRED FROM LISTED ENTITIES

IFRS 8 Operating segments

This is a disclosure standard. It covers segmental reporting which is an important aspect of reporting financial performance.

An entity must disclose information to enable users of its financial statements to evaluate the nature and financial effects of the business activities in which it engages and the economic environments in which it operates.

Only entities whose equity or debt securities are publicly traded need to disclose segmental information. In group financial statements, only consolidated segmental information needs to be shown.

((IMP)) ***Operating segment***: it is a component of an entity:

- That engages in business activities from which it may earn revenues and incur expenses.
- Whose operating results are regularly reviewed by the entity's chief operating decision maker (CODM) to make decisions about allocating resources and assessing performance.
- For which discrete financial information is available

The term 'chief operating decision maker' identifies a function or a role, not a person or a title. That function is to allocate resources and assess performance of the entity's operating segments.

*two or more operating segments may be aggregated if the segments have similar economic characteristics, and the segments are similar in each of the following:

- The nature of the products or services
- The nature of the production process
- The type or class of customer for their products or services
- The methods used to distribute their products or provide their services
- If applicable, the nature of the regulatory environment

Reportable operating segment's qualifications:

An entity must report separate information about each reporting segment that:

a. Has been identified as meeting the definition of an operating segment, and
b. It exceeds at least one of the following 3 thresholds:
   (i) Reported revenue is 10% or more of the combined revenue of all operating segments
   (ii) Its assets are 10% or more of the total assets of all operating segments
   (iii) The absolute amount of its reported profit or loss is 10% or more of the greater, in absolute amount, of [1]the combined reported profit of all operating segments that didn't report a loss and [2]the combined reported loss of all operating segments that reported a loss

*At least 75% of total external revenue must be reported by operating segments. Where this is not the case, additional segments must be identified even if they don't meet the 10% threshold.

*Two or more operating segments below the threshold may be aggregated to produce a reportable segment if the segments have similar economic characteristics, and the segments are similar in a majority of the aggregation criteria above

*Operating segments that don't meet any of the quantitative thresholds may be reported separately if management believes that information about the segment would be useful to users of the financial statements.

Operating segment's disclosures required by IFRS 8:

- ✓ Operating segment profit or loss
- ✓ Segment assets
- ✓ Segment liabilities
- ✓ Certain income and expense items
- ✓ Revenue derived from products or services
- ✓ About the geographical areas in which revenues are earned or assets are held

Memorize:

"The definition of operating segment is generally based on the entity's business model, which could be different from entity to entity. Disclosures focus on what information management believes is important when running the business"

"IFRS 8 normally requires entities to give details of revenues by geographical area and by product type and non-current assets by geographical type. However, the above is not required if the information could only be made available at a prohibitive cost"

IAS33- Earnings per share

Earnings per share is a measure of the amount of profits earned by a company for each ordinary share. Earnings are profits after tax and preference dividends.

Ordinary share: is an equity instrument that is subordinate to all other classes of equity instruments.

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

*Ordinary shares participate in the net profit for the period only after other types of shares, e.g., preference shares.

Potential ordinary share: is a financial instrument or other contract that may entitle its holder to ordinary shares.

Examples:

- ➢ Debt or equity instruments, including preference shares that are convertible into ordinary shares
- ➢ Share warrants and options
- ➢ Employee plans that allow employees to receive ordinary shares as part of their remuneration and other share purchase plan
- ➢ Shares that would be issued upon the satisfaction of certain conditions resulting from contractual arrangements

Basic EPS:

It is calculated by dividing the net profit or loss for the period attributable to ordinary shareholders by the weighted average number of the ordinary shares outstanding during the period.

~The net profit or loss attributable to ordinary shareholders is the consolidated profit after deducting income taxes, non-controlling interest and preference dividends on preference shares which have been classified as equity (preference dividends on preference shares classified as financial liability should not be deducted as they will have been already reported as finance cost.)

~The weighted average number of ordinary shares is the number of ordinary shares during the period. This figure should be adjusted for events, other than the conversion of potential ordinary shares, that have changed the number of shares outstanding without a change in the resources.

Shares are usually included in the weighted average number of shares from the date the consideration is receivable which is usually the date of issue. The treatment for the issue is different in the following:

1- Ordinary shares issued as a purchase consideration in an acquisition: should be included as of the date of acquisition
2- Ordinary shares that are partly paid: are treated as a fraction of an ordinary shares to the extent they are entitled to dividends relative to fully paid ordinary shares
3- Contingently issuable shares: are included in the computation when all necessary conditions for issue have been satisfied

Bonus issue and share split:

These two types of events can be considered together as they have a similar effect. In both cases, ordinary shares are issued to existing shareholders for no additional consideration. The number of ordinary shares has increased without an increase in resources.

