IFRS

A CONCEPTUAL ANALYSIS

B V Subramaniam FCMA

INTRODUCTION

International Financial Reporting Standards (IFRS) are the world-wide accounting standards which consists of

1) Standards (IFRS statements & IAS standards)

2) Interpretations (IFRS implementations)

3) the Framework

adopted by the International Accounting Standards Board (IASB).

- International Financial Reporting Standards (IFRS) are principle based standards as against the rule based standards currently in force; that establishes
- recognition,
- measurement,
- presentation and disclosure requirements relating to transactions and events that are reflected in the financial statements.

- IFRS was developed in the year 2001 by the International Accounting Standards Board (IASB) to provide a single set of high quality, understandable and uniform accounting standards.

International Accounting Standards Board (IASB)

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

- IASB members are responsible for the development and publication of IFRS, including the *IFRS for SMEs*.

- The IASB is also responsible for approving Interpretations of IFRS as developed by the IFRS Interpretations Committee (formerly IFRIC).

IFRS INTERPRETATIONS COMMITTEE(IFRIC)

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

- The mandate of the Interpretations Committee is to,

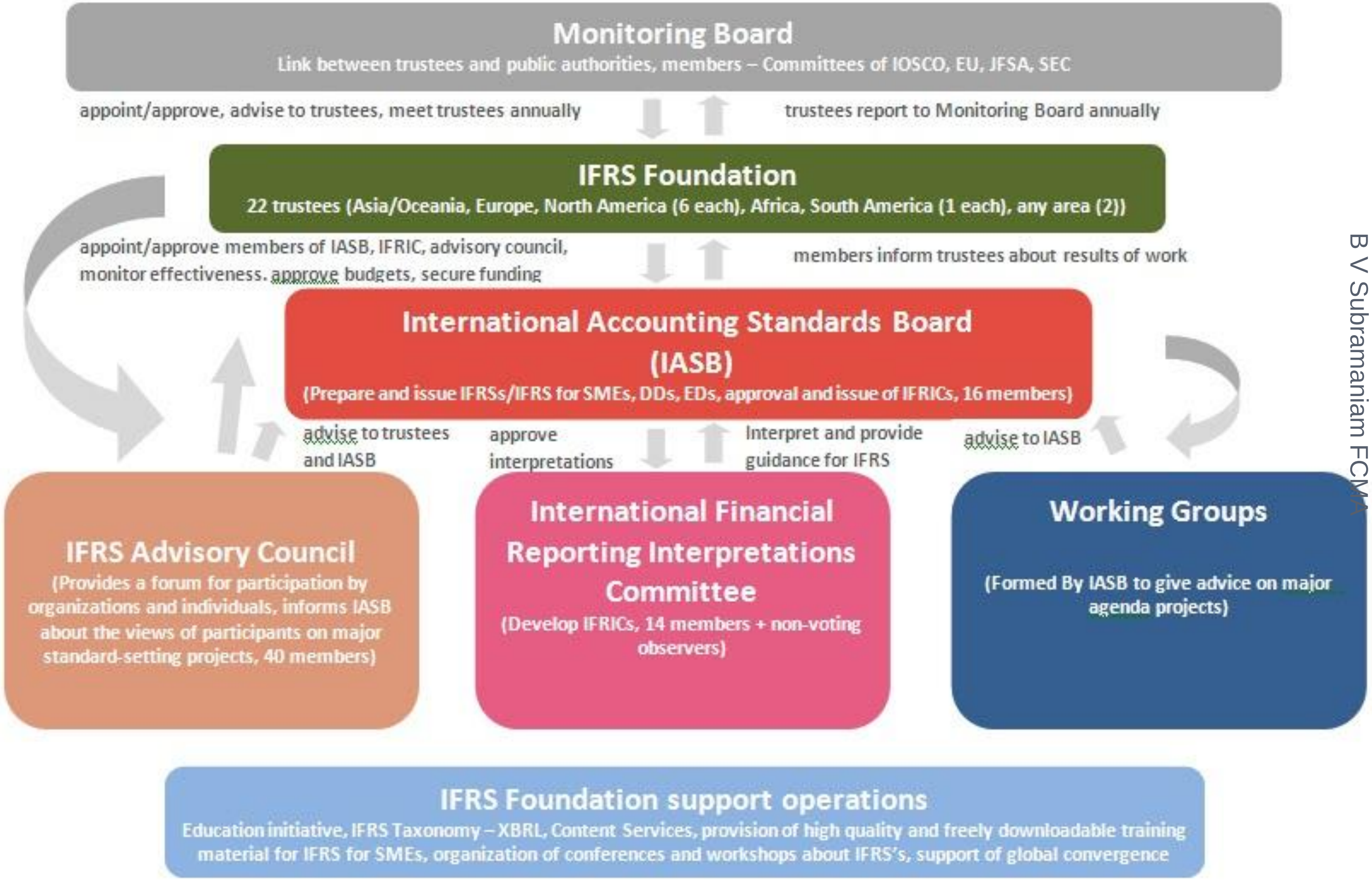
  Review on a timely basis

  Implementation issues arisen within the context of current IFRS and

  To provide authoritative guidance (IFRICs) on those issues.

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

IFRS Foundation structure



Monitoring Board

Link between trustees and public authorities, members – Committees of IOSCO, EU, JFSA, SEC

appoint/approve, advise to trustees, meet trustees annually

trustees report to Monitoring Board annually

IFRS Foundation

22 trustees (Asia/Oceania, Europe, North America (6 each), Africa, South America (1 each), any area (2))

appoint/approve members of IASB, IFRIC, advisory council, monitor effectiveness. approve budgets, secure funding

members inform trustees about results of work

International Accounting Standards Board (IASB)

(Prepare and issue IFRSs/IFRS for SMEs, DDs, EDs, approval and issue of IFRICs, 16 members)

advise to trustees and IASB

approve interpretations

Interpret and provide guidance for IFRS

advise to IASB

IFRS Advisory Council

(Provides a forum for participation by organizations and individuals, informs IASB about the views of participants on major standard-setting projects, 40 members)

International Financial Reporting Interpretations Committee

(Develop IFRICs, 14 members + non-voting observers)

Working Groups

(Formed By IASB to give advice on major agenda projects)

IFRS Foundation support operations

Education initiative, IFRS Taxonomy – XBRL, Content Services, provision of high quality and freely downloadable training material for IFRS for SMEs, organization of conferences and workshops about IFRS's, support of global convergence

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- A series of accounting standards, known as the International Accounting Standards (IAS), were released by the International Accounting Standards Committee(IASC) between 1973 and 2000, and were ordered numerically. The series started with IAS 1, and concluded with the IAS 41, in December 2000.
- After International Accounting Standards Board (IASB) was established, they agreed to adopt the set of standards that were issued by the IASC, i.e. the IAS 1 to 41, but that any standards to be published after that would follow a series known as the International Financial Reporting Standards (IFRS).

In simple..

Formerly known as (Up to 2000)	Now (After 2000)
IASC (International Accounting Standards Committee)	IASB (International Financial Reporting Standards)
IAS (International Accounting Standards)	IFRS (International Financial Reporting Standards)
IAS 1 – IAS 41	IFRS 1- IFRS 15 till now

- IAS standards were issued by the IASC, while the IFRS are issued by the IASB, which succeeded the IASC.
- Principles of the IFRS take precedence if there’s contradiction with those of the IAS, and this results in the IAS principles being dropped.

Financial Accounting Standards Board (FASB)

- The Financial Accounting Standards Board (FASB) has been the designated organization in the private sector for establishing standards of financial accounting that govern the preparation of financial reports by nongovernmental entities.

- Those standards are officially recognized as authoritative by the Securities and Exchange Commission (SEC)

- The SEC has statutory authority to establish financial accounting and reporting standards for publicly held companies under the Securities Exchange Act of 1934

- The *FASB Accounting Standards Codification* is the single source of authoritative nongovernmental U.S. Generally Accepted Accounting Principles (GAAP).

Overview of the revised IFRS convergence roadmap

- The Ministry of Corporate Affairs (MCA) of the Government of India, through notification dated 16 February 2015 has issued the Companies (Indian Accounting Standards) Rules, 2015 (Rules) which lay down a roadmap for companies other than
- banking companies,
- insurance companies and non-banking finance companies

for implementation of Indian Accounting Standards (Ind AS) converged with International Financial Reporting Standards (IFRS).

APPLICABILITY OF IND AS TO COMPANIES

PHASE I- The following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after 1 st April, 2016, with the comparatives for the periods ending on 31st March, 2016, or thereafter

(a)	Companies whose equity or debt securities are *listed* or are *in the process of being listed* on any stock exchange in India or outside India and Net Worth of INR 500 crore or more
(b)	Companies other than those covered by sub-clause (a) i.e. Unlisted companies having a net worth of INR 500 crore or more
(c)	Holding, Subsidiary, Joint venture or Associate companies of companies covered in sub-clause (a) and (b)

PHASE **II** - The following companies shall comply with the Indian Accounting Standards (Ind AS) for the accounting periods beginning on or after 1 st April, 2017, with the comparatives for the periods ending on 31st March, 2017, or thereafter

(a)	Companies whose equity or debt securities are *listed* or are *in the process of being listed* on any stock exchange in India or outside India and having Net Worth of less than INR 500 crore
(b)	Companies other than those covered in sub clause (a) i.e. Unlisted companies having Net Worth of INR 250 crore or more but less than INR 500 crore.
(c)	Holding, Subsidiary, Joint venture or Associate companies of companies covered in sub-clause (a) and (b)

- Any company may voluntary comply with the Indian Accounting Standards (Ind AS) for financial statements for accounting periods beginning on or after 1 st April, 2015, with the comparatives for the periods ending on 31st March, 2015, or thereafter.

List of IFRS/IAS

- IAS 1 Presentation of Financial Statements 2003
- IAS 2 Inventories 2003
- IAS 7 Statement of Cash Flows 1992
- IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors 2003
- IAS 10 Events after the Reporting Period 2003
- IAS 11 Construction Contracts* 1993
- IAS 12 Income Taxes 1996
- IAS 16 Property, Plant and Equipment 2003

- IAS 17 Leases 2003
- IAS 18 Revenue* 1993
- IAS 19 Employee Benefits 2004
- IAS 20 Accounting for Government Grants and Disclosure of Government Assistance 2008
- IAS 21 The Effects of Changes in Foreign Exchange Rates 2003
- IAS 23 Borrowing Costs 2007
- IAS 24 Related Party Disclosures 2003

- IAS 26 Accounting and Reporting by Retirement Benefit Plans

  1987
- IAS 27 Separate Financial Statements 2003
- IAS 28 Investments in Associates and Joint Ventures 2011
- IAS 29 Financial Reporting in Hyperinflationary Economies 2008
- IAS 32 Financial Instruments: Presentation 2003
- IAS 33 Earnings per Share 2003

- IAS 34 Interim Financial Reporting 1998
- IAS 36 Impairment of Assets 2004
- IAS 37 Provisions, Contingent Liabilities and Contingent Assets 1998
- IAS 38 Intangible Assets 2004
- IAS 39 Financial Instruments: Recognition and Measurement** 2003
- IAS 40 Investment Property 2003
- IAS 41 Agriculture 2008

List of converged Indian Accounting Standards

Ind AS	IFRS/IAS
Ind-AS 101 First-time adoption of Indian Accounting Standards	IFRS 1
Ind-AS 102 Share based Payment	IFRS 2
Ind-AS 103 Business Combination	IFRS 3
Ind-AS 104 Insurance Contracts	IFRS 4
Ind-AS 105 Non-Current Assets Held for Sale and Discontinued Operations	IFRS 5

Ind-AS 106 Exploration for and Evaluation of Mineral Resources	IFRS 6
Ind-AS 107 Financial Instruments: Disclosures	IFRS 7
Ind-AS 108 Operating Segments	IFRS 8
Ind-AS 1 Presentations of Financial Statements	IAS 1
Ind-AS 2 Inventories	IAS 2
Ind-AS 7 Statement of cash flows	IAS 7

Ind-AS 8 Accounting Policies, Changes in Accounting Estimates and Errors	IAS 8
Ind-AS 10 Events after the Reporting Period	IAS 10
Ind-AS 11 Construction Contracts	IAS 11
Ind-AS 12 Income Taxes	IAS 12
Ind-AS 16 Property, Plant and Equipment	IAS 16
Ind-AS 17 Leases	IAS 17

Ind-AS 18 Revenue	IAS 18
Ind-AS 19 Employee Benefits	IAS 19
Ind-AS 20 Accounting for Government Grants and Disclosure of Government Assistance	IAS 20
Ind-AS 21 The Effects of changes in Foreign Exchange Rates	IAS 21
Ind-AS 23 Borrowings Costs	IAS 23
Ind-AS 24 Related Party Disclosures	IAS24

Ind-AS 27 Consolidated and Separate Financial Statement	IAS 27
Ind-AS 28 Investment in Associates	IAS 28
Ind-AS 29 Financial Reporting in Hyperinflationary Economies	IAS 29
Ind-AS 31 Interest in Joint Ventures	IAS 31
Ind-AS 32 Financial Instruments: Presentation	IAS 32
Ind-AS 33 Earnings Per Share	IAS 33

Ind-AS 34 Interim Financial Reporting	IAS 34
Ind-AS 36 Impairment of Assets	IAS 36
Ind-AS 37 Provisions, Contingent liabilities and Contingent Assets	IAS 37
Ind-AS 38 Intangible Assets	IAS 38
Ind-AS 39 Financial Instruments: Recognition and Measurement	IAS 39
Ind-AS 40 Investment Property	IAS 40

Conceptual Framework

- Conceptual Framework for Financial Reporting (the ‘Conceptual Framework’) describes,

  the objective of, and

  the concepts for general purpose financial reporting

THE OBJECTIVE OF GENERAL PURPOSE FINANCIAL REPORTING

- IFRS Framework explains who needs information about entity’s financial situation and why—
- investors,
- lenders,
- creditors, but also
- other parties.

