

2010

International Financial Reporting Standards (IFRSs®)

## A Briefing for Chief Executives, Audit Committees & Boards of Directors





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This booklet was prepared by IFRS Foundation education staff. It has not been approved by the International Accounting Standards Board (IASB). For more information about the IFRS education initiative visit <http://www.ifrs.org/Use+around+the+world/Education/Education.htm>.

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# Introduction

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The text of this collection summarises, at a high level and in non-technical language, the consolidated versions of International Financial Reporting Standards (IFRSs) as issued at 1 July 2010 and required to be applied in 2010 or from a future date.

## The Briefing

These concise and easy to use briefings notes are prepared by the IFRS Foundation education staff for Chief Executives, members of Audit Committees, Boards of Directors and others who want a broad overview of International Financial Reporting Standards (IFRSs) and the business implications of implementing them. They have not been reviewed by the International Accounting Standards Board (IASB).

For the requirements reference must be made to the Standards issued by the IASB at 1 July 2010.

## IFRSs

The objective of the IFRS Foundation is to develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles.

The IASB is the standard-setting operation of the IFRS Foundation. The IASB is selected, overseen and funded by the IFRS Foundation, and it has complete responsibility for all IASB technical matters including the preparation and issuing of IFRSs.

The organisation's objective is achieved primarily by developing and publishing IFRSs and promoting the use of those standards in general purpose financial statements.

IFRSs set out recognition, measurement, presentation and disclosure requirements dealing with transactions and events that are important in general purpose financial statements. IFRSs are based on the *Framework*, which addresses the concepts underlying the information presented in general purpose financial statements. The *Framework* provides the concepts from which to develop principle-based standards.

IFRSs are mandatory pronouncements and comprise International Financial Reporting Standards, International Accounting Standards and Interpretations developed by the IFRS Interpretations Committee (formerly called the International Financial Reporting Interpretations Committee (IFRIC)) or the former Standing Interpretations Committee.

In July 2009 the IASB published a separate standard intended to apply to entities that in many countries are referred to by a variety of terms, including small and medium-sized entities (SMEs), private entities, and non-publicly accountable entities. That standard is the *IFRS for SMEs*.

# Framework for the Preparation and Presentation of Financial Statements

## The Framework

The *Framework* sets out concepts underlying the preparation and presentation of financial statements for external users.

It assists the IASB in the development of standards, and also assists preparers of financial statements in accounting for transactions and events not specifically covered by an existing International Financial Reporting Standard (IFRS).

The *Framework* deals with:

- the objective of financial statements.
- qualities that financial information should have for it to be useful.
- definitions of the elements in financial statements (assets, liabilities, equity, income and expenses), and their recognition and measurement.

The objective of financial statements is to provide information—about the financial position, performance and changes in financial position of an entity—that is useful to investors and other external users in making economic decisions about that entity. In order to be useful, information should be understandable, relevant, reliable and comparable.

The chief elements are assets and liabilities:

- An asset is a resource controlled by an entity as a result of past events. Future economic benefits are expected from this resource.

- Sets out the concepts that underlie financial statements
- It is not an IFRS and it does not override the requirements in IFRSs

- A liability is a present obligation of the entity arising from past events. Settlement of the obligation is expected to result in an outflow of economic benefits from the entity.

Equity is the residual interest in the assets after deducting all liabilities.

Increases in equity (from increases in assets or decreases in liabilities) are either income or contributions from equity participants. Conversely, decreases in equity are either expenses or distributions to equity participants.

An element is recognised in the financial statements if it is probable that there will be future economic benefits flowing to or from the entity, and the cost or value can be reliably measured.

The *Framework* is not an IFRS. It does not define standards for any particular recognition, measurement or disclosure issue, and does not override specific standards or interpretations.

## Business implications

The *Framework* assists preparers of financial statements in accounting for transactions and events not specifically covered by an existing standard or interpretation. In accounting for such transactions and events, management must first look to standards and interpretations applicable to similar and related issues, and then to the *Framework*.

IFRSs and the *Framework* apply to financial statements prepared and presented to external users, not management. Management has access to financial information and the ability to determine the form and content of reports to meet its needs.

# IFRS 1

## First-time Adoption of International Financial Reporting Standards

### The Standard

This standard applies when an entity first adopts International Financial Reporting Standards (IFRSs) in its annual financial statements. The IFRS financial statements must include an explicit and unreserved statement of compliance with IFRSs.

The standard also applies to interim financial reports for part of the period covered by its first IFRS financial statements.

IFRSs include all International Financial Reporting Standards, International Accounting Standards and Interpretations adopted by the International Accounting Standards Board (IASB).

The financial statements will include comparative information for a prior period or periods. The 'date of transition' to IFRSs is the beginning of the earliest period for which full comparative information is presented.

For example, assume an entity presents comparative information for one year and its first IFRS financial statements are for the year ended 31 December 2010. The date of transition will be 1 January 2009 (equivalent to close of business on 31 December 2008).

- Provides a starting point for financial reporting in accordance with IFRSs
- Aims to ensure that the information in an entity's first IFRS financial statements and interim reports is transparent and comparable over all periods presented

The financial statements and comparative information are prepared and presented in compliance with IFRSs as at the end of the reporting period (31 December 2010). The financial statements include only those assets and liabilities that qualify for recognition under IFRSs. The assets and liabilities are measured in accordance with IFRSs. There are some exemptions and exceptions available.