IAS 33 requires the weighted average to be calculated as if the bonus shares have always been in issue

The problem is solved by adjusting the ***number of ordinary shares outstanding*** before the event for the proportionate change in the number of shares outstanding as if the event had occurred at the beginning of the earliest period reported.

Right issue:

A right issue of shares is an issue of new shares to existing shareholders at a price below the current market value. For example: a 1 for 3 right issue is an offer of 1 new share at the offer price for every 3 shares currently held. this means that there Is a bonus element included. To arrive to EPS when a right issue is made, we need to calculate the theoretical ex-right value first. This is a weighted average value per share.

The procedure for calculating the EPS for the current year and a corresponding figure for the previous year are as follows:

- The EPS for the corresponding previous year:
  EPS of that year * (theoretical ex-right/ fair value of share before the exercise of the right)

- The EPS for the current year:
  - The number of shares before the right issue* the fraction of the year before the right issue * (fair value of share before the exercise of the right/theoretical ex-right) +
  - The number of shares after the right issue * the fraction of the year after the right issue

  the total earnings should be divided by the total number of shares calculated.

Diluted EPS:

It is calculated by adjusting the ***net profit*** due to continuing operations attributable to ordinary shareholders and ***the weighted average number of shares outstanding*** for the effects of all dilutive potential ordinary shares.

A company may issue some securities which do not have any claim to a share of equity earnings at the present time, but may give rise to such a claim in the future. These include:

i. A separate class of equity shares which at the present are not entitled to any dividend, but will be entitled after some future date

ii. Convertible loan stock or convertible preferred shares which give their holders the right at some future date to exchange their securities for ordinary shares of the company, at a pre-determined conversion date
iii. Options or warrants

In such circumstances, the future number of ordinary shares might increase, which in turn results in a fall in the EPS. A future increase in the number of ordinary shares will cause a dilution or watering down of equity. It is possible to calculate the diluted EPS. This will indicate to investors the possible effects of a future dilution.

Diluted EPS are calculated as the EPS that would have been obtained during the financial period if the dilution had already taken place.

~ the earnings calculated for basic EPS should be based on continuing operations and adjusted by the post-tax effect of:

- Any dividends on dilutive potential ordinary shares that were deducted to arrive at earnings for basic EPS (+)
- Interest recognized in the period for the dilutive potential ordinary shares (+)
- Any other changes in income or expenses that would result from the conversion of the dilutive potential ordinary shares (+/-)

~ the number of ordinary shares is the weighted average number of ordinary shares calculated for basic EPS + the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares

*It should be assumed that dilutive ordinary shares were converted into ordinary shares at the beginning of the period or at the actual date of issue. There are two other points:

1- The most advantageous conversion rate from the view of the holder of the potential ordinary shares

2-Contingently issuable potential ordinary shares are treated as for basic EPS; are included in the computation when all necessary conditions for issue have been satisfied. if conditions have not been met, those included in the computation of number of ordinary shares is based on the number of shares that would be issuable if the end of the reporting period was the end of the contingency period. Restatement is not allowed if the conditions are not met when the contingency period expires.

Potential ordinary shares should not be treated as dilutive when, and only when, their conversion to ordinary shares would decrease net profit per share from continuing operations.

^ If the number of ordinary or potential ordinary shares outstanding increase as a result of a capitalization, bonus issue or share split, the calculation of basic and diluted EPS for all periods presented should be adjusted retrospectively.

*If these changes occur after the reporting date but before the financial statements are authorized for issue, the calculations per share should be based on the new number of shares and this should be disclosed,

-Basic and diluted EPS should be adjusted for the effects of material errors, and adjustments resulting from changes in accounting policies, dealt with in accordance with IAS8. Diluted EPS should not be restated for changes in the assumptions used or for the actual conversion of potential ordinary shares into ordinary shares outstanding.

Disclosures: entities are encouraged to disclose a description of ordinary share or potential ordinary share transactions which occur after the reporting period when they are of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions. EPS amounts are not adjusted for such events occurring after the reporting date if they don't affect the amount of capital used to produce the net profit or loss for the period.

An entity should disclose the following:

- ✓ The amounts used as the numerators in calculation of basic and diluted EPS, and a reconciliation of those amounts to the net profit or loss for the period

- ✓ The weighted average number of ordinary shares used in the denominator in calculation of basic and diluted EPS, and a reconciliation of these denominators to each other

*Disclosures must still be made where the EPS figures are negative

Presentation: basic and diluted EPS should be presented by the entity in the statement of profit or loss for each class of ordinary shares that has a different right to share in the net profit for the period.