Financial statements shall provide information about a reporting entity’s economic resources and claims, plus their changes.

The following small table shows how:

What to Report	Where to Report
Economic resources and claims (ER&C)	Statement of Financial position
Changes in ER&C resulting from financial performance	Statement of comprehensive income
Changes in cash flows	Statement of Cash flows
Changes in ER & C not resulting from financial performance	Statement of changes in equity

Qualitative Characteristics of Useful Financial Information

- **Fundamental** Qualitative Characteristics are

  Relevance and

  Faithful representation.

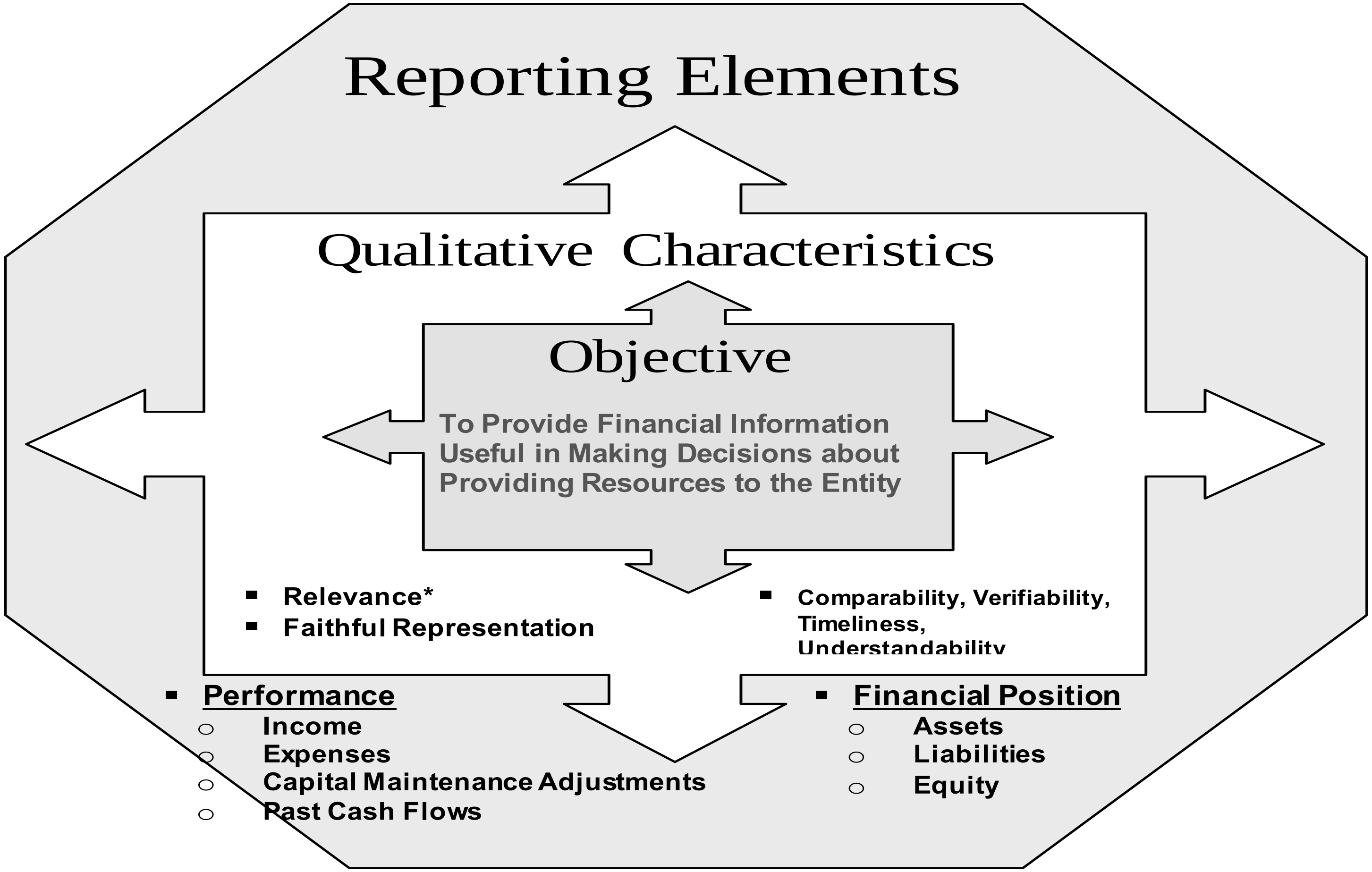
- **Enhancing** Qualitative Characteristics are;

  Comparability,

  Verifiability,

  Timeliness and

  Understandability.



Reporting Elements

Qualitative Characteristics

Objective

To Provide Financial Information Useful in Making Decisions about Providing Resources to the Entity

- Relevance*
- Faithful Representation

- Comparability, Verifiability, Timeliness, Understandability

- **Performance**
  - Income
  - Expenses
  - Capital Maintenance Adjustments
  - Past Cash Flows

- **Financial Position**
  - Assets
  - Liabilities
  - Equity

Constraint

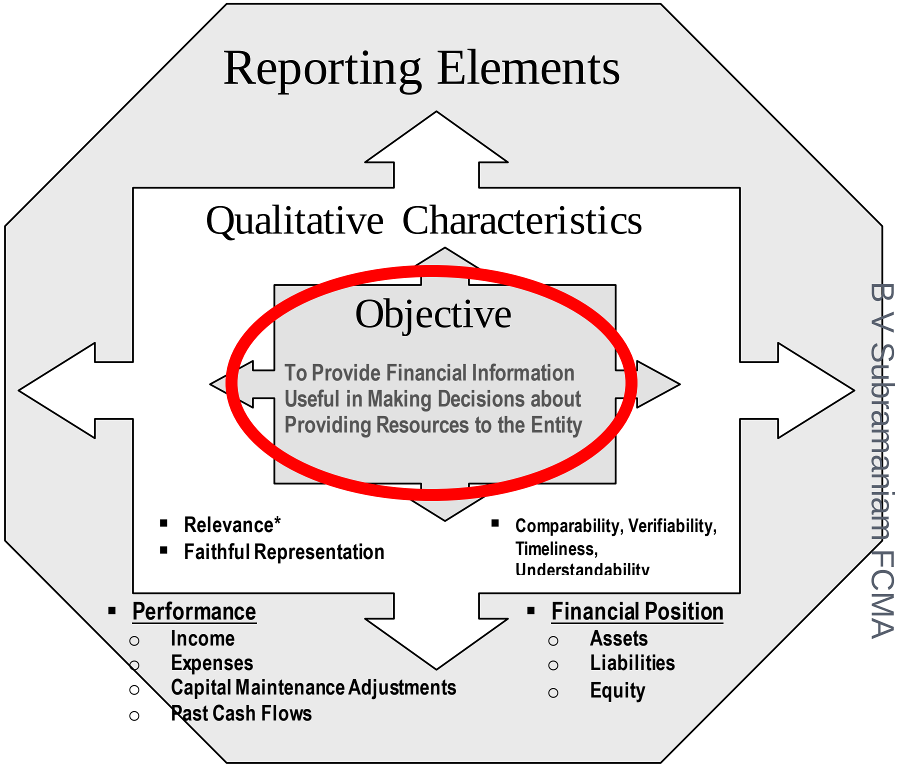
- Cost (cost/benefit considerations)

Underlying Assumption

- Accrual Basis
- Going Concern

*Materiality is an aspect of relevance.

- At the core of the *Conceptual Framework* is the objective to provide financial information that is useful to current and potential providers of resources in making decisions.
- All other aspects of the framework flow from that central objective.



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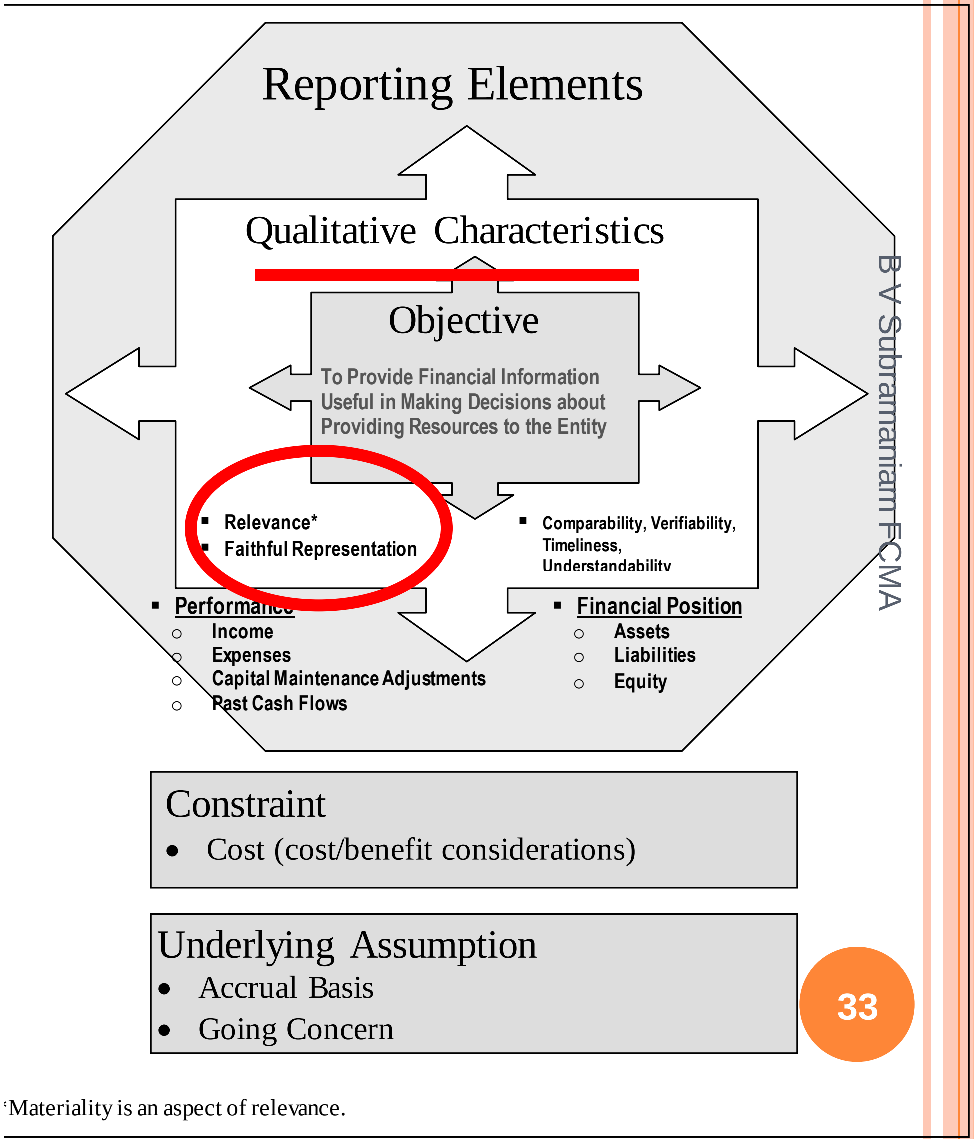
- Two **fundamental** qualitative characteristics that make financial information useful:
  - *Relevance*: Information that could potentially make a difference in users' decisions.
  - *Faithful Representation*: Information that faithfully represents an economic phenomenon that it purports to represent. It is ideally
    - complete,
    - neutral, and
    - free from error.



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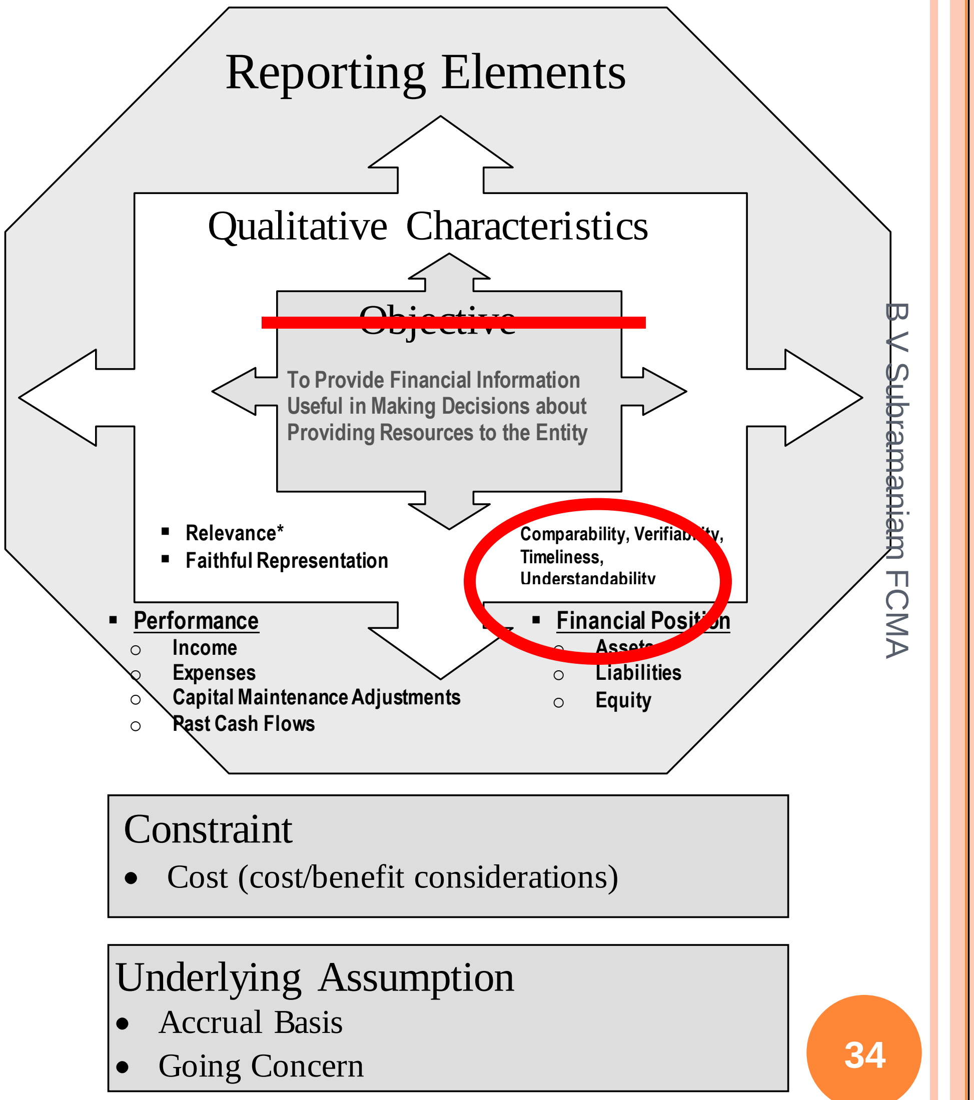
- Four **enhancing** qualitative characteristics that make financial information useful:
  - *Comparability*: Companies record and report information in a similar manner.
  - *Verifiability*: Independent people using the same methods arrive at similar conclusions.
  - *Timeliness*: Information is available before it loses its relevance.
  - *Understandability:* Reasonably informed users should be able to comprehend the information.