The same accounting policies are used throughout all periods presented in the first IFRS financial statements. The accounting policies may differ from those used immediately before adopting IFRSs (previous GAAP). Changes in the accounting policies do not affect profit.

The financial statements must explain how transition from previous GAAP to IFRSs affected the entity's reported financial position, financial performance and cash flows.

### Business implications

Plan the transition to IFRSs. It will take time, and may require information systems changes and training. The organisational culture may be affected.

Accounting for particular items, such as hedges, will require decisions at or before the transition date (1 January 2009). Are these in the transition plan?

Understand the effect of the adoption of IFRSs on the financial statements.

Understand the effect on contracts and agreements, such as remuneration agreements and covenants in finance agreements.

Communicate the financial statement changes to analysts and the market.

# IFRS 2

## Share-based Payment

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### The Standard

IFRS 2 requires an entity to recognise share-based payment transactions in its financial statements. Equity settled share based payment transactions are generally those in which shares, share options or other equity instruments are granted to employees or other parties in return for goods or services.

Cash settled share based payment transactions are generally those to be settled in cash or other assets. They are share-based because the payment amount is based on the price of the entity's shares.

The share based payment transaction is recognised when the entity obtains the goods or services. Goods or services received are recognised as assets or expenses as appropriate. The transaction is recognised as equity (if equity-settled) or as a liability (if cash-settled).

Equity-settled share-based payment transactions are measured at the fair value of the goods or services received. If the fair value of the goods or services cannot be estimated reliably, the fair value of the equity instruments at grant date is used.

- In the case of employee and similar services it is difficult to estimate reliably the fair value of additional benefits received by the entity, so the fair value of the equity instruments measured at grant date is used instead.

- In other cases there is a rebuttable presumption that the fair value of the goods or services received can be estimated reliably. If not, the fair value of the equity instruments is used instead. If the identifiable consideration received is less than the fair value of the equity instruments granted or the liability incurred, the unidentifiable goods or services are measured by reference to the difference between the fair value of the equity instruments granted (or liability incurred) and the fair value of the goods or services received at grant date. In other cases, the fair value is measured at the date the entity obtains the goods or services.

Cash-settled share-based payments are measured at the fair value of the liability. The liability is remeasured at each balance date and at the date of settlement. Changes in value are recognised in profit or loss.

In some cases, the entity or the other party may choose whether the transaction is settled in cash or by issuing equity instruments. The accounting treatment depends on whether the entity or the counterparty has the choice.

### Business implications

The scope of IFRS 2 is broader than employee share options. It applies to transactions in which shares or other equity instruments are issued in return for goods or services, and those in which the payment amount is based on the price of the entity's shares.

Before this standard was issued, employee share options were often not recognised in the financial statements, or if recognised, were not at fair value. Hence, expenses associated with granting share options were often omitted or understated.

If the terms of a share-based payment transaction are modified or cancelled, the amount of the expense to be recognised may change.

Requires the effects of share-based payment transactions, including employee share options to be recognised in profit or loss and the statement of financial position

# IFRS 3

## Business Combinations

### The Standard

A business combination is a transaction or other event in which a reporting entity (the acquirer) obtains control of one or more businesses (the acquiree).

Control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities.

The acquirer accounts for a business combination by recognising the acquiree's assets and liabilities. The acquirer measures the identifiable assets and liabilities of the acquiree at fair value. However, IFRS 3 contains exceptions to those principles for the recognition and/or measurement of some identifiable assets and liabilities. Particular requirements apply to contingent liabilities, income taxes, employee benefits, indemnification assets, reacquired rights, share-based payment awards and assets held for sale.

Goodwill is measured indirectly as the difference between the consideration transferred in exchange for the acquiree and the acquiree's identifiable assets and liabilities. If that difference is negative because the value of the acquired identifiable assets and liabilities exceeds the consideration transferred, the acquirer recognises a gain from a bargain purchase.

Aims to improve the relevance, reliability and comparability of the information about business combinations and their effects

When calculating goodwill the acquirer measures the consideration transferred at its fair value at the acquisition date. The fair value of the consideration transferred includes the fair value of an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree if specified events occur or conditions are met, for example the meeting of an earnings target (contingent consideration). The acquirer recognises an asset, a liability or equity from contingent consideration. Transaction costs must be accounted for separately from the business combination in accordance with other IFRSs.

If the acquirer acquires less than 100 per cent of the equity interests of another entity in a business combination it recognises non-controlling interest. Non-controlling interest is equity in a subsidiary that is not attributable, directly or indirectly, to the acquirer. The acquirer may choose in each business combination to measure non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets.

An acquirer sometimes obtains control of an acquiree in which it held an equity interest immediately before the business combination. In such a step acquisition, an acquirer measures any equity interest it holds in the acquiree immediately before achieving control at its fair value and recognises the resulting gain or loss, if any, in profit or loss.

continued

# IFRS 3

## Business Combinations continued

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The acquirer accounts subsequently for assets and liabilities that it acquired in a business combination in accordance with other IFRSs. However, IFRS 3 contains requirements for the subsequent measurement of reacquired rights, contingent liabilities and indemnification assets. Contingent consideration is measured subsequently in accordance with other IFRSs. IAS 36 *Impairment of Assets* provides requirements for the subsequent measurement of goodwill. According to those requirements goodwill is not amortised, but is tested for impairment at least annually.