If the entity has reported discontinued operations in accordance with IFRS 5 at the reporting date, then basic and dilutive EPS should be presented using earnings from:

A. Both continuing and discontinued operations
B. Continuing operations only
C. Discontinued operations only

EPS from discontinued operations can be presented either in the statement of profit or loss and other comprehensive income or in the notes

OTHER STANDARDS

IAS 21 – The effects of changes in foreign exchange rates

There are two distinct types of foreign currency transaction, conversion and translation. Conversion is the process of exchanging amounts of one foreign currency for another. Profits or losses on conversion would be included in profit or loss for the year in which conversion takes place.

Translation is required at the end of an accounting period when a local company still holds assets or liabilities in the statement of financial position which were obtained or incurred in a foreign currency.

A foreign currency is a currency other than the functional currency of the entity

The functional currency is the currency of the primary economic environment in which the entity operates.

Presentation currency is the currency in which the financial statements are presented.

Each entity should determine its functional currency and measure its results and financial position in that currency. An entity can present its financial statements in any currency (or currencies) it chooses. For most individual companies, their presentation currency will normally be the same as their functional currency (the currency of the country in which they operate).

A holding or parent company with foreign operations must translate the financial statements of those operations into its own reporting currency before they can be consolidated into the group financial statements. IAS 21 states that an entity should consider the following factors in determining its functional currency:

- The currency that mainly influences sales price for goods and services
- The currency of the country whose competitive forces and regulations mainly determine the sales prices
- The currency that mainly influences labor, material and other costs of providing goods or services

Where a parent has a foreign operation a number of factors are considered:

- Whether the activities of the foreign operation are carried out as an extension of the parent.
- Whether transactions with the parent are a high or low proportion of the foreign operation's activities
- Whether the cash flows from the activities of the foreign operation directly affect the cash flows of the parent

- Whether the activities of the foreign operation are financed from its own cash flows or by borrowing from the parent

In situations where the foreign operations have the same functional currency as the reporting entity, the foreign operation normally carries on its business as though it were an extension of the reporting entity's operations.

Any movement in the exchange rate between the reporting currency and the foreign operation's currency will have an immediate impact on the reporting entity's cash flows from the foreign operations. In other words, changes in the exchange rate affect the individual monetary items held by the foreign operation, not the reporting entity's net investment in the operation.

In situations where the foreign operations have different functional currency as the reporting entity, the foreign operation normally operates in a semi-autonomous way. It accumulates cash and other monetary items, generates income and incurs expenses, and may also arrange borrowings, all in its own local currency

A change in the exchange rate will produce little or no direct effect on the present and future cash flows from operations of either the foreign operation or the reporting entity. Rather, the change in exchange rate affects the reporting entity's net investment in the foreign operation, not the individual monetary and non-monetary items held by the foreign operation.

*The functional currency of an entity can be changed only if there is a change to the underlying transactions, events and conditions that are relevant to the entity. Where there is a change in an entity's functional currency, the entity should translate all items into the new functional currency prospectively using the exchange rate at the date of the change.

<u>Recognition of foreign currency transactions:</u>

IAS 21 states that a foreign currency transaction should be recorded, on initial recognition in the functional currency, **by applying the exchange rate between the reporting currency and the foreign currency at the date of transaction to the foreign currency amount.**

Exchange rate is the ratio of exchange of two currencies

Spot exchange rate is the exchange rate for immediate delivery

Closing rate is the spot exchange rate at the yearend date

<u>Subsequently at year end:</u>

- Report foreign currency **monetary items** → using the closing rate
- Report **non- monetary items** which are carried at **historical cost** in a foreign currency→ using the exchange rate at the date of the transaction
- Report **non- monetary items** which are carried at **fair value** in a foreign currency→ using the exchange rate that existed when the values were measured

Exchange differences occur when there is a change in the exchange rate between the transaction date and the date of settlement of monetary items arising from foreign currency transaction.

Exchange differences should be recognized in profit or loss in the period in which they arise

There are two situations to consider:

(a) The transaction is settled in the same period as that in which it occurred:
All the exchange difference is recognized for that period
(b) The transaction is settled in a subsequent accounting period:
The exchange difference recognized in each intervening period up to the period of settlement is determined by the change in exchange rates during the period

*In other words, where a monetary item has not been settled at the end of a period, it should be restated using the closing exchange rate and any gain or loss taken to profit or loss.

*When a gain or loss on a non-monetary item is recognized in other comprehensive income ("revaluation surplus"), any related exchange differences should be recognized in other comprehensive income.

IFRS 2 – Share-based payment

Share-based payment transaction: a transaction in which the entity [1]receives goods or services as consideration for equity instruments of the entity, or [2]acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price of the entity's shares or other equity instruments of the entity.

IFRS 2 requires an entity to reflect the effects of share-based payment transactions in its profit or loss and financial position

IFRS 2 applied to all share-based payment transactions. There are three types:

1. **<u>Equity-settled share- based payment:</u>**
   The entity received goods or services as consideration for *equity instruments* of the entity.