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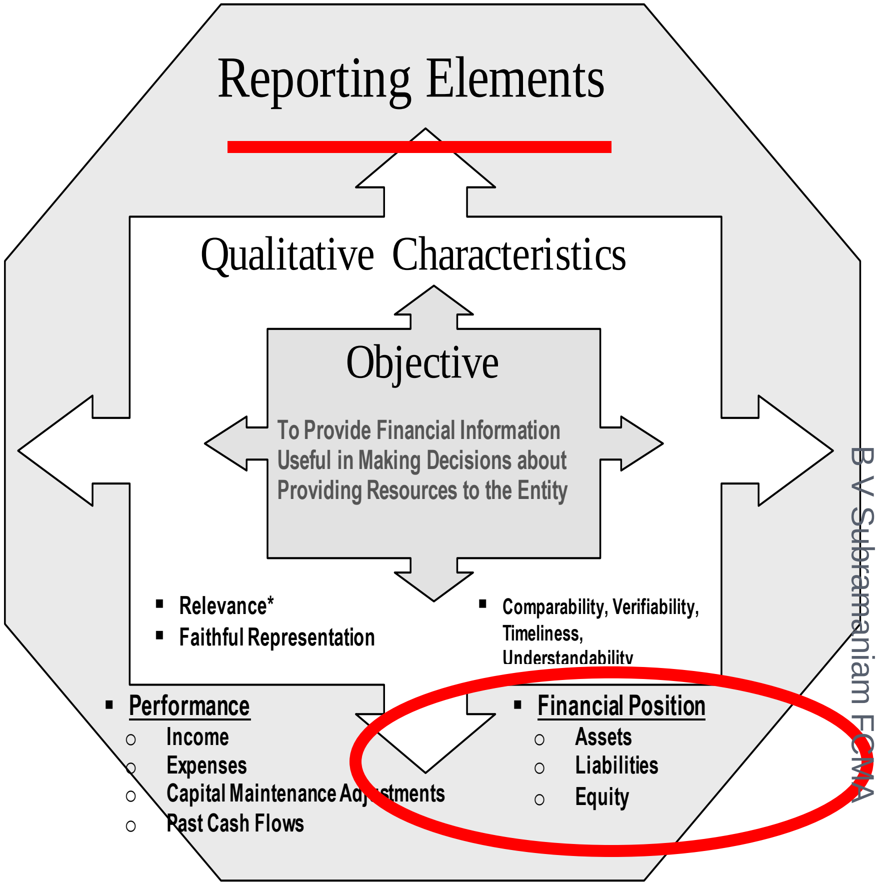
*Materiality is an aspect of relevance.

- Elements directly related to the measurement of financial position:
  - *Assets*: Resources controlled by the enterprise as a result of past events and from which future economic benefits are expected to flow to the enterprise.
  - *Liabilities*: Present obligations of an enterprise arising from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits.
  - *Equity*: Residual interest in the assets after subtracting the liabilities.



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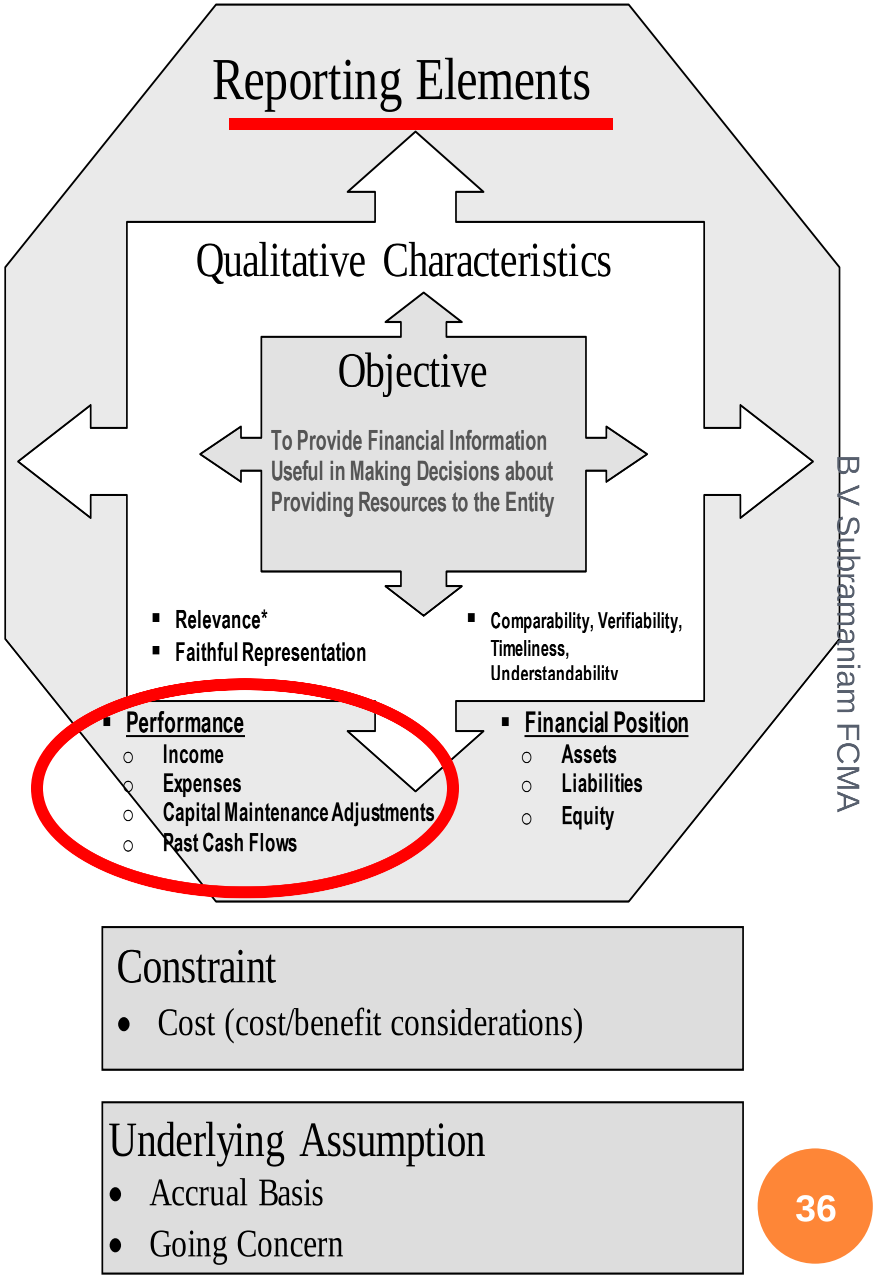
- Elements directly related to the measurement of performance:
  - *Income*: Increases in economic benefits in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity (other than increases resulting from contributions by owners).
  - *Expenses*: Decreases in economic benefits in the form of outflows or depletions of assets or increases in liabilities that result in decreases in equity (other than decreases because of distributions to owners).



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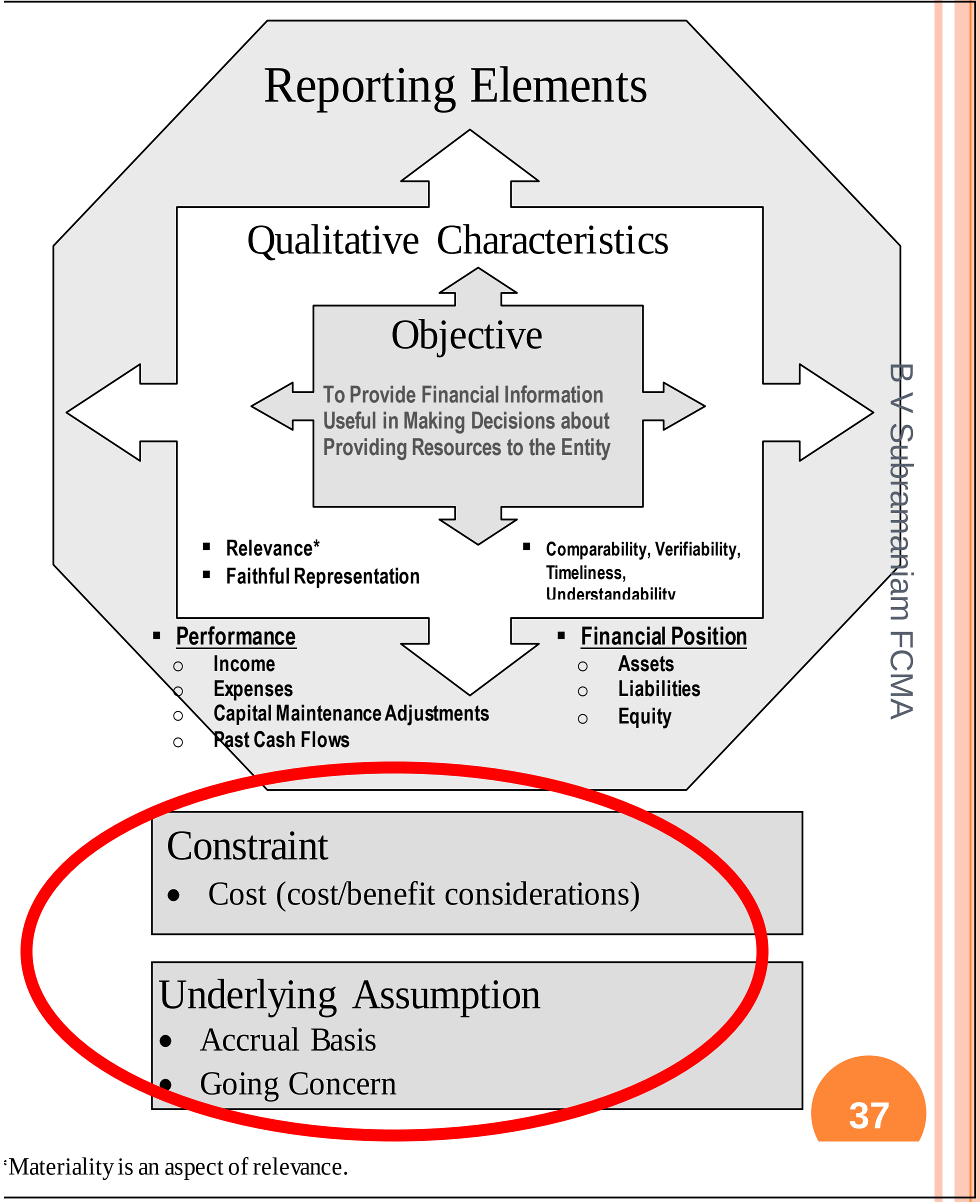
- Constraint: The benefits of information should exceed the costs of providing it.
- Underlying Assumptions:
  - *Accrual Basis*: Financial statements should reflect transactions in the period when they actually occur, not necessarily when cash movements occur.
  - *Going Concern*: Assumption that the company will continue in business for the foreseeable future.



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The Elements of Financial Statements

- The elements of financial statements are broad classes that group various transactions and items info financial statements. Short classification of the elements is shown in the following table:

Related to	
Financial Position (Balance sheet, Cash Flow Statement)	Financial Performance (Income Statement, Cash Flow Statement)
Assets	Income(Revenue and Gains)
Liabilities	Expenses (from ordinary activities and losses
Equity(residual;=Assets – Liabilities)	

Elements: Definitions of assets and liabilities

	Existing definitions	**Exposure Draft 2015 (proposed)**
Assets	A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.	An asset is a present economic resource controlled by the entity as a result of past events.
Liability	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.	A liability is a present obligation of the entity to transfer an economic resource as a result of past events.
Economic resource	nil	an economic resource is a right, or other source of value, that is capable of producing economic benefits.

Users of Financial Statements

Investors	The providers of Risk Capital and their Advisers
Employees	Employees and their representative groups
Lenders	Lenders are interested in information to determine repayment capacity
Suppliers and other trade creditors	Suppliers and other creditors are interested in information about ability to pay obligations when they become due
Customers	Interested in Continuance of an Entity especially when long term investment
Governments and their agencies	Government and their agencies interested in an entity's financial information for taxation and regulatory purposes
Public	Anyone outside the company such as researchers, students, analysts and others are interested in the financial statements of a company for some valid reason

Role of Management in preparation and presentation of Financial Statements

- Management of an Entity has the primary responsibility of preparation and presentation of Financial Statements lies with management of the entity.

- Management is also interested in the information contained in the financial statements to carry out planning, decision making and control responsibilities.

- **Substance over form ;**

Transactions accounted and presented in their substance and economic reality and not merely their legal form.

Substance over form concept entails the use of judgment on the part of the preparers of the financial statements in order for them to derive the business sense from the transactions and events and to present them in a manner that best reflects their true essence.