### Business implications

The accounting for business combinations is complex and requires valuation expertise. Even though IFRS 3 does not mandate the use of external advisers, many acquirers will need to seek professional assistance to account for a business combination.

The acquiree's identifiable intangible assets at the acquisition date are recognised separately (ie not included within the amount recognised as goodwill) if their fair value can be measured reliably. Such intangible assets might include in-process research and development that have not been recognised by the acquiree.

The acquirer does not recognise liabilities for future losses or other costs (such as restructuring costs) that it expects to incur as a result of the business combination. Only liabilities and contingent liabilities of the acquiree that exist at the date of the business combination are recognised at fair value.

Transaction costs are usually recognised as expenses (rather than included in goodwill) because they are not part of the business combination.

The recognition and measurement of assets and liabilities in the business combination determines their subsequent accounting. The fair value measurement of the acquiree's identifiable assets might result in higher amortisation and depreciation expenses when compared with the acquiree's expenses before the business combination. Goodwill might subsequently be subject to impairment charges. Changes in the fair value of contingent consideration that is measured at fair value through profit or loss might result in post-combination gains or losses.

IFRS 3 does not apply to:

- the formation of a joint venture.
- the acquisition of an asset or a group of assets that does not constitute a business.
- a combination of entities or businesses under common control.

# IFRS 4

## Insurance Contracts

### The Standard

IFRS 4 specifies accounting for insurance contracts issued by any entity. It also specifies accounting for reinsurance contracts issued or held by an entity. The standard applies to these contracts, irrespective of whether the entity is regulated as an insurer and whether the contract is regarded as an insurance contract for legal purposes.

An **insurance contract** is a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder. **Insurance risk** does not include financial risk (eg risk of changes in market prices or interest rates).

IFRS 4 has been issued as a short-term measure to fill a gap in IFRSs. In the absence of IFRS 4, entities would be required to account for insurance contracts following precedents in other standards, and the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Framework for the Preparation and Presentation of Financial Statements*. For most entities, applying those precedents and the *Framework* could have resulted in substantial changes in accounting.

In most respects, IFRS 4 allows an entity to continue to account for insurance contracts under its previous accounting policies. However, the standard makes some limited improvements to accounting for insurance contracts:

### Specifies financial reporting for insurance contracts issued by any entity

- Catastrophe provisions and equalisation provisions are not permitted. They are not liabilities.
- The adequacy of insurance liabilities must be tested at the end of each reporting period. The liability adequacy test is based on current estimates of future cash flows. Any deficiency is recognised in profit or loss. Furthermore, reinsurance assets are tested for impairment.
- Insurance liabilities are presented without offsetting them against related reinsurance assets.

- Discretionary participation features (as found in with-profits and participating contracts) must be reported as liabilities or as equity (or split into liability and equity components). They may not be reported separately from liabilities and equity.

Some insurance contracts contain both an insurance component and a deposit component. In some cases the entity must 'unbundle' the components and account for them separately. This requirement is particularly relevant for financial reinsurance.

The IFRS restricts accounting policy changes. Any changes in accounting for insurance contracts must result in information that is more relevant and no less reliable or more reliable and no less relevant.

continued

# IFRS 4

## Insurance Contracts continued

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A significant review of accounting for insurance contracts is planned by the IASB, in phase II of its project on insurance contracts. Meanwhile, an entity must not introduce (but may continue) the following practices:

- Measuring insurance liabilities on an undiscounted basis.
- Measuring contractual rights to future investment management fees at an amount that exceeds fair value (as implied by current fees charged in the market).
- Using non-uniform accounting policies for insurance liabilities of subsidiaries.
- Measuring insurance liabilities with excessive prudence.
- Except in unusual cases, using a discount rate that reflects returns on assets held rather than the characteristics of the insurance liabilities.

### Business implications

IFRS 4 applies to insurance contracts issued by any entity, including entities that are not regulated as insurers.

Some contracts that have the legal form of insurance contracts, or are described for other purposes as insurance contracts, may not be insurance contracts as defined in IFRS 4. If these contracts create financial assets and financial liabilities (deposits) IAS 39 *Financial Instruments: Recognition and Measurement* applies.

Financial assets are measured in accordance with IAS 39, often at fair value. To avoid an accounting mismatch, an entity is permitted to change its accounting policies for insurance liabilities, so that both assets and liabilities reflect changes in market conditions (particularly interest rates).

Senior management should consider how best to satisfy the high level disclosure principles in IFRS 4. Implementing these principles may require a review of systems and additional data collection.

## IFRS 5

# Non-current Assets Held for Sale and Discontinued Operations

### The Standard

Non-current assets held for sale and discontinued operations must be disclosed separately in the financial statements.

#### Assets held for sale

Non-current assets are reclassified as current assets when they are held for sale. A non-current asset is regarded as 'held for sale' if its carrying amount will be recovered principally through a sale transaction, rather than through continuing use. To be classified as a non-current asset held for sale:

- the asset must be available for immediate sale; and
- the sale must be highly probable. This requires management commitment to sell, active marketing at a reasonable price, and the expectation of a completed sale within one year.

Assets that are to be abandoned are not classified as held for sale.