2. **<u>Cash-settled share-based payment:</u>**
   The entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are *based on the price* (or value) of the entity's shares or other equity instruments.

3. **<u>Transactions with a choice of settlement:</u>**
   The entity receives or acquires goods or services and the terms of the arrangements provide either the entity or the supplier with a choice of whether the entity settles the transaction in cash or by issuing equity instruments.

<u>Vesting:</u>

Vesting conditions are conditions that determine whether the entity receives the services that entitle the counterparty to receive cash, other assets or equity instruments of the entity, under a share-based payment arrangement. A vesting condition is either a service condition or performance condition.

Vesting period is the period during which all the specified vesting conditions of a share-based payment arrangement are to be satisfied.

Vesting conditions can be market-based or non-market based. They include service conditions and performance conditions.

Service conditions:

They are where the counterparty is required to complete a specified period of service. This is the typical scenario in which an employee is required to complete a specified period of service.

The share-based payment is recognized over the required period of service.

Performance conditions (other than market conditions):

There may be performance conditions that must be satisfied before share-based payment vests, such as achieving a specific growth in profit or earnings per share.

The amount recognized as share—based payment is based on the best available estimate of the number of equity instruments expected to vest, revised as necessary at each period end.

Market-based and non-market based vesting conditions:

A market-based vesting condition is taken into account by reflecting it in the measurement of the fair value of the share-based payment. This is at the grant date if equity-settled and at the yearend if cash-settled.

A non-market condition is taken into account by reflecting it in the calculation of the number of options ultimately expected to vest.

Recognition: an entity should recognize goods or services received or acquired in share-based payment transaction when it obtains the goods or as the services are received. Goods or services received or acquired should be recognized as expenses unless they qualify for recognition as asset. For example, services received are normally recognized as expenses (because they are normally rendered immediately), while goods can often be recognized as assets.

If the goods or services were received or acquired in equity-settled share-based payment transaction the entity should recognize a corresponding increase in equity

Dr	Expense (or asset)	XX
Cr	Equity	XX

If the goods or services were received or acquired in a cash-settled share-based payment transaction the entity should recognize a liability

Dr	Expense (or asset)	XX
Cr	Liability	XX

Equity- settled share-based payment transactions:

- The general principal in IFRS 2 is that when an equity recognizes the goods or services received and the corresponding increase in equity, it should measure these at the fair value of the goods or services receive.

Transaction is with employees or other parties:

*IF transaction is ***with parties other than employees***, there is a presumption that the fair value of the goods or services received can be estimated reliably. If the fair value cannot be measured reliably, the entity should measure their value by reference to the fair value of the equity instruments granted. And the fair value should be measured at the date the entity obtains the goods or services.

Where shares, share options or other equity instruments are granted ***to employees*, it is not possible to measure directly the service received. For this reason, the entity should measure the fair value of the employee services received by reference to the fair value of the equity instruments granted. The fair value of those equity instruments should be measured at the grant date.

Granted immediately or in periods:

- If the equity instruments granted vest immediately, it is presumed that the services have already been received. The entity should recognize the services received in full, with a corresponding increase in equity, on the grant date.
- If the instruments granted do not vest until the counterparty completes a specified period of service, the entity should account for those services as they are rendered by the counterparty during the vesting period. The entity should recognize the amount of goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest, In a proportion based on the period elapsed since the right was granted compared to the total vesting period. It should be revised if there are indications of a different estimate. On vesting date, the entity should revise the estimate to equal the number of equity instruments that actually vest. Once the goods and services received and the corresponding increase in equity have been recognized, the entity should make no subsequent adjustment to total equity after vesting date.

= no. of employees * no. of shares *FV of shares* period proportion to the vesting period

Modification to the terms and conditions of share options:

An entity might modify its share options, for example, by repricing them or by changing them from cash- settled to equity settled.

For example, if there is a downturn in the equity markets, an entity may modify its share options by reducing the exercise price. Reducing the exercise price would cause the fair value of the share-based payment to increase. IFRS 2 requires that this increase in value must be recognized over the remaining period until the options vest.

Cancellation and reissuance:

An alternative to re-pricing the share options is to cancel them and issue new options based on revised terms. The end result is essentially the same as an entity modifying the original options and therefore should be recognized in the same way.

As well as the entity, the equity instruments may be cancelled by the counterparty (e.g., the employee) or a third party (e.g., the shareholder)

Cancellations by the employee must be treated in the same way as cancellations by the employer, resulting in an accelerated charge to profit or loss of the unamortized balance of the options granted.