Whereas legal aspects of transactions and events are of great importance, they may have to be disregarded at times in order to provide more useful and relevant information to the users of financial statements.

By Subramaniam CMA

Prudence ;

Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated.

RECOGNITION OF ASSET

- An asset is recognized in the balance sheet when it is probable that,

  the future economic benefits will flow to the entity and

  the asset has a cost or value that can be measured reliably.

- An asset is not recognized in the balance sheet when expenditure has been incurred for which it is considered improbable economic benefits will flow to the entity beyond the current accounting period.

SIGNIFICANCE OF ASSETS

- Potential to contribute to flow of cash and cash equivalents
- Cash itself renders a service to the entity because of its command over other resources.
- Assets include tangible and intangible
- Relevant of right of ownership in determining existence of an asset
- Acquisition and generation of asset
- Incurring of expenditure and recognition of asset

Recognition of Liability

- A liability is recognized in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably.

BY Subramaniam FCMA

SIGNIFICANCE OF LIABILITY

- Present obligation
- Liability to result from past transactions and past events
- When provision regarded as a liability;

When a provision involves a present obligation as a result of past event it is a liability even if the amount has to be estimated.

RECOGNITION OF EQUITY

- The amount at which equity is shown in the balance sheet is dependent on the measurement of asset and liabilities.

Recognition of Income

- Income is recognized in the statement of profit and loss when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably.

- Effectively the recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities.

e.g. the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable

RECOGNITION OF EXPENSES

- Expenses are recognized in the statement of profit and loss when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

- This is done on the basis of a direct association between cost incurred and earning of specific items of income(Matching cost with revenues).

- Recognition of expenses when economic benefits are expected to arise over several accounting periods are on the basis of systematic and rational allocation procedures.

- An expense is also recognized in those cases when a liability is incurred without recognition of an asset, as when a liability under a product warranty arises.

CONCEPT OF CAPITAL

- A financial concept of capital is adopted by most entities in preparing their financial statements.
- Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the entity.

- Under physical concept of capital such as operating capability, capital is regarded as the productive capacity of the entity.

  e.g. units of output per day

CAPITAL MAINTENANCE

- An accounting concept based on the principle that income is only recognized after capital has been maintained or there has been a full recovery of costs.

- Financial Capital Maintenance;

  Under this concept, a profit is earned only if the financial amount of the net asset at the end of the period exceeds the financial amount of net asset at the beginning of the period after excluding any

  distributions to, and
  contributions from, owners during the period.

- Physical capital maintenance;

Physical capital maintenance implies that a profit is earned only if the enterprise's productive or operating capacity at the end of a period exceeds the capacity at the beginning of the period, after excluding any owners' contributions or distributions.

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RECOGNITION OF ELEMENTS OF FINANCIAL STATEMENTS

- Recognition is the process of incorporating in the balance sheet or statement of profit and loss an item that meets the definition of an element and satisfies the criteria for recognition set out in sub-item(ii) ifra.(when is an element recognized)
- When is an element recognized; Should be recognized if,

  (a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and

  (b) the item has a cost or value that can be measured with reliability.

THE PROBABILITY OF FUTURE ECONOMIC BENEFIT

- The concept of probability is used in the recognition criteria to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the entity.

- The concept is in keeping with the uncertainty that characterizes the environment in which an entity operates.

RELIABILITY OF MEASUREMENT

- Cost or value must be measured

This is the second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability.

MEASUREMENT OF THE ELEMENTS OF FINANCIAL STATEMENTS

- Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognized and carried in the balance sheet and statement of profit and loss.
- Different measurement bases;

Historical Cost

Current Cost

Realizable Value

Present Value

Fair Value

- Historical Cost;

Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition.

Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

- Current Cost;

Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently.

Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

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- Realizable (settlement) value;

  Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal.

  Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.

- Present value.
- Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business.
- Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

- Fair Value

  Assets are carried at the amount at which they could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.

BASIC ANALYSIS OF IFRS 15, IFRS 9, IFRS 13, IAS 36

IFRS 15 Revenue from Contracts with Customers

REVENUE

- Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

CUSTOMER

- A customer "as a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration"

CONTRACT

- An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:
- (a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;
- (b) the entity can identify each party's rights regarding the goods or services to be transferred;
- (c) the entity can identify the payment terms for the goods or services to be transferred;

- (d) the contract has commercial substance (ie the risk, timing or amount of the entity’s future cash flows is expected to change as a result of the contract); and
- (e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer.

In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer’s ability and intention to pay that amount of consideration when it is due.

The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession

PERFORMANCE OBLIGATIONS

- A promise in a contract with a customer to transfer to the customer either;

(a) Good or service(Or a bundle of goods and Services) that is distinct or

(b) A series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer.

TRANSACTION PRICE

- The amount of consideration to which an entity expected to be entitled in exchange for transferring promise to goods or services, excluding amounts collected on behalf of third parties.

ALLOCATE THE TRANSACTION PRICE TO THE PERFORMANCE OBLIGATIONS

- Once the distinct (or separate) performance obligations are identified and the transaction price has been determined, the standard requires an entity to allocate the transaction price to the performance obligations. This is generally done in proportion to their stand-alone selling prices

CASE STUDY

- An entity enters into a contract with a customer to construct a facility for 140 over 2 years. The contract also requires the entity to procure specialized equipment from a third party and integrate that equipment into the facility.

The entity expects to transfer control of the specialized equipment approximately 6 months from when the project begins.

The installation and integration of the equipment continue throughout the contract.

continued…

- The contract is a single performance obligation, because all of the promised goods or services in the contract are highly interrelated and the entity also provides a significant service of integrating those goods or services into the single facility for which the customer has contracted.
- In addition, the entity significantly modifies the bundle of goods and services to fulfil the contract.
- The entity measures progress towards complete satisfaction of the performance obligation on the basis of costs incurred relative to total costs expected to be incurred.
- At contract inception, the entity expects the following :

Transaction price		140
Costs : Specialized equipment	40	
Others	80	120

The entity concludes that the best depiction of the entity's performance is to recognize revenue for the specialized equipment in an amount equal to the cost of the specialized equipment upon the transfer of control of the customer.

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- Hence, the entity would exclude the cost of the specialized equipment from its measure of progress towards complete satisfaction of the performance obligation on a cost-to-cost basis and account for the contract as follows :

During the first 6 months, the entity incurs 20 of costs relative to the total 80 of expected costs (excluding the 40 cost of the specialized equipment).

Hence, the entity estimates that the performance obligation is 25% complete (20/80 *100) and recognizes revenue of 25 [25% *(140 – 40)]. Upon transfer of control of the specialized equipment, the entity recognizes revenue and costs of 40.

Subsequently, the entity continues to recognize revenue on the basis of costs incurred relative to total expected costs (excluding the revenue and cost of the specialized equipment).

RECOGNITION OF REVENUE

- Revenue can only be recognized when (or as) the entity satisfies a performance obligation.
- This occurs when it transfers a promised good or renders a promised service to its customer.
- Substance over form principles are particularly relevant at this point because essentially a good or service is transferred or rendered when the customer obtains control of that good or service.
- In the broadest sense, therefore, revenue is recognized when the customer receives control over the associated asset.

- ***IFRS 15 will replace*** the following standards and interpretations:
  - IAS 18 Revenue,
  - IAS 11 Construction Contracts
  - SIC 31 Revenue – Barter Transaction Involving Advertising Services
  - IFRIC 13 Customer Loyalty Programs
  - IFRIC 15 Agreements for the Construction of Real Estate and
  - IFRIC 18 Transfer of Assets from Customers

- The core principle of IFRS 15 is that –

  An entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration (payment) to which the entity expects to be entitled in exchange for those goods or services.

- To apply this principle, you need to follow a five-step model framework described below.
- IFRS 15- contains guidance for transactions not previously addressed (service revenue, contract modifications);
- IFRS 15 - improves guidance for multiple-element arrangements;
- IFRS 15 - requires enhanced disclosures about revenue.

FIVE-STEP MODEL FRAMEWORK

- Step 1: Identify the contract(s) with a customer.

IFRS 15 defines a contract as an agreement between two or more parties that creates enforceable rights and obligations and sets out the criteria for every contract that must be met

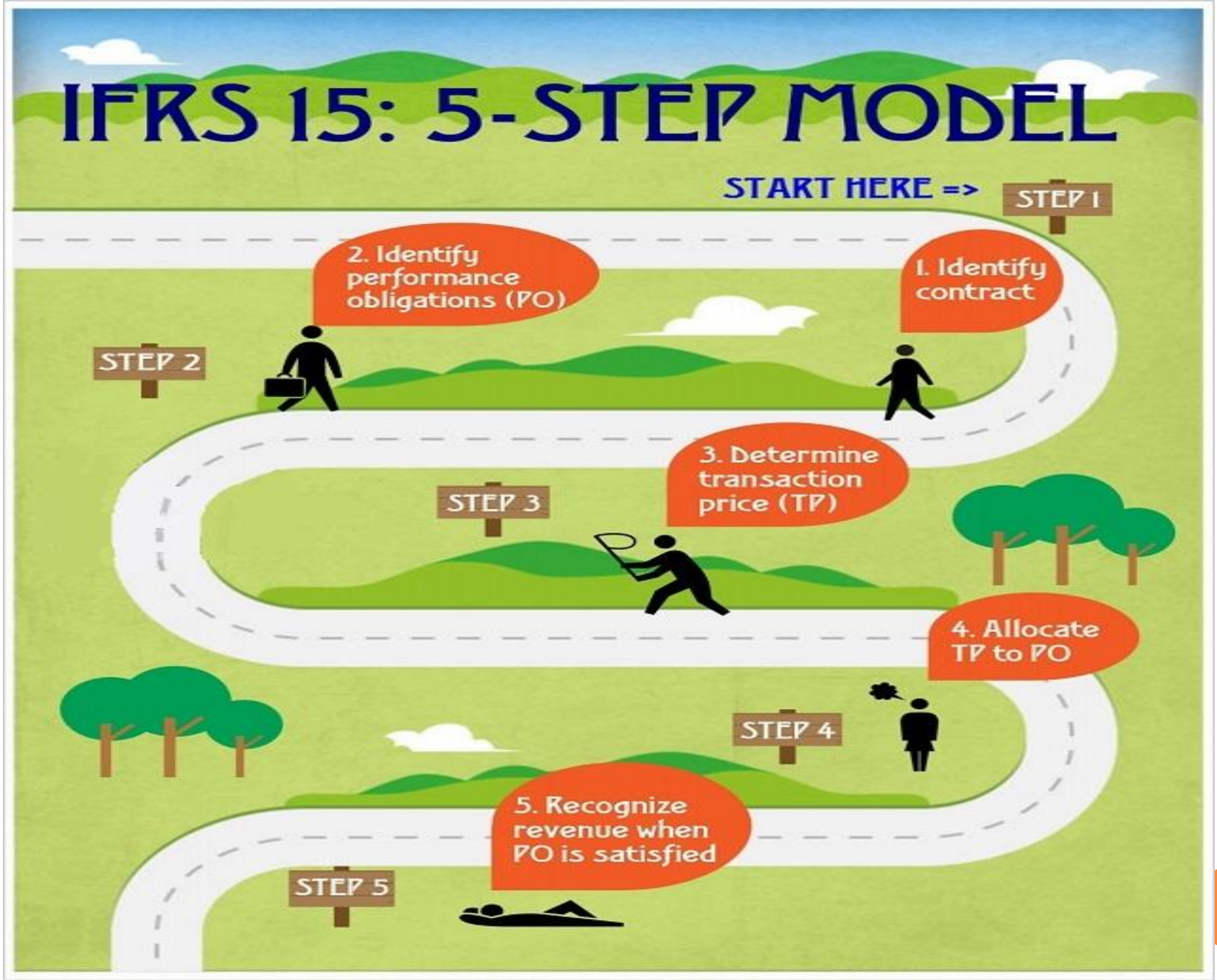
Step 2: Identify the performance obligations in the contract.

A performance obligation is a promise in a contract with a customer to transfer a good or service to the customer.

- Step 3: Determine the transaction price.

  The transaction price is the amount of consideration (for example, payment) to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.