Non-current assets held for sale are not depreciated. They are measured at the lower of fair value less costs to sell and carrying amount and presented separately on the statement of financial position.

Specifies the accounting for assets whose carrying amount will be recovered principally through a sale transaction, and the presentation and disclosure of discontinued operations

#### Business implications

Disclosures about non-current assets held for sale and discontinued operations are intended to assist readers of the financial statements in assessing the entity's future results and cash flows.

The classification of an asset as 'held for sale' is based on actions taken by management at or before the end of the reporting period and management's expectation that a sale will be achieved.

#### Discontinued operations

A 'discontinued operation' is a component of an entity that either has been disposed of or is classified as held for sale. The component must be a major line of business, a geographical area of operations, or a subsidiary that was acquired exclusively for resale.

Discontinued operations are presented separately within profit or loss in the statement of comprehensive income and the statement of cash flows.

# IFRS 6

## Exploration for and Evaluation of Mineral Resources

### The Standard

IFRS 6 specifies the financial reporting for expenditures incurred in exploration for and evaluation of mineral resources before the technical feasibility and commercial viability of extracting the mineral resources is demonstrable. It does not specify the financial reporting for the development of mineral resources.

Exploration and evaluation expenditures and mineral rights are excluded from the scope of the standards dealing with intangible assets and property, plant and equipment. IFRS 6 has been issued as a short-term measure to fill a gap in IFRSs. In the absence of IFRS 6, entities would have been required to account for exploration and evaluation expenditures in accordance with standards dealing with similar items, and the definitions, recognition criteria and measurement concepts for assets and expenses in the *Framework for the Preparation and Presentation of Financial Statements*. For most entities, applying the other standards and the Framework would have resulted in accounting changes.

In most respects, an entity may continue to account for exploration and evaluation expenditures using the same accounting policies it applied immediately before adopting IFRS 6. However, the standard makes some limited improvements to accounting for such expenditures:

- The entity must determine accounting policies specifying which exploration and evaluation expenditures are recognised as assets, and how such assets are to be measured.

- On recognition, exploration and evaluation assets are measured at cost. Subsequently they are measured using either the cost model or the revaluation model.
- Exploration and evaluation assets are classified as tangible or intangible assets according to their nature.
- An exploration and evaluation asset is assessed for impairment when facts and circumstances suggest the carrying amount exceeds the recoverable amount. The entity determines the 'level' (cash-generating unit or group of units) at which impairment is assessed. The 'level' must not be larger than a segment used for purposes of segment reporting. Impairment is measured in accordance with the standard on impairment of assets, IAS 36 *Impairment of Assets*.

The standard restricts accounting policy changes. Any changes in accounting for exploration and evaluation expenditures must result in information that is more relevant and reliable.

### Business implications

In most respects, an entity may continue to use the accounting policies for exploration and evaluation expenditures that it applied immediately before adopting IFRS 6.

Impairment is sometimes assessed at a higher level than would be required by IAS 36, ie the test in IFRS 6 is not as stringent.

The financial statements must identify and explain amounts recognised in the financial statements arising from exploration for and evaluation of mineral resources.

Specifies the financial reporting for expenditures incurred in exploration for and evaluation of mineral resources before the technical feasibility and commercial viability of extracting the mineral resources is demonstrable

# IFRS 7

## Financial Instruments: Disclosures

### The Standard

IFRS 7 specifies disclosure for financial instruments. The presentation and recognition and measurement of financial instruments are the subjects of IAS 32 *Financial Instruments: Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement* respectively.\*

The standard applies to all risks arising from all financial instruments of all entities. However, the extent of disclosure required depends on the extent of the entity's use of financial instruments and of its exposure to risk.

The standard requires disclosure of:

- the significance of financial instruments for an entity's financial position and performance.
- qualitative information about exposure to risks arising from financial instruments. The disclosures describe management's objectives, policies and processes for managing those risks.
- quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. These disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel.

Requires disclosures that enable users to evaluate:

- the significance of financial instruments for the entity's financial position and performance
- the risks arising from financial instruments to which the entity is exposed, and how the entity manages those risks

The required disclosures provide an overview of the entity's use of financial instruments and its exposure to the risks they create.

Such information can influence a user's assessment of the financial position and financial performance of an entity or of the amount, timing and uncertainty of its future cash flows.

Greater transparency regarding those risks allows users to make more informed judgements about risk and return.

### Business implications

The significance of financial instruments for an entity's financial position and performance will be disclosed.

The extent of the entity's exposure to and management of risks arising from financial instruments will be available to users of its financial statements.

\* IFRS 9 *Financial Instruments* is the first part of phase 1 of the IASB's project to replace IAS 39. The main phases are: phase 1: *Classification and measurement*; phase 2: *Impairment methodology*; and phase 3: *Hedge accounting*. IFRS 9 specifies how an entity should classify and measure financial assets, including some hybrid contracts. The IASB aims ultimately to replace IAS 39 (with IFRS 9) in its entirety. In the meantime those entities that choose to apply IFRS 9 (it is mandatory only from 1 January 2013) must apply it in conjunction with those parts of IAS 39 that are not yet superseded by IFRS 9.

# IFRS 8

## Operating Segments

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### The Standard

IFRS 8 requires disclosure of information about an entity's operating segments, its products and services, the geographical areas in which it operates, and its major customers. This information enables users of its financial statements to evaluate its business activities and the environment in which it operates.