<u>Cash-settled share-based transactions:</u>

Examples include:

- Share appreciation rights granted to the employees: the employees become entitled to a future cash payment, based on the increase in the entity's share price from a specified level over a specified period of time,
- An entity might grant to its employees a right to receive a future cash payment by granting to them a right to shares that are redeemable

The basic principle is that the entity measures the goods or services acquired and the liability incurred at the fair value of the liability. The entity should remeasure the fair value at each reporting cate until the liability is settled and at the date of settlement. Any changes in fair value are recognized in profit or loss for the period.

The entity should recognize the service received, and a liability to pay for those services, as the employees render service.

<u>Share-based payment with a choice of settlement:</u>

If the entity has the choice whether to settle the share-based payment in cash or by issuing shares, the accounting treatment depends on whether there is a present obligation to settle the transaction in cash.

Where the present obligation exists, it should be treated as cash-settled share-based payment transaction. If not, it should be treated as equity-settled share-based payment transaction

If instead the counterparty (employee or supplier) has the right to choose whether the share-based payment is settled in cash or shares, the entity has granted a compound financial instrument

- ✓ The debt component of the compound financial instrument→ is treated as for cash-settled transaction
- ✓ The equity component of the compound financial instrument→ is measured as the residual value at grant date:

"Equity component= Fair value of shares alternative at grant date- fair value of cash alternative at grant date"

Once the debt and equity components have been established, the accounting of each follows that for a cash-settled scheme or an equity-settled scheme respectively.

Deferred tax implications:

The issue: for example, an entity recognizes an expense for share options granted under IFRS 2 share-based payment, but does not receive a tax deduction until the options are exercised and receives the tax deduction at the share price on the exercise date.

Measurement: the deferred tax asset temporary difference is measured as

* Carrying amount of share-based payment expense
* Less: tax base of share-based payment expense
  = temporary difference

Deferred tax asset= temporary difference* tax%

If the amount of the tax deduction exceeds the amount of the related cumulative remuneration expense, IFRS 2 states that this indicates that the tax deduction relates also to an equity item. IFRS 2 requires that the excess is therefore recognized directly in equity (not in OCI).

IFRS 1 – First time adoption of international financial reporting standards

IFRS1 gives guidance to entities applying IFRS for the first time. The adoption of a new body of accounting standard will have a significant effect on the accounting treatments used by the entity on the related systems and procedures.

An entity applies IFRS 1 in its first IFRS financial statements. An entity's first IFRS financial statements are the first annual financial statements in which the entity adopts IFRS standards by an explicit and unreserved statement of compliance with IFRS.

An entity prepares and presents an opening IFRS statement of financial position at the date of transition to IFRS standards as a starting point for IFRS accounting.

Generally, this will be the beginning of the earliest comparative period shown. Given that the entity is applying a change in accounting policy on adoption of IFRS, IAS 1- presentation of financial statements, requires the presentation of at least three statements of financial position "SOFP" and two of each of the other statements.

Preparation of an opening IFRS statement of financial position typically involves adjusting the amounts reported at the same date under previous GAAP. All adjustments are recognized directly in retained earnings (or, if appropriate, another category of equity) not in profit or loss. There are some exceptions: i.e., bad debts, insurance contract, hedging, business combination, etc.

Disclosure:

(a) ***A reconciliation of previous GAAP equity to IFRS standards*** is required at the date of transition to IFRS standards and for the most recent financial statements presented under previous GAAP.
(b) ***A reconciliation of profit*** for the most recent financial statements presented under previous GAAP.

IAS24 Related party disclosures

IAS24 is Primarily a disclosure standard. It is assumed that a reporting entity is independent and transactions are presumed to have been undertaken on an arm's length basis, these assumptions may not be present when related party relationships exist. This issue is tackled by IAS24 as it ensures that financial statements contain the necessary disclosures.

The standard requires disclosure of related party transactions and outstanding balances in the separate financial statements of the parent as well as in consolidated financial statements when transactions are with other entities in a group. Intragroup transactions and balances are eliminated in the preparation of consolidated financial statements.

Related party: a related party is a person or entity that is related to the entity that is preparing its financial statements.

Related party transactions: a transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

Key management personnel: are those persons having authority and responsibility of planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of the entity.

Joint control: is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

IAS24 lists the following which are not related parties:

(a) Two entities simply because they have the same director or ither key management in common.
(b) Two ventures, simply because they share joint control over a joint venture
(c) Other bodies, simply as a result of their role in normal business dealings with the entity. E.g., provider of finance, government departments and agencies, trade unions and public utilities.
(d) Any single customer, supplier, franchisor, distributor or general agent with whom the entity transacts a significant amount of business, simply by virtue of the resulting economic dependence.