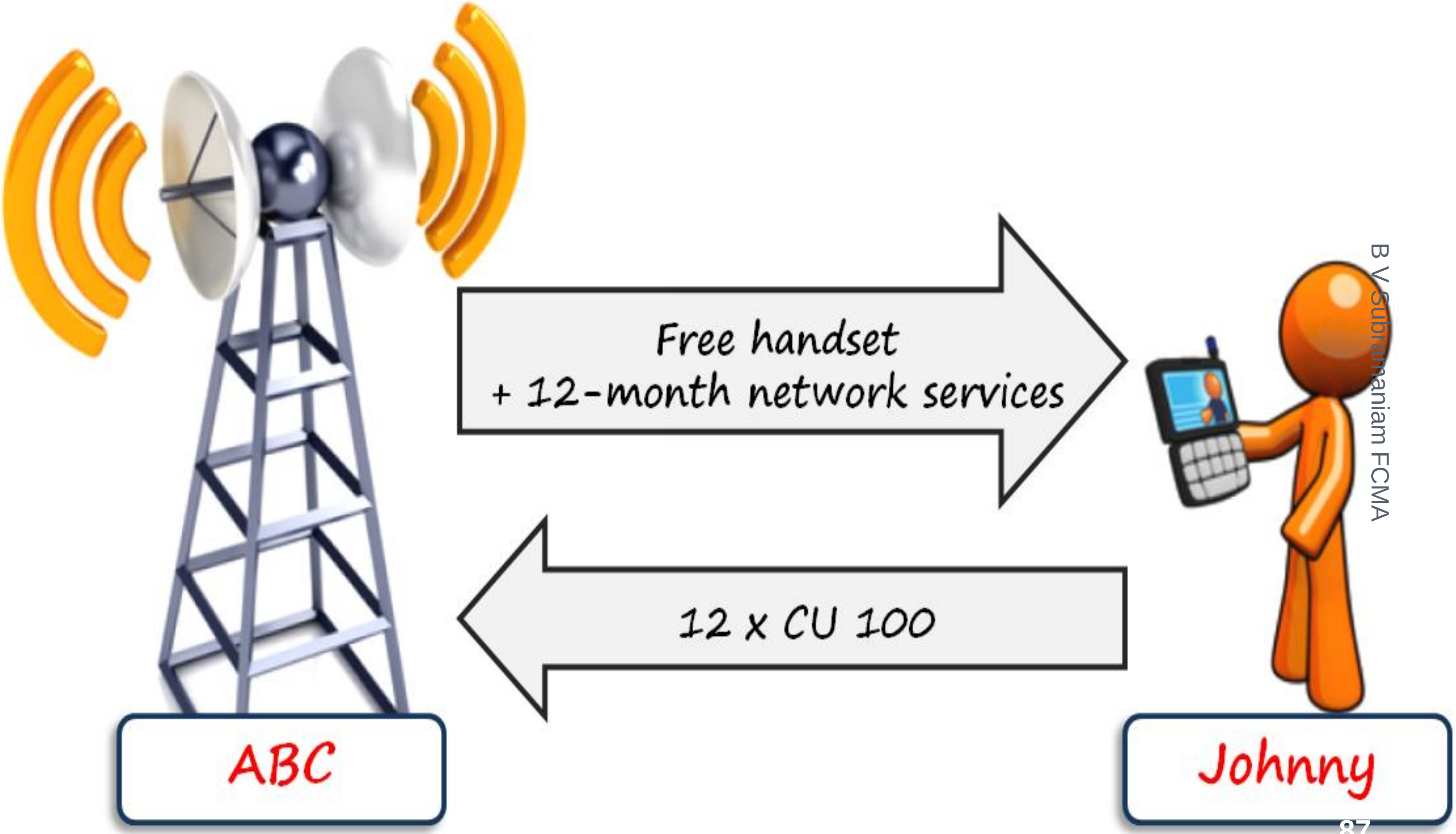
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation


IFRS 15: 5-STEP MODEL
START HERE =>
STEP 1
1. Identify contract
STEP 2
2. Identify performance obligations (PO)
STEP 3
3. Determine transaction price (TP)
4. Allocate TP to PO
STEP 4
5. Recognize revenue when PO is satisfied
STEP 5

- Under the new model, companies in telecom and software will probably recognize revenue earlier than under older rules.
- Because under **new IFRS 15**, the transaction price must be allocated to the individual performance obligations in the contract and recognized when these obligations are delivered or fulfilled.
- ***Under IAS 18***, the revenue is defined as a gross inflow of economic benefits arising from ordinary operating activities of an entity.

EXAMPLE: IAS 18 VS. IFRS 15

- Johnny enters into a 12-month telecom plan with the local mobile operator ABC. The terms of plan are as follows:
  - Johnny’s monthly fixed fee is CU 100.
  - Johnny receives a free handset at the inception of the plan.
- ABC sells the same handsets for CU 300 and the same monthly prepayment plans without handset for CU 80/month.
- How should ABC recognize the revenues from this plan in line with IAS 18 and IFRS 15?


Free handset
+ 12-month network services
12 x CU 100
ABC
Johnny

Revenue under IFRS 15

- Under new rules in IFRS 15,

ABC needs to ***identify the contract first (step 1)***, which is obvious here as there's a clear 12-month plan with Johnny.

(as per example)

- Then, ABC needs to ***identify all performance obligations*** from the contract with Johnny (***step 2*** in a 5-step model):
  - Obligation to deliver a handset
  - Obligation to deliver network services over 1 year

- The transaction price (step 3) is CU 1 200, calculated as monthly fee of CU 100 times 12 months.

- Now, ABC needs to allocate that transaction price of CU 1 200 to individual performance obligations under the contract based on their relative stand-alone selling prices (or their estimates) – this is step 4.

- let’s do it in the following table,

Performance obligation	***Stand-alone selling price***	***% on total***	***Revenue (=relative selling price = 1 200*%)***
Handset	300.00	23.8%	285.60
Network services	960.00 (=80*12)	76.2%	914.40
Total	**1 260.00**	**100.0%**	1200.00

- The step 5 is to recognize the revenue when ABC satisfies the performance obligations.
- Therefore:
  - When ABC gives a handset to Johnny, it needs to recognize the revenue of CU 285.60;
  - When ABC provides network services to Johnny, it needs to recognize the total revenue of CU 914.40. It’s practical to do it once per month as the billing happens.

- The journal entries are summarized in the following table:

Description	Amount	Debit	Credit	When
Sale of handset	285.60	FP – Unbilled revenue	P/L – Revenue from sale of goods	When handset is given to Johnny
Network services	100.00 (= monthly billing to Johnny)	FP – Receivable to Johnny		When network services are provided; on a monthly basis according to contract with Johnny
	76.20 (=914.40/12)		P/L – Revenue from network services	
	23.80 (=285.60/12)		FP – Unbilled revenue	

- So Johnny effectively pays not only for network services, but also for his handset.

- The biggest impact of the new standard is that the companies will report profits in a different way and profit reporting patterns will change.

- In our telecom example, ABC reported loss in the beginning of the contract and then steady profits under IAS 18, because they recognized the revenue in line with the invoicing to customers.

- Under IFRS 15, ABC’s reported profits are the same in total, but their pattern over time is different.

- Some contracts surpass one accounting period.

They are long-term and reporting revenues in incorrect accounting periods might cause wrong taxation, different reporting to stock exchange and other things, too.

Let's say that contract started on 1 July 20X1 and ABC's financial year end is 31 December 20X1.

Just look how much profits ABC reports from the same contract with Johnny under IAS 18 and IFRS 15 in the year 20X1

Performance obligation	Under IAS 18	Under IFRS 15
Handset	0.00	285.60
Network services	600.00 (=100*6)	457.20 (=76.2*6)
Total	**600.00**	**742.80**

How to Prepare for IFRS 15

- Go through your contracts and evaluate. If your company has a number of different types of contracts, you need to assess each type separately and decide how to deal with that type in line with IFRS 15.

- Change your accounting system. The implementation of IFRS 15 will cost affected companies significant amount of money for system upgrades, consultants, training the employees and other related activities.

- Go back and restate existing contracts ;

When you apply IFRS 15, you need to apply it as the new rules have always been in place, that is retrospectively.

IFRS 9 Financial Instruments

IFRS 9 Financial Instruments

- The new financial instruments' standard – IFRS 9 was under development for a long time and in July 2014, it was finally completed.

- Its aim is to replace IAS 39 —older standard dealing with financial instruments.

OBJECTIVES

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

- Here, the principal aim is to present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows.

SCOPE

- IFRS 9 makes reference to IAS 39, because it says that IFRS 9 shall be applied to all items within the scope of IAS 39.

- The standard retains a mixed measurement model, with some assets measured at amortized cost and others at fair value.
- The distinction between the two models is based on the business model of each entity and a requirement to assess whether the cash flows of the instrument are only principal and interest.

- The business model approach is fundamental to the standard, and is an attempt to align the accounting with the way in which management uses its assets in its business while also looking at the characteristics of the business.

- A debt instrument generally must be measured at amortized cost if both the 'business model test' and the 'contractual cash flow characteristics test' are satisfied.

- The business model test is whether the objective of the entity's business model is to hold the financial asset to collect the contractual cash flows rather than have the objective to sell the instrument before its contractual maturity to realize its fair value changes.

- The contractual cash flow characteristics test is whether the contractual terms of the financial asset give rise, on specified dates, to cash flows that are solely payments of principal and interest on the principal amount outstanding.

- All recognized financial assets that are in the scope of IAS 39 will be measured at either amortized cost or fair value.
- A debt instrument, such as a loan receivable, that is held within a business model whose objective is to collect the contractual cash flows and has contractual cash flows that are solely payments of principal and interest generally must be measured at amortized cost.

- All other debt instruments must be measured at fair value through profit or loss (FVTPL).

- An investment in a convertible loan note would not qualify for measurement at amortized cost because of the inclusion of the conversion option, which is not deemed to represent payments of principal and interest.

- This criterion will permit amortized cost measurement when the cash flows on a loan are entirely fixed, such as a fixed interest rate loan or where interest is floating or a combination of fixed and floating interest rates.

- IFRS 9 contains an option to classify financial assets that meet the amortized cost criteria as at FVTPL if doing so eliminates or reduces an accounting mismatch.

- An example of this may be where an entity holds a fixed rate loan receivable that it hedges with an interest rate swap that changes the fixed rates for floating rates.

- Measuring the loan asset at amortized cost would create a measurement mismatch, as the interest rate swap would be held at FVTPL.
- In this case, the loan receivable could be designated at FVTPL under the fair value option to reduce the accounting mismatch that arises from measuring the loan at amortized cost.

- All equity investments within the scope of IFRS 9 are to be measured in the statement of financial position at fair value with the default recognition of gains and losses in profit or loss.
- Only if the equity investment is not held for trading can an irrevocable election be made at initial recognition to measure it at fair value through other comprehensive income (FVTOCI) with only dividend income recognized in profit or loss.
- The amounts recognized in other comprehensive income (OCI) are not recycled to profit or loss on disposal of the investment although they may be reclassified in equity.

- When a reclassification is required it is applied from first day of the first reporting period following the change in business model.
- All derivatives within the scope of IFRS 9 are required to be measured at fair value.
- IFRS 9 does not retain IAS 39's approach to accounting for embedded derivatives.

- Consequently, embedded derivatives that would have been separately accounted for at FVTPL under IAS 39 because they were not closely related to the financial asset host will no longer be separated.

- Instead, the contractual cash flows of the financial asset are assessed as a whole and are measured at FVTPL if any of its cash flows do not represent payments of principal and interest.

- A frequent question is whether IFRS 9 will result in more financial assets being measured at fair value.
- It will depend on the circumstances of each entity in terms of the way it manages the instruments it holds, the nature of those instruments and the classification elections it makes.
- One of the most significant changes will be the ability to measure some debt instruments, such as investments in government and corporate bonds, at amortized cost.
- Many available for sale debt instruments measured at fair value will qualify for amortized cost accounting

- IFRS 9 does not address impairment.

  However as IFRS 9 eliminates the available for sale (AFS) category, it also eliminates the AFS impairment rules.

- Under IAS 39 measuring impairment losses on debt securities in illiquid markets based on fair value often led to reporting an impairment loss that exceeded the credit loss management expected.

- Additionally, impairment losses on AFS equity investments cannot be reversed under IAS 39 if the fair value of the investment increases.
- Under IFRS 9, debt securities that qualify for the amortized cost model are measured under that model and declines in equity investments measured at FVTPL are recognized in profit or loss and reversed through profit or loss if the fair value increases.

FINANCIAL ASSET

- A Financial asset is an asset that is:
- Cash
- Equity Instruments of other enterprise, eg. Investment in ordinary shares.
- A contractual right to receive cash, or to exchange financial assets or liabilities with other enterprise under conditions that are potentially favorable to the enterprise.

FINANCIAL LIABILITY

- Financial Liability is a contractual obligation to deliver cash or to exchange financial assets or financial liabilities with another enterprise under conditions which are potentially unfavorable to the enterprise.

- It also includes contracts which may be settled in the enterprise’s equity shares. Eg. Convertible debenture, convertible Preference share.

Recognition and De recognition

- Initial recognition;
- IFRS 9 requires recognizing a financial asset or a financial liability in the statement of financial position when the entity becomes a party to the contractual provisions of the instrument.

DERECOGNITION OF FINANCIAL ASSETS

- Standard IFRS 9 provides extensive guidance on derecognition of a financial asset.

Before deciding on derecognition, an entity must determine whether derecognition is related to:

(a) a financial asset (or a group of similar financial assets) in its entirety, or

(b) a part of a financial asset (or a part of a group of similar financial assets).

- The part must fulfill the following conditions,

- the part comprises only specifically defined cash flows from a financial asset (or group)
- the part comprises only a fully proportionate (pro rata) share of the cash flows from a financial asset (or group)
- the part comprises only a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (or group).

- An entity shall derecognize the financial asset when,

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

DERECOGNITION OF A FINANCIAL LIABILITY

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

CLASSIFICATION OF FINANCIAL INSTRUMENTS

- **Classification of financial assets**

- IFRS 9 classifies financial assets into 2 main categories:

- Financial asset subsequently measured at amortized cost;

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

(a) the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows, and

(b) the only contractual cash flows are payments of principal and related interest on specified dates.

- Financial assets subsequently measured at fair value**:**

  all financial assets not falling to the above category.

- **Classification of financial liabilities;**
- IFRS 9 classifies financial liabilities as follows;

- Financial liabilities at fair value through profit or loss:

  These financial liabilities are subsequently measured at fair value and here, all derivatives belong

- Other financial liabilities measured at amortized cost using the effective interest method.

IMPAIRMENT OF FINANCIAL ASSETS

- New rules about the impairment of financial assets were added only in July 2014.
- IFRS 9 requires entities to estimate and account for expected credit losses for all relevant financial assets, starting from when they first acquire a financial instrument.

EMBEDDED DERIVATIVES

- **Embedded derivative** is simply a component of a hybrid instrument that also includes a non-derivative host contract.
- IFRS 9 says that a derivative that is attached to the financial instrument, but is contractually transferable independently of that instrument or has a different counterparty, is not embedded derivative.

Instead, it is a separate financial instrument.

- According to IFRS 9, you should look whether the host contract is a financial asset within the scope of IFRS 9 or not.
- If the host is within the scope of IFRS 9, then the whole hybrid contract shall be measured as one and not be separated.
- Under IAS 39, if you have a host contract that is a financial asset with some embedded derivative whose economic characteristics are not closely related, these 2 would have been separated.