An entity must report financial and descriptive information about its operating segments that meet specified criteria. Operating segments are components of an entity about which separate financial information is available and which the chief operating decision maker regularly evaluates in deciding how to allocate resources and in assessing performance. The financial information reported is the same as the chief operating decision maker uses.

The IFRS generally applies to listed entities. However, if a financial report contains the consolidated financial statements of a parent as well as its separate financial statements, segment information is required only in the consolidated financial statements.

An entity must give descriptive information about the way the operating segments were determined, the products and services provided by the segments, differences between the measurements used in reporting segment information and those used in the entity's financial statements, and changes in the measurement of segment amounts from period to period.

Disclosures about an entity's operating segments, its products and services, the geographical areas in which it operates, and its major customers enable users to evaluate its business activities and the environment in which it operates

An entity must report a measure of operating segment profit or loss and of segment assets. It must also report a measure of segment liabilities and particular income and expense items if such measures are regularly provided to the chief operating decision maker. Total reportable segment revenues, total profit or loss, total assets, liabilities and other amounts disclosed for reportable segments must be reconciled to corresponding amounts in the entity's financial statements.

An entity must report information about the revenues derived from its products or services, about the countries in which it earns revenues and holds assets, and about major customers, regardless of whether that information is used by management in making operating decisions. However, an entity is exempt from reporting information that is not prepared for internal use if the necessary information is not available and the cost to develop it would be excessive.

### Business implications

Many entities are diversified and/or multinational operations. Their products and services, or the geographical areas in which they operate, may differ in profitability, future prospects and risks. Segment information may be more relevant than consolidated or aggregated data for users in assessing risks and returns.

Segment information allows users of the entity's financial statements to view the entity's operating segments through the eyes of management.

Consider including further explanation of segment information in any management commentary issued with the financial statements.

# IFRS 9

## Financial Instruments

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### The Standard

IFRS 9 specifies how an entity should classify and measure financial assets, including some hybrid contracts. It is the first part of Phase 1 of the IASB's project to replace IAS 39 *Financial Instruments: Recognition and Measurement*. The main phases are: Phase 1: *Classification and measurement*; Phase 2: *Impairment methodology*; and Phase 3: *Hedge accounting*.

The IASB aims to ultimately replace IAS 39 (with IFRS 9) in its entirety. In the meantime those entities that choose to apply IFRS 9 (it is mandatory only from 1 January 2013) must apply it in conjunction with those parts of IAS 39 that are not yet superseded by IFRS 9.

IFRS 9 requires all financial assets to be classified on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial asset.

Financial assets are initially measured at fair value plus, in the case of a financial asset not at fair value through profit or loss, particular transaction costs. After initial recognition a financial asset is measured at amortised cost if both of the following conditions are met:

- the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows.
- 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.

The standard requires all other financial assets be measured at fair value. For all financial assets measured at fair value the fair value changes are recognised in profit or loss except in the case of equity investments that are not held for trading in which case the standard allows an election to be made on initial recognition to recognise changes in fair value in other comprehensive income.

The standard includes a limited option to designate a financial asset at fair value through profit or loss, ie when at initial recognition doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.

When, and only when, an entity changes its business model for managing financial assets it shall reclassify all affected financial assets.

### Business implications

By adopting IFRS 9 an entity can align the measurement attribute of financial assets with its business model—the way the entity manages its financial assets—and their contractual cash flow characteristics. In so doing, it significantly reduces complexity by eliminating the numerous rules associated with each classification category in IAS 39.

Consistently with all other financial assets, hybrid contracts with financial asset hosts are classified and measured in their entirety, thereby eliminating the complex and rule-based requirements in IAS 39 for embedded derivatives.

Furthermore, as a result of IFRS 9 a single impairment method replaces the different impairment methods associated with the many classification categories in IAS 39. The IASB believes that these changes will improve the ability of users to understand the financial reporting of financial assets and to better assess the amounts, timing and uncertainty of future cash flows.

# IAS 1

## Presentation of Financial Statements

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### The Standard

IAS 1 sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for content. Recognition, measurement and disclosure of specific transactions and events are dealt with in other standards (and in Interpretations).

A set of financial statements comprises a statement of financial position (formerly, balance sheet), statement of comprehensive income (in a single statement or two statements, ie separating the income statement and other comprehensive income), statement of changes in equity, statement of cash flows, and notes, including a summary of significant accounting policies. The financial statements state the name of the reporting entity, whether the financial statements are of an individual entity or a group of entities, the period covered by the statements, the presentation currency and whether the financial statements comply with IFRSs.

IAS 1 specifies items to be presented in each component of the financial statements.

Financial statements must present fairly the financial position, financial performance and cash flows of an entity. Except in rare circumstances, a fair presentation is achieved by compliance with IFRSs.

### Sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content

Each material class of similar items is presented separately. Dissimilar items are presented separately, unless they are immaterial. Materiality is determined by the potential of the information, or its omission, to influence economic decisions made by users of the financial statements.

Preparation of financial statements requires judgement and the use of estimates. Explanation in the notes is required of the most significant judgements made by management in applying its accounting policies and the basis of estimates used in the financial statements.

### Business implications

Compliance with IFRSs is presumed to result in financial statements that achieve a fair presentation. Non-compliance with any IFRS requires detailed explanation in the financial statements.