If the transaction is between the entity and a government that has control, joint control or significant influence over the reporting entity or a transaction with another entity that is a related party because the same government has control, joint control or significant influence over the reporting entity and the other entity, the disclosures listed above need not to be made in respect of this transaction. Instead, the reporting entity should disclose:

1- The name of the government and the nature of the relationship with the reporting entity
2- Information to enable the users of the financial statement to understand the effect of the related party transactions on those financial statements, including:
   (i) The nature and amount of each individually significant transaction, and
   (ii) For those transactions that are collectively significant, a qualitative or quantitative indication of their extent.

*Relationships between parents and subsidiaries must be disclosed irrespective of whether any transactions have taken place between the related parties.

*IAS24 permits similar items to be aggregated and disclosed, but only if this would not affect the user's understanding of the effect of those items on the financial statements.

*A related party transaction should only be disclosed as being at 'arm's length' if the entity can prove it.

Memorize:

"IAS 24 requires that the existence of all related party relationships be disclosed together with details of any transactions and outstanding balances."

"IAS24 regards related party relationships as material by their nature. So, the fact that the transaction is financially insignificant and ordinary is not relevant in terms of requiring disclosure"

"Related parties are generally characterized by the presence of control or influence between two parties"

"Close family member to a key management personnel"

Reporting for small and medium- sized entities (SMEs)

IFRS standards are designed for entities quoted on the world's capital markets. However, most entities are small and medium-sized. Various approaches were proposed to deal with the so-called Big GAAP/Little GAAP divide. Which arise due to the existence of two types of companies and company accounts

1) 'simple' ones for small companies with fewer regulations and disclosure requirements.
2) 'complicated' ones for larger companies with extensive and detailed requirements.

There are two approaches to overcome this Big GAAP/Little GAAP divide:

a- Differential reporting. I.e., producing new reduced standards specifically for smaller companies, such as the IFRS for SMEs.
b- Providing exemptions for smaller companies from some of the requirements of existing standards.

Differential reporting:

A one-size-fits-all framework does not generate relevant and useful information. Differential reporting overcomes this by tailoring the reporting requirements to the entity. The main characteristic that distinguishes SMEs from other entities is the degree of public accountability. Despite the name SMEs, size is not the only or even the main criterion. Differential reporting may have drawbacks in terms of reducing comparability between small and large company accounts.

Exemptions from IFRS standards:

Some IFRS standards are not applicable on small company accounts, for example, a company with equity not quoted on a stock exchange doesn't have to comply with IAS33. Other standards always have an impact and are core standards. For example, IFRS standards on revenue, inventory, property plant and equipment and taxes on income. This approach would reduce the exposure of small companies to IFRS standards on a standard-by-standard basis. For the 'core' standards small companies would be required to follow all or most of their rules. For more complicated standards, small companies would face very brief general obligations.

*IF the cost of compliance exceeds the benefits to users, an entity may decide not to follow an IFRS standard. This applies to all reporting entities, not just smaller ones.

*IFRS standards apply to material items. In the case of smaller entities, the amount that is material may be very small in monetary terms. However, the effect of not reporting that item may be material in that it would mislead users of the financial statements.

*IFRS for SMEs is suitable for all entities except [1]those whose securities are publicly traded and [2]financial institutions such as banks and insurance companies.

*It is revised only once every three years to further reduce the reporting burden for SMEs.

*There are no quantitative thresholds for qualification as a SME; instead, it is determined by a test of public accountability.

*An entity must either apply the IFRS for SMEs or full IFRS standards, it cannot pick and choose from both.

IFRS for small and medium-sized entities aims to simplify financial reporting for SMEs. It facilitates financial reporting for SMEs in a number of ways:

a- It provides significantly less guidance than full IFRS standards.
b- Provide simplified principles for recognizing and measuring assets, liabilities, income and expenses than full IFRS
c- Where full IFRS standards allow accounting policy choices, the IFRS for SMEs allows only the easier option.
d- Topics that are not relevant for SMEs are omitted
e- Significant fewer disclosures are required
f- The standard has been written in clear language that can easily be translated.

Advantages of IFRS for SMEs:

1. It is virtually a 'one stop shop'
2. It is structured according to topics, which should make it practical to use
3. It is written in an accessible style
4. There is a considerable reduction in disclosure requirements
5. Guidance not relevant to private entities is excluded

Disadvantages of IFRS for SMEs:

1. It does not focus on the smallest companies
2. The scope is too wide, it extends to 'non-publicly accountable' entities
3. The standard will be onerous for small companies
4. Further simplifications can be made

Differences between IFRS for SMEs and Full IFRS

Area	IFRS for SMEs	Full IFRSs
Impairment of assets	Impairment test (carrying amount vs recoverable amount) only required where there are **indicators of impairment** (except for **inventories** which are tested **annually**). Impairment losses are charged to **profit or loss**. Non-current assets **held for sale** tested for impairment in the same way as other assets	**Annual tests for:** • Indefinite life intangibles • Intangibles not yet available for use • Goodwill Impairment losses charged first to OCI re any rev'n surplus on revalued assets Non-current assets held for sale held under IFRS 5 rules
Employee benefits	Actuarial gains and losses can be recognised immediately in **profit or loss** *or* **other comprehensive income**. Actual return on plan assets recognised in **profit or loss** **Simplified calculation** of defined benefit obligations permitted	Remeasurements in **other comprehensive income** only Projected unit credit method must be used