- If the host contract is outside the scope of IFRS 9 (some non-financial asset), then IFRS 9 requires separation of embedded derivative from the host contract when the following conditions are fulfilled,

(a) the economic risks and characteristics of the embedded derivative are not closely related to the economic risks and characteristics of the host contract

(b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative.

(c) the hybrid instrument is not measured at fair value with changes in fair value recognized in the profit or loss.

- Separation means that you account for embedded derivative separately in line with IFRS 9 and the host contract in line with other appropriate standard.
- If an entity is not able to do this, then the whole contract must be accounted for as a financial asset at fair value through profit or loss.

MEASUREMENT OF FINANCIAL INSTRUMENTS

- Initial measurement;

Financial asset or financial liability shall be initially measured at its fair value.

When financial asset or financial liability are NOT measured at fair value through profit or loss, then directly attributable transaction costs shall be included in the initial measurement.

- Subsequent measurement;

- IFRS 9 reduced the number of categories of financial assets and simplified the matter, also their subsequent measurement is simple.

- **Financial assets** shall be subsequently measured either at fair value or at amortized cost.
- **Financial liabilities** held for trading are measured at fair value through profit or loss, and all other financial liabilities are measured at amortized cost unless the fair value option is applied.

HEDGE ACCOUNTING

- A hedge accounting means designating one or more hedging instruments so that their change in fair value offsets the change in fair value or the change in cash flows of a hedged item. When you apply hedge accounting, you show to the readers of your financial statements:
- That your company faces certain risks.
- That you perform certain risk management strategies in order to mitigate those risks.
- How effective these strategies are.

WHAT DO IAS 39 AND IFRS 9 HAVE IN COMMON

- Optional;

  A hedge accounting is an option, not an obligation – both in line with IAS 39 and IFRS 9.

- Terminology;

  Both standards use the same most important terms: hedged item, hedging instrument, fair value hedge, cash flow hedge, hedge effectiveness, etc.

- Hedge documentation;

  Both IAS 39 and IFRS 9 require hedge documentation in order to qualify for a hedge accounting.

- Categories;

  Both IAS 39 and IFRS 9 arrange the hedge accounting for the same categories: fair value hedge, cash flow hedge and net investment hedge.

- Hedge ineffectiveness;

  Both IAS 39 and IFRS 9 require accounting for any hedge ineffectiveness in profit or loss.

- No written options;

  You cannot use written options as a hedging instrument in line with both IAS 39 and IFRS 9.

DIFFERENCES IN HEDGE ACCOUNTING BETWEEN IAS 39 AND IFRS 9

(a) Under older rules in IAS 39, companies did not have much choices of hedging instruments. Either they took some derivatives, or alternatively they could take also non-derivative financial asset or liability in a hedge of a foreign currency risk.

- IFRS 9 allows you to use broader range of hedging instruments, so now you can use any non-derivative financial asset or liability measured at fair value through profit or loss.

(b) With regard to non-financial items IAS 39 allows hedging only a non-financial item in its entirety and not just some risk component of it.

- IFRS 9 allows hedging a risk component of a non-financial item if that component is separately identifiable and measurable.

IFRS 13

Fair Value Measurement

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MEANING

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

OBJECTIVES OF IFRS 13

- To define fair value;
- To set out in a single IFRS a framework for measuring fair value; and
- To require disclosures about fair value measurements.

- Fair value is a market-based measurement, not an entity-specific measurement.

It means that an entity:

(a) shall look at how the market participants would

look at the asset or liability under measurement.

(b) shall not take own approach (e.g. use) into account.

When an entity performs the fair value measurement, it must determine all of the following:

- the particular asset or liability that is the subject of the measurement (consistently with its unit of account)
- for a non-financial asset, the valuation premise that is appropriate for the measurement. (consistently with its highest and best use)
- the principal (or most advantageous) market for the asset or liability

- The valuation techniques appropriate for the measurement, considering;

  - The availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability; and

  - The level of the fair value hierarchy within which the inputs are categorized.

ASSET OR LIABILITY

- The asset or liability measured at fair value might be either:
- a stand-alone (individual) asset or liability (for example, a share or a pizza oven)
- a group of assets, a group of liabilities, or a group of assets and liabilities (for example, controlling interest represented by more than 50% of shares in some company, or cash-generating unit being pizzeria).

- When measuring fair value, an entity takes into account the **characteristics** of the asset or liability that a market participant would take into account when pricing the asset or liability at measurement date.
- These characteristics include for example:
- the ***condition and location*** of the asset
- the ***restrictions*** on the sale or use of the asset.

TRANSACTION

- A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants at the measurement date under current market conditions.

ORDERLY TRANSACTION

- The transaction is **orderly** when 2 key components are present:
  - There is adequate market exposure in order to provide market participants the ability to obtain knowledge and awareness of the asset or liability necessary for a market-based exchange
  - Market participants are motivated to transact for the asset or liability (not forced).

MARKET PARTICIPANTS

- Market participants are buyers and sellers in the principal or the most advantageous market for the asset or liability, with the following characteristics:
- independent
- knowledgeable
- able to enter into transaction
- willing to enter into transaction.

PRINCIPAL VS. THE MOST ADVANTAGEOUS MARKET

- A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:
- in the principal market for the asset or liability; or
- in the absence of a principal market, in the most advantageous market for the asset or liability.

PRINCIPAL MARKET

- Principal market is the market with the greatest volume and level of activity for the asset or liability.

- Different entities can have different principal markets, as the access of an entity to some market can be restricted.

THE MOST ADVANTAGEOUS MARKET

- The most advantageous market is the market that maximizes the amount that would be received to sell the asset or minimizes the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs.

APPLICATION TO NON-FINANCIAL ASSETS

- Fair value of a non-financial asset shall be measured based on its highest and best use from a market participant's perspective.

- The highest and best use takes into account the use of the asset that is,

- **physically possible** – it takes into account the physical characteristics that market participants would consider (for example, property location or size);

- **legally permissible** – it takes into account the legal restrictions on use of the asset that market participants would consider (for example, zoning regulations); or

- **financially feasible** – it takes into account whether a use of the asset generates adequate income or cash flows to produce an investment return that market participants would require.

This should incorporate the costs of converting the asset to that use.

- The highest and best use of a non-financial asset may be on a ***stand-alone basis*** or may be achieved in combination with other assets and/or liabilities (as a ***group***).

APPLICATION TO FINANCIAL LIABILITIES AND OWN EQUITY INSTRUMENTS

- A fair value measurement of a financial or non-financial liability or an entity’s own equity instruments assumes it is ***transferred*** to a market participant at the measurement date, without settlement, extinguishment, or cancellation at the measurement date.

- In the first instance, an entity shall set the fair value of the liability or equity instrument by the reference to the quoted market price of the identical instrument, if available.

- If the quoted price of identical instrument is not available, then the fair value measurement depends on whether the liability or equity instrument is held by other parties as assets or not:

- If the liability or equity instrument is held by other party as an asset, then

  - If there is the quoted price in an active market for the identical instrument held by another party, then use it (adjustments are possible for the factors specific for the asset, but not for the liability/equity instrument)

  - If there is no quoted price in an active market for the identical instrument held by another party, then use other observable inputs or another valuation technique

- If the liability or equity instrument is not held by other party as an asset,
- then use a valuation technique from the perspective of market participant.

NON-PERFORMANCE RISK

- The fair value of a liability reflects the effect of non-performance risk – the risk that an entity will not fulfill its obligation.
- Non-performance risk includes, but is not limited to an entity's own credit risk.

TRANSFER RESTRICTIONS

- An entity shall ***not include*** a separate input or an adjustment to other inputs relating to the potential restriction preventing the transfer of the item to somebody else.

DEMAND FEATURE

- The fair value of a liability with a demand feature is not less than the amount payable on demand discounted from the first date that the amount could be required to be paid.

FINANCIAL ASSETS AND FINANCIAL LIABILITIES WITH OFFSETTING POSITIONS

- IFRS 13 requires a market-based measurement, not for an entity-based measurement.

However, there is an exception to this rule:

If an entity manages a group of financial assets and financial liabilities on the basis of its NET exposure to market risks or counterparty risks, an entity can opt to measure the fair value of that group on the net basis.

- The price that would be received to sell a net long position (asset) for particular risk exposure, or

- The price that would be paid to transfer a net short position (liability) for particular risk exposure.

- This is an option and an entity does not necessarily need to follow it. In order to apply this exception, an entity must fulfill the following conditions:

- It must manage the group of financial assets/liabilities based on its net exposure to market/credit risk according to its documented risk management or investment strategy,

- It provides information on that basis about the group of financial assets/liabilities to key management personnel,

- It measures those financial assets and liabilities at fair value in the statement of financial position at the end of each reporting period (so not at amortized cost, or other measurement basis).

- When an entity acquires an asset or assumes a liability, the price paid/received or the transaction price is an entry price.

- However, IFRS 13 defines fair value as the price that would be received to sell the asset or paid to transfer the liability and that’s an exit price.

- there are some situations when transaction price is not necessarily the same as exit price or fair value:

- The transaction happens between related parties

- The transaction takes place under duress or the seller is forced to accept the price in the transaction

- The unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value

- The market in which the transaction takes place is different from principal or the most advantageous market.

- If the transaction price differs from the fair value, then an entity shall recognize the resulting gain or loss (“Day 1 profit“) to profit or loss unless another IFRS standard specifies other treatment.

VALUATION TECHNIQUES

When determining fair value, an entity shall use valuation techniques:

- Appropriate in the circumstances
- For which sufficient data are available to measure fair value
- Maximizing the use of relevant observable inputs
- Minimizing the use of unobservable inputs.

- Valuation techniques used to measure fair value shall be applied consistently.

- However, an entity can change the valuation technique or its application, if the change results in equally or more representative of fair value in the circumstances.

VALUATION APPROACHES

- IFRS 13 allows 3 valuation approaches:

- Market approach:

  Uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets, liabilities, or a group of assets and liabilities, such as a business

- Cost approach:

Reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

- Income approach:

Converts future amounts (e.g. cash flows or income and expenses) to a single current (i.e. discounted) amount.

The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.

FAIR VALUE HIERARCHY

- IFRS 13 introduces a fair value hierarchy that categorizes inputs to valuation techniques into 3 level
- An entity must maximize the use of Level 1 inputs and minimize the use of Level 3 inputs.

- **Level 1** inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

- **Level 2** inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

- **Level 3** inputs are unobservable inputs for the asset or liability. An entity shall use Level 3 inputs to measure fair value only when relevant observable inputs are not available.

DISCLOSURE

- IFRS 13 requires extensive disclosure of sufficient information to asses:
- Valuation techniques and inputs used to develop fair value measurement for both recurring and non-recurring measurements;
- The effect of measurements on profit or loss or other comprehensive income for recurring fair value measurements using significant Level 3 inputs.

- Recurring fair value measurements are those presented in the statement of financial position at the end of each reporting period (for example, financial instruments).

- Non-recurring fair value measurements are those presented in the statement of financial position in particular circumstances (for example, an asset held for sale in line with IFRS 5).

IAS 36 Impairment

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OBJECTIVE

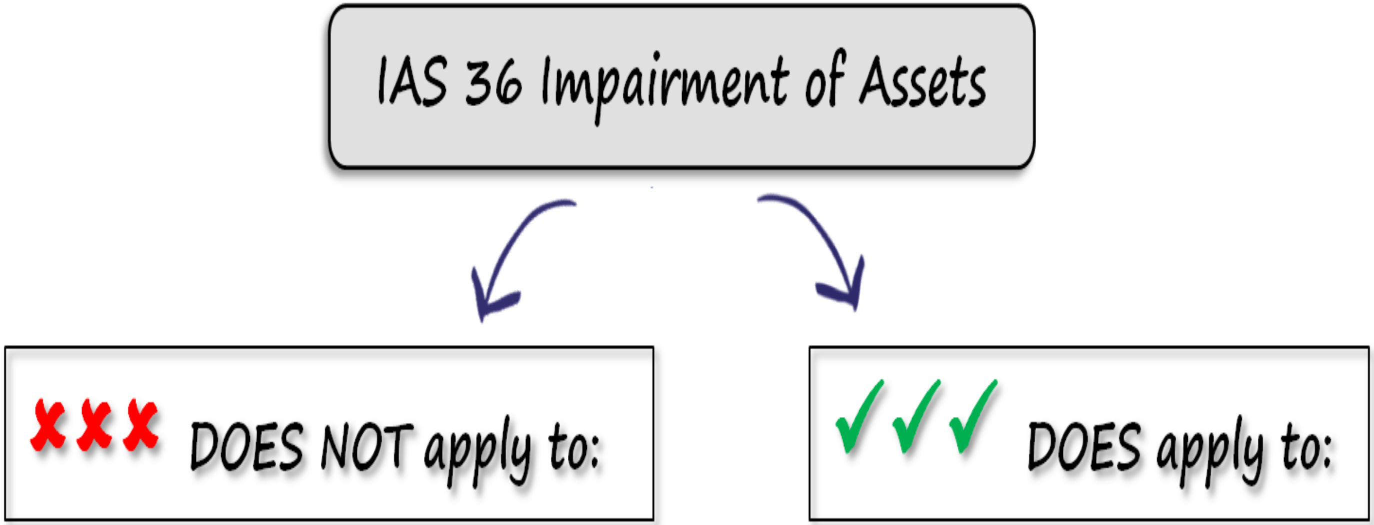
- IAS 36 Impairment of assets is to make sure that entity’s assets are carried at no more than their recoverable amount.

- The Standard also defines when an asset is impaired,

  how to recognize an impairment loss,

  when an entity should reverse this loss and

  what information related to impairment should be disclosed in the financial statements.