IAS 1 prohibits presentation of items of income or expense as 'extraordinary'.

Assets and liabilities are classified as current or non-current, or presented in order of their liquidity. Current items are part of the entity's working capital or items that will be realised/settled within 12 months of the end of the reporting period. The classification is based on conditions at the end of the reporting period, and is not affected by events, such as refinancing, after that date.

Information about management's most significant judgements and bases for estimations will be available to users of the entity's financial statements.

# IAS 2

## Inventories

### The Standard

IAS 2 defines inventories and specifies requirements for the recognition of inventory as an asset and an expense, the measurement of inventories, and disclosures about inventories.

IAS 2 does not apply to inventories that are covered by other standards: work in progress on construction contracts; financial instruments; biological assets; and agricultural produce at the point of harvest.

Inventories are measured at cost. Some inventories are excluded from this requirement: agricultural products (after harvest) and mineral products that are measured at net realisable value in accordance with industry practice; and the inventories of those commodity broker-traders who measure their inventories at fair value less costs to sell. In all such cases changes in inventory value must be recognised in profit or loss as they occur.

The cost of inventory includes costs of purchase and production or conversion. Cost does not include abnormal wastage, administrative overheads that are not production costs, and selling costs.

Cost is assigned to each item of inventory that is unique or segregated for specific projects, by using an allowable cost formula, such as first-in, first-out (FIFO) or weighted average cost.

Specifies requirements for the recognition of inventory as an asset and an expense, the measurement of inventories, and disclosures about inventories

Inventories are reduced to net realisable value (NRV) when this is lower than cost. NRV is estimated selling price less estimated costs of completion and of making the sale.

A write-down (reduction in carrying amount) to NRV may be required when inventory is damaged, or becomes wholly or partially obsolete, or when selling price reduces, or the costs to complete the product and to get it ready for sale increase. The write-down is made item by item, or by groups of items when those items have similar uses, are produced or marketed in the same area and cannot be easily evaluated separately from other items in that product line.

### Business implications

Use of the last-in, first-out (LIFO) cost formula is not permitted.

In some jurisdictions, measurement of inventories for tax purposes is required to be the same as the measurement used in annual financial statements.

The same cost formula must be used for all inventories having a similar nature and use. A difference in geographical location or in tax rules does not justify use of a different formula for similar inventories.

# IAS 7

## Statement of Cash Flows

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### The Standard

A statement of cash flows is required as part of a complete set of financial statements. The statement of cash flows provides information about changes in cash and cash equivalents. Non-cash transactions are excluded.

Cash equivalents are short-term, highly liquid investments that are readily convertible to a known amount of cash. There must be little risk of changes in their value.

Cash flows are classified by activities: operating; investing; and financing.

Investing activities are the acquisition and disposal of long-term assets and investments that are not cash equivalents. Financing activities are changes in the equity capital and borrowings of the entity. Operating activities are the revenue-producing activities of the entity, and all activities that are not investing or financing.

Cash flows are generally reported as gross flows. There are limited exceptions.

There is a choice of ways of presenting cash flows from operating activities:

- the direct method – gross cash receipts and gross cash payments are shown, or
- the indirect method – profit or loss is adjusted to determine operating cash flow.

- Requires disclosures about the historical changes in cash and cash equivalents of an entity
- Assisting users to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows

### Business implications

The information conveyed by a statement of cash flows depends on the items treated as 'cash and cash equivalents'. Cash equivalents have a short maturity (three months at most) and exclude equity investments. While bank borrowings are usually classified as financing activities, a bank overdraft that is repayable on demand may be regarded as a component of 'cash and cash equivalents', particularly if the bank account fluctuates from being in funds to being overdrawn.

Cash flow information is important to users of financial statements. There should be an explanation of cash flows in any management commentary issued with the annual financial statements.

## IAS 8

# Accounting Policies, Changes in Accounting Estimates and Errors

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### The Standard

IAS 8 sets out the criteria for selecting and changing accounting policies, and specifies the accounting treatment when an accounting policy is changed. It also requires specific disclosures about changes in accounting policies, changes in accounting estimates and corrections of prior period errors.

Accounting policies must comply with IFRSs. When no IFRS is applicable to a transaction or event, management uses judgement in developing and applying an accounting policy that results in information that is relevant and reliable. Management considers standards that deal with similar issues, the definitions, recognition criteria and measurement concepts in the *Framework for the Preparation and Presentation of Financial Statements*, and recent pronouncements of standard-setters that use a similar conceptual framework.

Accounting policies must be applied consistently to similar transactions and events.

A new or amended standard or interpretation may require a change in an accounting policy and may include specific transitional provisions. In other cases, changes in accounting policies are applied retrospectively, ie as if the new policy had always been applied. Prior period amounts are adjusted. Disclosure is made about the change and its effect on the financial statements.

Many items in financial statements cannot be measured with precision and can only be estimated. Estimates are based on the latest available, reliable information. They are revised as a result of new information or changed circumstances. A change in an estimate is recognised in the current period and any future periods affected. Prior period amounts are not adjusted.

Errors can arise from mistakes and oversights or misinterpretations of available information. Errors are corrected in the first set of financial statements issued after their discovery. Prior period amounts are restated as if the error had never occurred. The error and the effect of its correction on the financial statements are disclosed.