Area	IFRS for SMEs	Full IFRSs
Investment property	**Fair value through profit or loss** (where fair value can be measured without undue cost or effort, otherwise as PPE under cost-depreciation-impairment model)	**Fair value** model, *or* **Cost** model (accounting policy choice)
Intangible assets	All intangibles (including goodwill) are **amortised**. Useful life cannot exceed ten years if cannot be established reliably Revaluation model **not permitted** All internally generated research and development expenditure is **expensed**.	Only **amortised if finite useful life** No specific limit Revaluations **permitted** where active market **Capitalised** when the 'PIRATE' criteria met
Separate financial statements of investor	Investments in subsidiaries, associates and joint ventures can be held at **cost** (less any impairment) or **fair value through profit or loss**.	**Cost** ***or*** **under IFRS 9** (fair value through **profit or loss**, or fair value through **other comprehensive income** if an election was made on purchase)
Consolidated and separate financial statements	Investments in associates and joint ventures can **remain at that same value** or be **equity accounted**. Only **partial goodwill** allowed, ie non-controlling interests cannot be measured at full fair value. It is **amortised** as for intangible assets. Exchange differences on translating a foreign operation are recognised in **other comprehensive income** and **not subsequently reclassified** to profit or loss.	**Associates and joint ventures** equity accounted Choice of **full or partial goodwill** method. Compulsory **annual test for impairment**, not amortised Recognised in **other comprehensive income** and **reclassified to profit or loss** on disposal of the foreign operation
Government grants	No specified future performance conditions: → Recognise as **income** when the grant is receivable Otherwise: → Recognise as **income** when performance conditions met	**Grants relating to income** recognised in P/L **over period** to match to related costs **Grants relating to assets** *either*: – Presented as **deferred income**; *or* – **Deducted** in arriving at the carrying amount of the asset
Borrowing costs	**Expensed** when incurred	**Capitalised** (when relate to an asset being constructed)

Area	IFRS for SMEs	Full IFRSs
Presentation & disclosure	**Combined** statement of profit or loss and other comprehensive income and statement of changes in equity **permitted** (where no OCI nor equity movements other than profit or loss, dividends and/or prior period adjustments) **Segment disclosures** and **earnings per share not required**. Other disclosures reduced by 90% versus full IFRS Standards.	**Not permitted** **Required** (as full IFRS Standards apply only to publicly quoted companies)
Revenue	*Goods*: when significant **risks and rewards of ownership transferred** (and no continuing managerial involvement nor effective control) *Services:* **stage of completion**.	When **performance obligation** satisfied (IFRS 15 five step approach)
Financial instruments	**Amortised cost** • All 'basic' financial instruments other than those publicly traded or whose fair value can be measured reliably **Cost** • Unquoted investments in equity instruments (where FV not reliably measurable) **Fair value through profit or loss** • All other financial instruments SMEs can also choose to use the IAS 39 rules (limiting disclosures to those required for SMEs).	**Amortised cost** • *Financial assets:* business model is held to collect cash flows • *Financial liabilities*: all others not held at fair value through profit or loss **Cost** Also the case **Fair value through profit or loss** • *Financial assets:* all others • *Financial liabilities:* held for trading or part of group evaluated on FV basis **Fair value through OCI** • *Investments in equity instruments* which are investments in equity instruments not held for trading and irrevocable election made at inception • *Financial assets* where business model is held to collect contractual cash flows and to sell financial assets

Accounting policies:

For situations where the IFRS for SMEs does not provide specific guidance, to determine a suitable accounting policy an SME must consider in the following order:

1- The guidance in the IFRS for SMEs on similar and related issues.
2- The definitions, recognition criteria and measurement concepts in section 2 of the standard
3- It also has the option of considering the requirement and guidance in full IFRS standards dealing with similar topics

IAS 10 Events after the reporting period

Events occurring after the reporting period are those events that occur between the end of the reporting period and the date on which the financial statements are authorized for issue. Two types of events can be identified:

1) Adjusting events: those that provide evidence of conditions that existed at the end of the reporting period
2) Non-adjusting events: those that are indicative of conditions that arose after the reporting period

An entity shall adjust the amounts recognized in the financial statements to reflect adjusting events after the reporting period and it shall not adjust them for non-adjusting events after the reporting period.