IAS 36 Impairment of Assets

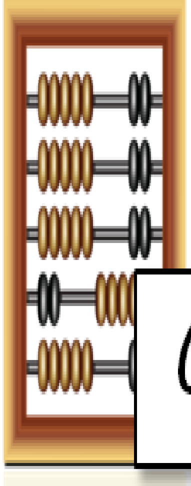
✘✘✘ DOES NOT apply to:

✓✓✓ DOES apply to:

- ✘ Inventories (IAS 2)
- ✘ Financial assets (IFRS 9)
- ✘ Deferred tax (IAS 12)
- ✘ Employee benefits (IAS 19)
- ✘ Construction contracts (IAS 11)
- ✘ Investment property at FV (IAS 40)
- ✘ Agricultural assets at FV (IAS 41)
- ✘ Insurance contracts (IFRS 4)
- ✘ Non-current assets held for sale (IFRS 5)

- ✓ Land, building, machinery (IAS 16)
- ✓ Investment property at cost (IAS 40)
- ✓ Intangible assets (IAS 38)
- ✓ Goodwill
- ✓ Subsidiaries, associates, JV at cost
- ✓ Assets at revalued amounts

Asset is impaired when



Carrying amount > Recoverable amount

(accounting records)

(FV-cost to sell / value in use)

IDENTIFY AN ASSET THAT MIGHT BE IMPAIRED

- If you want to be compliant with IAS 36, you have to perform the following procedures:

- A whether there is any indication that an asset might be impaired at the end of each reporting period.

- If you hold some

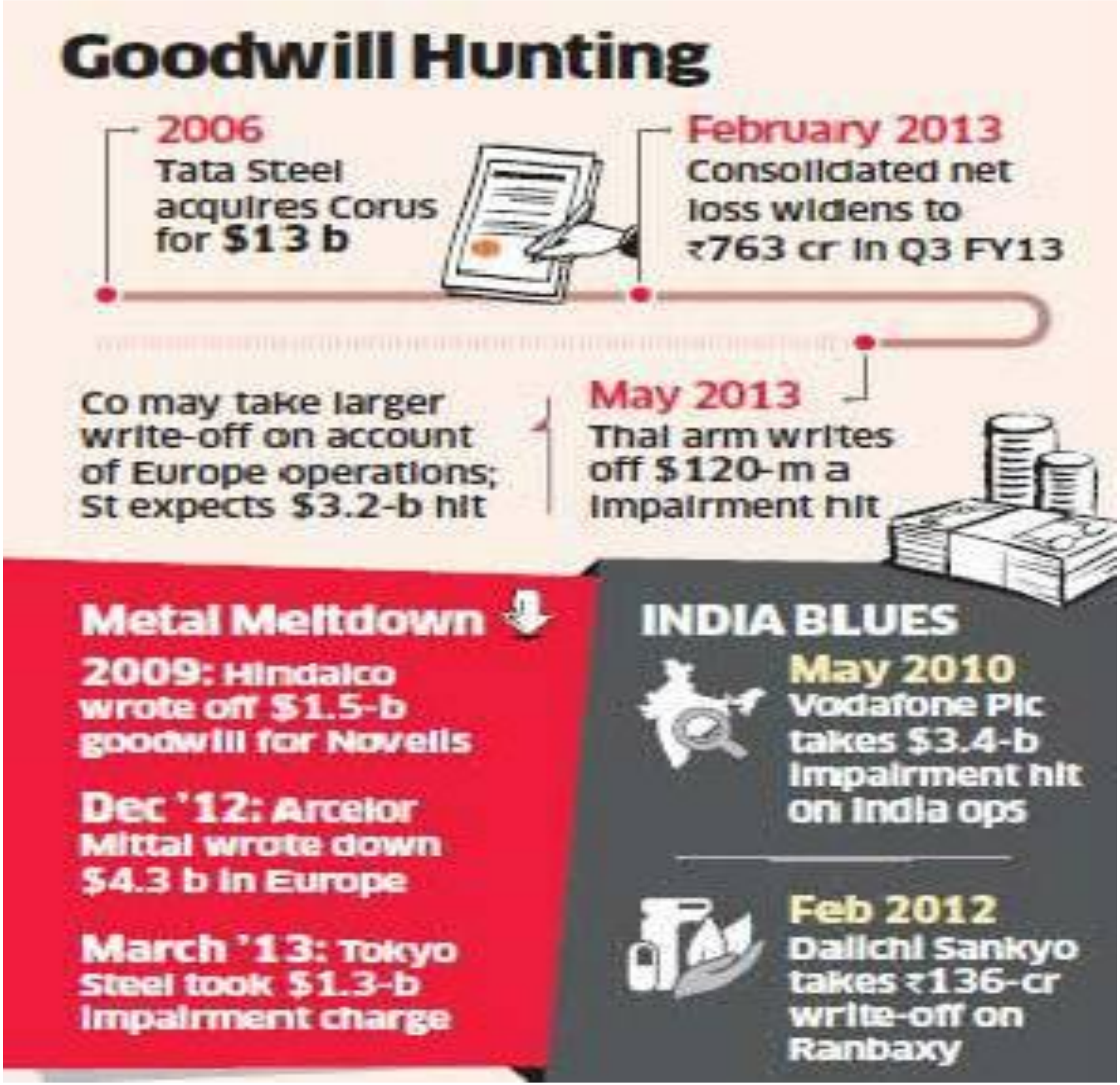
  Intangible asset with an indefinite useful life (such as trademarks) or

  Intangible asset not yet available for use, then you need to test these assets for impairment annually.

- If your accounting records show some *goodwill* acquired in a business combination, you also need to test this goodwill for impairment annually.

TATA STEEL ANNOUNCES $1.6 BN GOODWILL IMPAIRMENT CHARGE; MOVE TO AID FUND RAISING IN US MARKETS

- Tata Group flagship Tata Steel has announced a $1.6-billion goodwill impairment charge for the loss of value of Tata Steel Europe (TSE), formerly Corus, and other overseas assets in Thailand and South Africa in the wake of a slump in demand across major overseas markets, particularly Europe. The final figures will be part of the annual numbers due on May 23, when the company announces its Q4 and annual results.



Goodwill Hunting

2006
Tata Steel acquires Corus for $13 b

February 2013
Consolidated net loss widens to ₹763 cr in Q3 FY13

May 2013
Thai arm writes off $120-m a impairment hit

Co may take larger write-off on account of Europe operations; St expects $3.2-b hit

Metal Meltdown

2009: Hindalco wrote off $1.5-b goodwill for Novelis

Dec '12: Arcelor Mittal wrote down $4.3 b in Europe

March '13: Tokyo Steel took $1.3-b impairment charge

INDIA BLUES

May 2010
Vodafone Plc takes $3.4-b impairment hit on India ops

Feb 2012
Daiichi Sankyo takes ₹136-cr write-off on Ranbaxy

Vedanta posts Rs 18,718-cr Q4 loss on Cairn India write-off

- Vedanta reported a Rs 18,718-crore loss for the fourth quarter of FY15 on account of a massive impairment charge at its oil and gas business arm, Cairn India, caused by a sharp fall in crude prices. The non-cash impairment charge of acquisition goodwill (about Rs 20,000 crore, or around $ 3 billion) is possibly the biggest such write-off by an Indian company ever.

INDICATIONS OF IMPAIRMENT

- External sources of information;

i. Asset's value has declined during the period significantly more than would be expected as a result of the passage of time or normal use.

ii. Significant changes with an adverse effect on the entity in the technological, market, in which the entity operates or in the market to which an asset is dedicated.

iii. The carrying amount of the net assets of the entity is higher than its market capitalization.

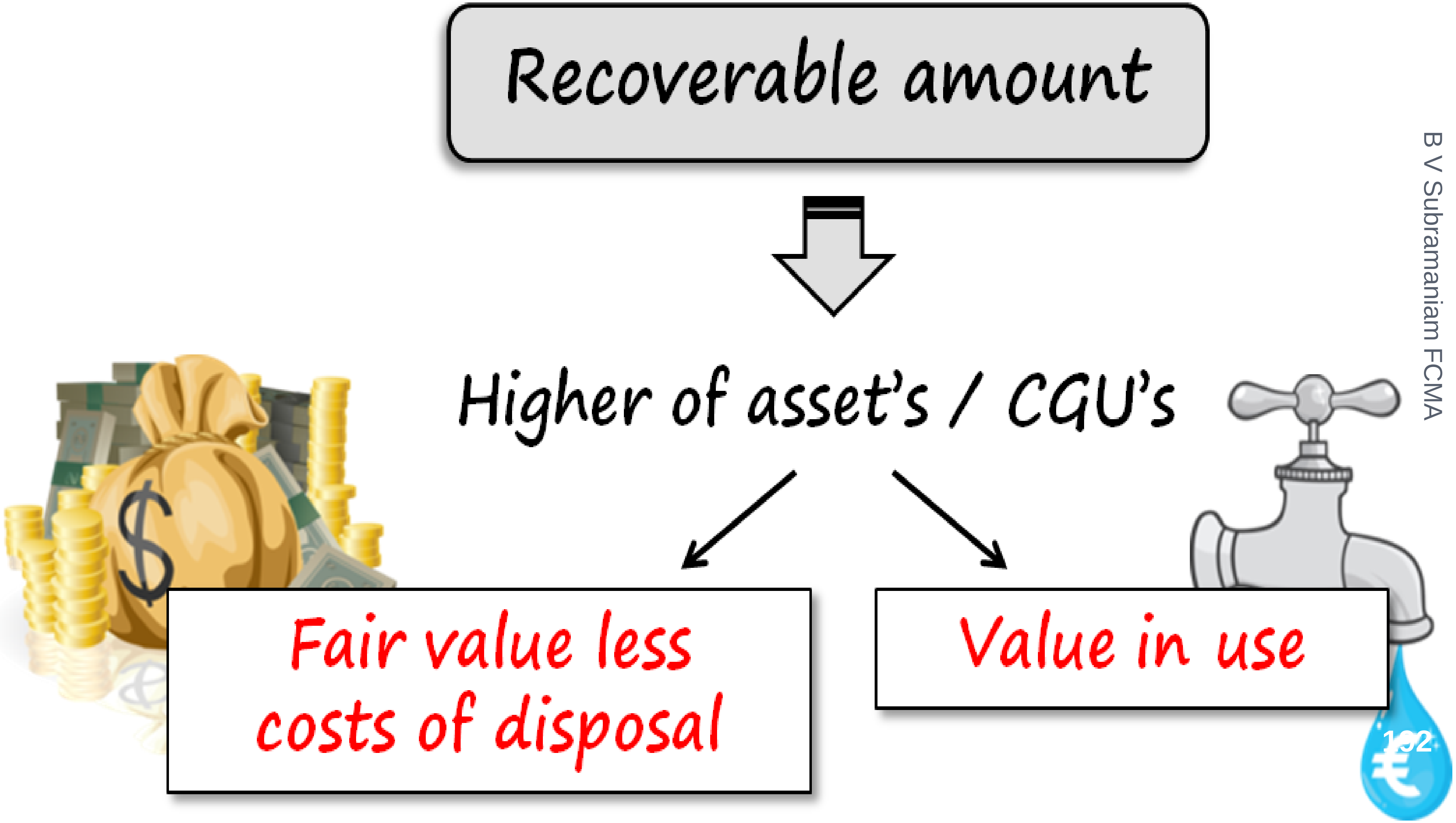
- Internal sources of information;

i. Obsolescence or physical damage of an asset.

ii. Significant changes with an adverse effect on the entity related to the use of an asset

iii. Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

MEASURE RECOVERABLE AMOUNT



Recoverable amount

Higher of asset's / CGU's

Fair value less costs of disposal

Value in use

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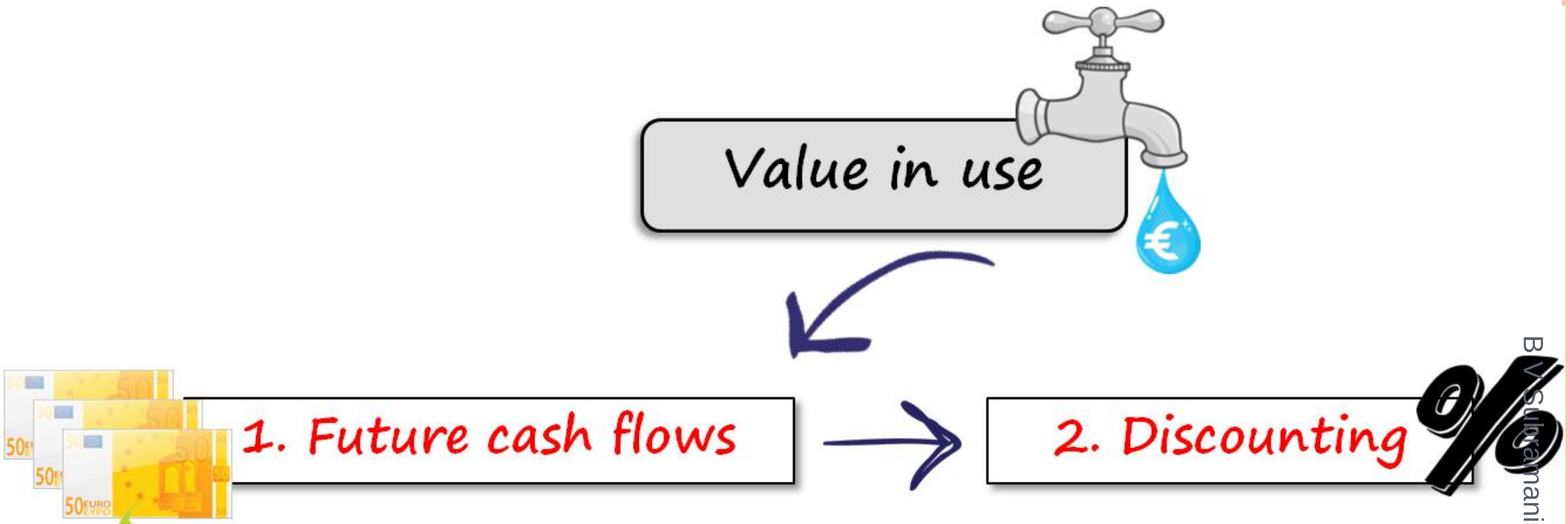
VALUE IN USE

- Value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.