### Business implications

Profit or loss for the current period does not include the effects of changes in accounting policies and correction of errors. Prior periods are adjusted so that they are comparable with the current period.

The effect of new standards must be considered early. An entity must disclose the impact of standards that have been issued but are not yet effective.

Specifies criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors

# IAS 10

## Events after the Reporting Period

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### The Standard

Events that happen after the reporting period may affect users' interpretation of the financial statements.

Events that occur between the end of the reporting period and the date the financial statements are authorised for issue are called events after the reporting period. Financial statements are adjusted for those events after the reporting period that provide evidence of conditions that existed at the end of the reporting period (adjusting events). By contrast, non-adjusting events reflect conditions that arise after the reporting period.

Examples of adjusting events are the settlement of a court case that confirms the entity had a present obligation at the end of the reporting period, and the receipt of information that indicates an asset was impaired at the end of the reporting period—the bankruptcy of a customer that occurs after the reporting period usually confirms that the loss existed at the end of the reporting period, or the sale of inventories below cost after the reporting period may give evidence about their net realisable value at the end of the reporting period.

Examples of non-adjusting events are changes in the market value of investments, and changes in currency exchange rates, after the reporting period.

Specifies when an entity should adjust its financial statements for events after the reporting period. Requires disclosures about the date when the financial statements were authorised for issue and about events after the reporting period

### Business implications

Dividends declared after the reporting period are not recognised as a liability at the end of the reporting period. They were not a present obligation at that date.

Disclosure in the notes to the financial statements is required of material non-adjusting events—such as a major business combination or disposal, a plan to discontinue an operation, fire affecting a major production plant, changes in tax rates or tax laws enacted or announced after the reporting period.

Financial statements are usually prepared on the basis that the entity will continue as a going concern. If a decision to liquidate the entity or to cease trading is made, the going concern basis is no longer appropriate, even if the decision is made after the reporting period.

# IAS 11

## Construction Contracts

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### The Standard

IAS 11 sets out the accounting treatment of revenue and costs associated with construction contracts. It applies to contractors, including those providing services directly related to a construction project, such as project managers and architects.

Determining whether an agreement for the construction of real estate is within the scope of IAS 11 or IAS 18 *Revenue* depends on the terms of the agreement and all the surrounding facts and circumstances. Such a determination requires judgement with respect to each agreement. It is within the scope of IAS 11 when the buyer is able to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in progress (whether or not it exercises that ability).

Each construction contract is assessed at the end of each reporting period. The accounting treatment depends on whether the outcome of the contract can be estimated reliably.

When the outcome of a construction contract can be estimated reliably, contract revenue is recognised as the work is performed and is matched with contract costs. This is commonly referred to as the percentage of completion method. The work performed determines the recognition of contract revenue, expense and thus profit. Progress payments and advances received from customers often do not reflect the work performed.

Costs incurred that relate to future activity on the contract are recognised as an asset if it is probable they will be recovered. If not, they are recognised as an expense immediately.

An expected loss on a construction contract is recognised as an expense immediately.

When the outcome of a construction contract cannot be estimated reliably, all contract costs are recognised as expenses when incurred. Contract revenue is recognised to the extent that costs incurred are recoverable. Consequently, no profit is recognised until the contract is completed or the outcome can be estimated reliably. Any expected loss is recognised as an expense immediately.

Prescribes the accounting treatment of revenue and costs associated with construction contracts

### Business implications

The timing of recognition of contract revenues and contract costs in the statement of comprehensive income affects a contractor's profit or loss.

Construction contracts are often long-term in nature. The contract may be agreed in one accounting period; construction activity may take place in another period (or periods); the contract may be completed in a third period. Several contracts may be completed in one period; and none in the next.

The effect of IAS 11 is to recognise contract profit as the work is performed, rather than on completion of the contract. Expected losses are recognised immediately.

Judgement is needed to determine the stage of completion of a contract; which costs are recoverable; and uncertainties such as variations, claims, cost escalation clauses, penalties, and incentive payments. Effective internal financial information is essential for an effective estimation process.

# IAS 12

## Income Taxes

### The Standard

IAS 12 specifies the accounting treatment for income taxes, including how to account for the current and future tax consequences of:

- transactions and events of the current period recognised in the financial statements
- future recovery of the carrying amount of assets in the statement of financial position
- future settlement of the carrying amount of liabilities in the statement of financial position.

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

Deferred tax relates to all differences between the carrying amount of assets and liabilities in the statement of financial position, and the tax base of assets and liabilities. A deferred tax asset or liability arises if recovery (settlement) of assets (liabilities) affects the amount of future tax payments. However, specified exceptions apply. A deferred tax asset can also result from unused tax losses and tax credits. Deferred tax assets are recognised only if it is probable that future taxable profit will be available to absorb the losses or credits or deductible differences. The existence of unused tax losses may indicate that future taxable profit is not probable.

### Prescribes the accounting treatment for income taxes

Deferred tax is measured at tax rates expected to apply when the deferred tax asset (liability) is realised (settled) and reflect the tax consequences that would follow from the manner in which the entity expects, at the end of the reporting period, to recover (settle) the carrying amount of its assets (liabilities). Deferred tax assets and liabilities are not discounted.