Examples of adjusting events:

Sale of inventory after the reporting period for less than its carrying value at the year end

Amounts received or paid in respect of legal claims which were in negotiation at the year end

Discovery of error or fraud which shows that the financial statements were incorrect

Note: in relation to going concern, the standard states that, where operating result and the financial position have deteriorated after the reporting period, it may be necessary to reconsider whether the going concern assumption is appropriate in the preparation of the financial statements.

Examples of non-adjusting events:

Major purchase or disposal of an asset

Acquisition of, or disposal of, a subsidiary after the year end

Destruction of a production plant by fire after the reporting period

While they may be non-adjusting, some events after the reporting period will require disclosure. For example, where the value of an investment falls between the end of the reporting period and the date of the financial statements are authorized for issue. The fall in value represents circumstances during the current period, not conditions existing at the end of the previous reporting period. So, it is not appropriate to adjust the value of the investment in the financial statements but rather disclose the information as an aid to users.

*The rule for disclosure of events occurring after the reporting period which relates to conditions that arose after that date, is that disclosure should be made if non-disclosure would hinder the user's ability to make proper evaluations and decisions based on the financial statements.

IAS 8 Accounting policies, changes in accounting estimates and errors

Accounting policies: the specific principles, bases, conventions, rules and practices adopted by an entity in preparing and presenting financial statements

Accounting policies are determined by applying the relevant IFRS standard and considering any relevant implementation guidance issued by the IASB for the IFRS standard.

Where there is no applicable IFRS standard or interpretation management should use its judgement in developing and applying an accounting policy that results in information that is relevant and reliable. Management should refer to:

- The requirements and guidance in IFRS standards dealing with similar and related issues
- The definitions, recognition criteria and measurement concepts for assets, liabilities and expenses in the conceptual framework

An entity must select and apply its accounting policies for a period consistently for similar transactions, other events and conditions, unless an IFRS standard specifically requires or permits categorization of items for which different policies may be appropriate.

The same accounting policies are usually adopted from period to period, to allow users to analyze trends over time in profit, cash flows and financial position. Changes in accounting policies are therefore rare and should be made only if:

1- The change is required by an IFRS standard; or
2- The change will result in a more appropriate presentation of events or transactions in the financial statements of the entity, providing more reliable and relevant information

*Two types of events that do not constitute changes in accounting policy are adopting a new accounting policy for a transaction which hasn't occurred in the past or adopting an accounting policy for a new type transaction which hasn't been dealt with previously

*A change in accounting policy must be applied retrospectively. Retrospective application means that it is applied from the earliest date such transactions or events occurred.

Prospective application is no longer allowed under IAS 8 unless it is impracticable to determine the cumulative effect of the change.

*When a new IFRS standard is adopted, resulting in a change of an accounting policy, IAS 8 requires any transitional provisions in the new IFRS standard itself to be followed. If none are given in the new one, then follow the general principle of IAS 8

Disclosures required when a change in accounting policy has a material effect on current and prior periods are:

- The nature of the change
- The reason why the change provides reliable and more relevant information
- The amount of adjustment relating to periods before those presented
- For the current period and each prior period presented, the amount of adjustment:
    - (i) For each financial statement line item effected, and
    - (ii) For basic and diluted earnings per share If IAS 33 Earnings per share applies to the entity
- If retrospective application is impracticable, the circumstances that lead to that condition and a description of how and from when the change in accounting policy has been applied.

Disclosure is important to maintain the principle of comparability. As changes in accounting policy affect comparability, so it's important they are disclosed.

Changes in accounting estimates:

<u>Accounting estimates:</u> they are monetary amounts in financial statements that are subject to measurement uncertainty

Some examples are bad debts, useful life of a depreciable asset or provision for obsolescence of inventory

Changes in accounting estimates are not applied retrospectively. The rule is that the effect of a change in an accounting estimate should be included in the determination of net profit or loss in the period of the change if the change affects the period only or in the period of the change and future periods if the change affects both.

Errors

Prior period errors, which are errors discovered during a current period which relates to a prior period, must be corrected retrospectively.

Most of the time these errors can be corrected through net profit or loss for the current period. However, where they are material prior period errors, this is not appropriate. The standard considers two possible treatments:

Either (a) restating the comparative amounts for the prior period(s) in which the error occurred.

Or (b) when the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for that period.

So that the financial statements are presented as if the error had never occurred

Only when its impracticable to determine the cumulative effect of an error on prior periods can an entity correct an error prospectively

Disclosures required:

- The nature of the prior period error
- The amount of correction at the beginning of the earliest prior period presented
- For each prior period, the amount of correction:
    - (iii) For each financial statement line item effected, and
    - (iv) For basic and diluted earnings per share If IAS 33 Earnings per share applies to the entity
- If retrospective restatement is impracticable, the circumstances that lead to that condition and a description of how and from when the error has been corrected

Subsequent prior periods need not repeat this disclosure