Value in use

1. Future cash flows

2. Discounting

Variations

Uncertainty

Other factors

Year	Future cash flow	Discount factor at 10%	Present value
1	3 000	0,909	2 727
2	2 800	0,826	2 314
3	2 500	0,751	1 878
4	2 000	0,683	1 366
5	1 200	0,621	745
Σ	11 500		9 031

Value in use

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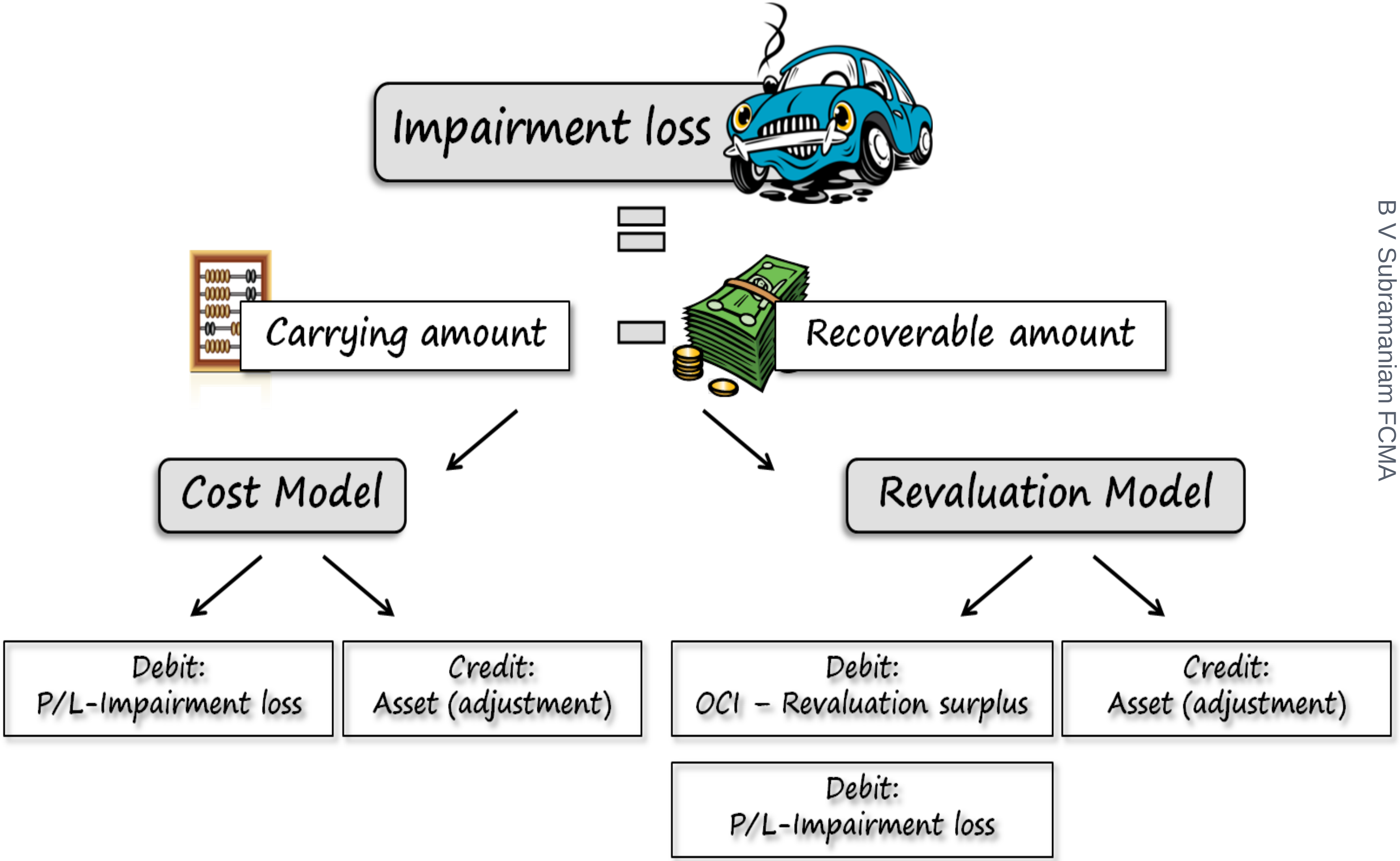

Impairment loss

=

Carrying amount − Recoverable amount

Cost Model

Debit:
P/L-Impairment loss

Credit:
Asset (adjustment)

Revaluation Model

Debit:
OCI – Revaluation surplus

Credit:
Asset (adjustment)

Debit:
P/L-Impairment loss

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GOODWILL

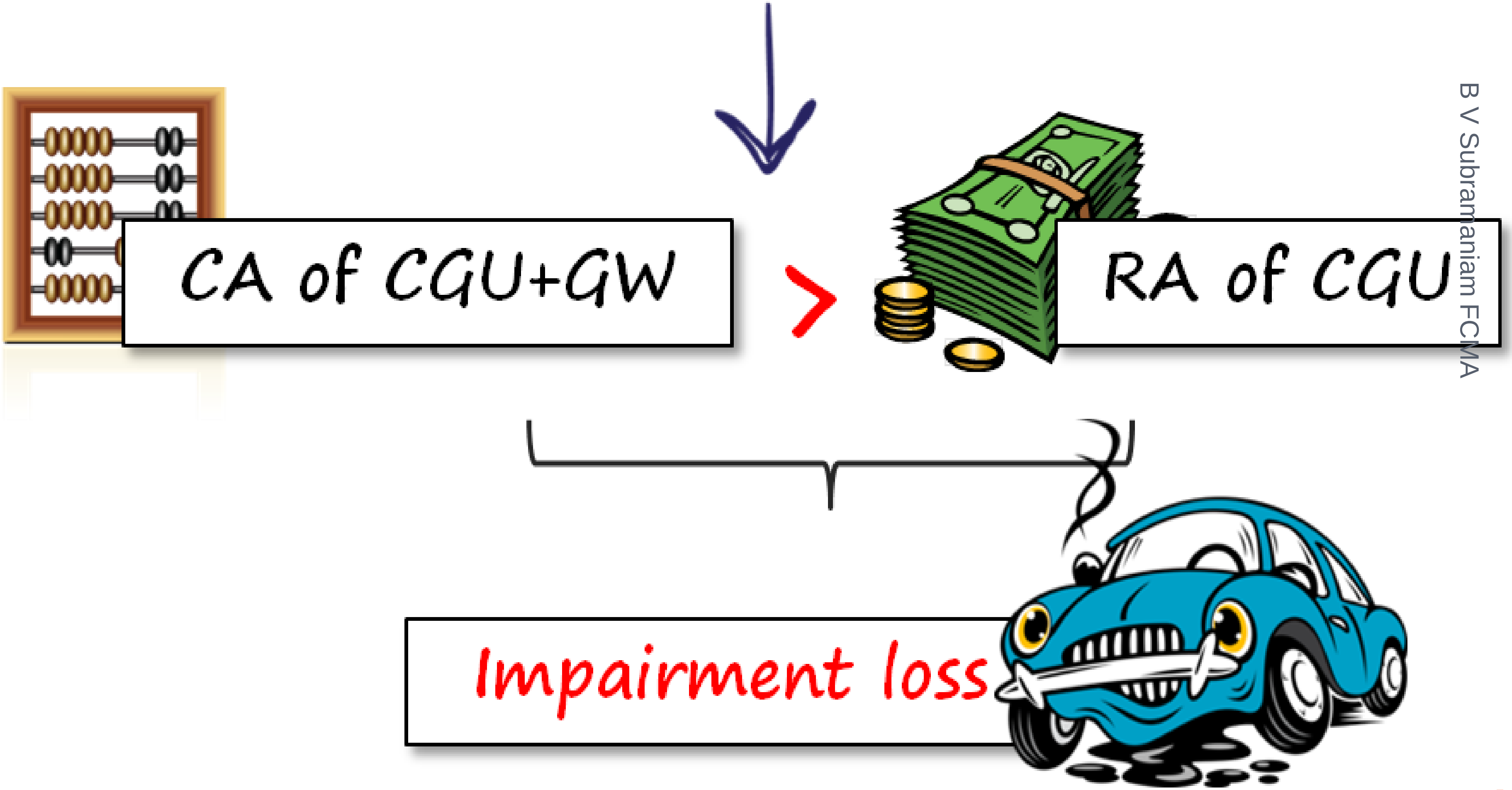
- Goodwill should be tested for impairment on an annual basis.

- A cash-generating unit (CGU) with allocated goodwill shall be tested for impairment at least ***annually***. In this case testing means to compare:

- The carrying amount of CGU including the goodwill, and

- The recoverable amount of that CGU.

Testing of CGU with goodwill:



CA of CGU+GW > RA of CGU

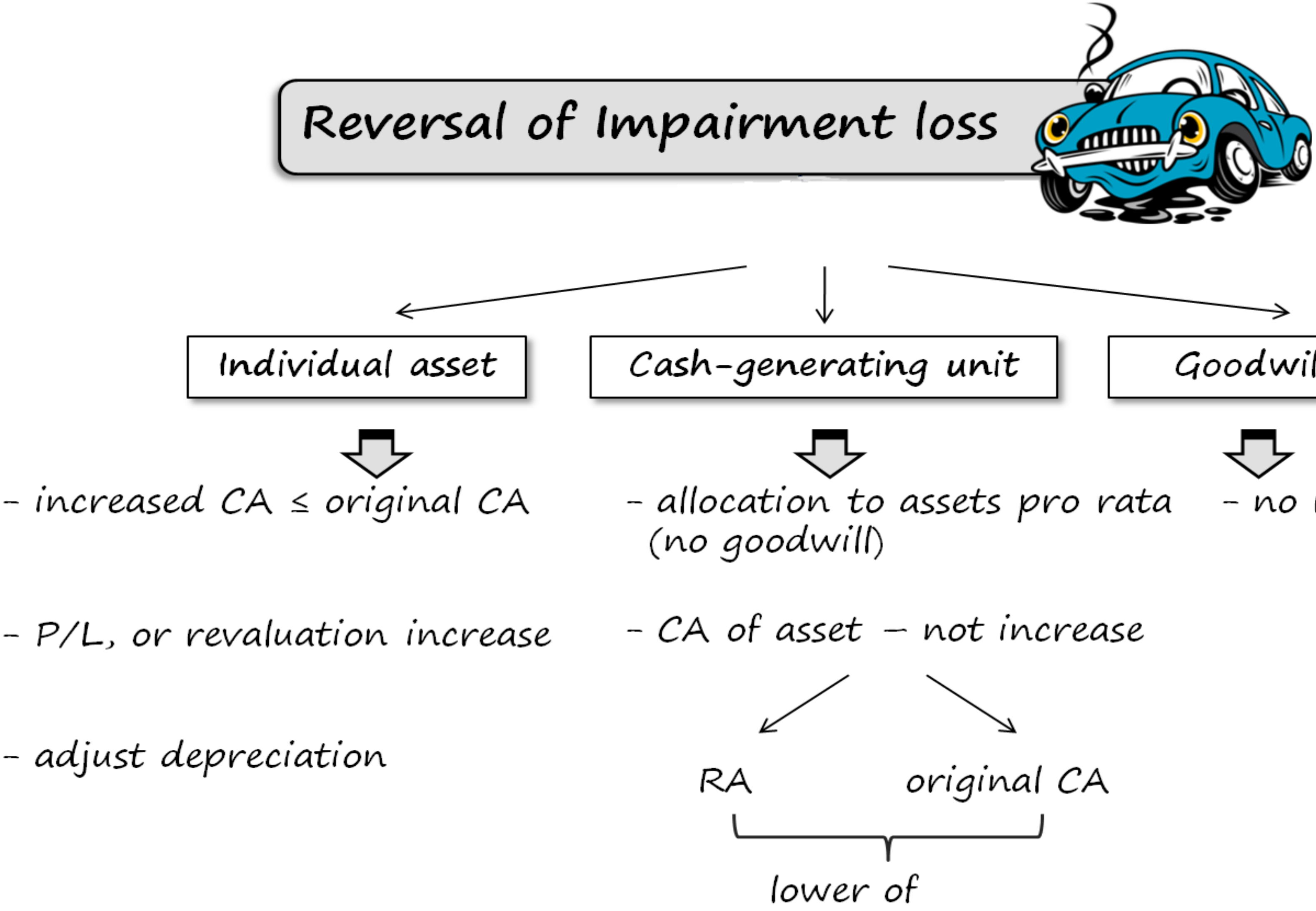
Impairment loss

REVERSAL OF IMPAIRMENT LOSS

- You need to assess at the end of each reporting period whether there is any indication that an impairment loss recognized in prior periods for an asset (other than goodwill) may no longer exist or may have decreased.
- Assess the same set of indications from external and internal sources than when assessing the existence of impairment, just from the other side.

- You can reverse an impairment loss only when there is a change in the estimates used to determine the asset’s recoverable amount.

- It means that you cannot reverse an impairment loss due to passage of time or unwinding the discount.



Reversal of Impairment loss

Individual asset

- increased CA ≤ original CA
- P/L, or revaluation increase
- adjust depreciation

Cash-generating unit

- allocation to assets pro rata (no goodwill)
- CA of asset – not increase

RA

original CA

lower of

Goodwill

- no reversal

NB; RA –Recoverable Amount,
CA – Carrying Amount

ACKNOWLEDGEMENTS

- IFRS box
- IFRS website
- IFRS demystified.com
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- KPMG, E&Y, PWC, DELOITTE, websites
- ACCA Global
- CFA (USA)

- PWC Manual of Accounting 2015

THANK YOU