The tax rate expected to apply in future is generally indicated by the tax rate that is in force at end of the reporting period. Deferred tax assets or liabilities are adjusted when a new tax rate is substantively enacted. The adjustment is accounted for as a revision to an accounting estimate, ie it affects that period's profit or loss.

The tax consequences of transactions and events are recognised in the same financial statement as the transaction or event—ie either in the statement of comprehensive income or directly in equity. Recognition of deferred tax assets or liabilities in a business combination affects the amount of goodwill.

### Business implications

The tax expense in the profit or loss will be an aggregate of current tax and deferred tax for the year. IAS 12 requires an explanation of the difference between tax expense and tax at the applicable tax rate on accounting profit.

# IAS 16

## Property, Plant and Equipment

### The Standard

Property, plant and equipment are tangible assets held for more than one accounting period and used in the production or supply of goods and services, or for administration. They also include assets rented to others, but not investment property. Investment property is covered by IAS 40 *Investment Property*.

Property, plant and equipment are recorded initially at cost, which includes all expenditure to get the item ready for use. Expenditure on repairs and maintenance is treated as an expense. An entity must record its property, plant and equipment in sufficient detail to recognise separately components with different useful lives. The replacement of a component of property, plant and equipment is recognised as an asset.

After acquisition, an entity may choose to measure property, plant and equipment either at cost less accumulated depreciation, or at fair value (ie revaluation). If it chooses revaluation, all assets within a class of property, plant and equipment must be revalued, and the valuations must be updated regularly. Revaluation increases are usually credited to other comprehensive income (ie outside profit or loss) in the statement of comprehensive income and accumulated in a separate component of equity called 'revaluation surplus'.

Property, plant and equipment are depreciated over their expected useful life. The depreciable amount takes into account the expected residual value at the end of the asset's useful life. The depreciation method and rate is reviewed annually.

If an item of property, plant and equipment is disposed of, the gain or loss on disposal is included in profit or loss in the statement of comprehensive income.

### Business implication

Professional judgement will determine the periods in which expenditure on property, plant and equipment is recognised as an expense, with a consequential effect on current and future profits. Judgement may be required about the following:

- the cost of an item of property, plant and equipment recognised as an asset includes costs of its dismantlement, removal or restoration.
- items of property, plant and equipment acquired for safety or environmental reasons are recognised as assets where they are necessary for the entity to gain benefits from using other assets.
- parts of some items of property, plant and equipment may require replacement at regular intervals. Significant components are separately recorded, depreciated, and derecognised when replaced by the new component.

- day-to-day servicing of an asset is treated as an expense for 'repairs and maintenance'.
- annual depreciation expense depends on the estimate of useful life.
- property, plant and equipment are reviewed annually for impairment.

The principal issues in accounting for property, plant and equipment are the recognition of the assets and determination of their carrying amounts, including allocating depreciation and determining impairment losses

# IAS 17

## Leases

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### The Standard

A lease is an agreement that conveys to the lessee a right to use an asset for a period of time. For accounting purposes, leases are classified as finance leases or operating leases. Leases are classified at the date there is substantial commitment to lease terms, ie at the inception of the lease.

A finance lease transfers to the lessee substantially all the risks and rewards incidental to ownership of the leased asset. All other leases are operating leases.

When a lease includes both land and buildings elements, the classification of the land and building elements are considered separately. In determining whether the land element is an operating or finance lease, an important consideration is that land normally has an indefinite economic life.

Operating lease payments are usually recognised in profit or loss on a straight-line basis. The leased asset remains in the statement of financial position of the lessor.

The classification of leases is based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee

In accordance with their economic substance finance leases are accounted for by lessees as a borrowing to acquire an asset. The lessee recognises a finance lease as an asset and liability in its statement of financial position. Lease payments are apportioned between a reduction in the lease liability and interest expense. Conversely, the lessor recognises a receivable, and apports receipts between a reduction in the receivable and interest income.

There are special rules for sale and leaseback transactions.

### Business implications

Judgement is required to determine whether a lease is a finance lease or an operating lease.

Recognition of a finance lease in the statement of financial position affects the entity's gearing (debt to equity ratio) and return on total assets.

# IAS 18

## Revenue

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### The Standard

IAS 18 prescribes accounting for revenue from sale of goods, from rendering of services, and from the use by others of entity assets yielding interest, royalties and dividends. Other standards prescribe how to account for other revenues. For example, IAS 11 *Construction Contracts* specifies accounting for revenue associated with construction contracts.

In general, revenue is recognised when it is probable that economic benefits from the transaction will flow to the entity and those benefits can be measured reliably.

Revenue from the sale of goods is recognised when:

- significant risks and rewards of ownership have been transferred to the buyer; and
- the entity has neither continuing managerial involvement in, nor effective control over, the goods.

For the rendering of services, revenue is recognised as work is performed. This is commonly referred to as the percentage of completion method. However, when the outcome of a service contract cannot be estimated reliably, revenue is recognised only to the extent of expenses recognised that are recoverable.

Interest is recognised over time, computed on the effective yield on the asset.

Royalties are recognised in accordance with the substance of the agreement.

### The primary issue in accounting for revenue is determining when to recognise revenue

Dividends are recognised when the shareholder has the right to receive payment.

Revenue is measured at the fair value of the consideration received or receivable by the entity on its own account. It does not include amounts collected on behalf of third parties.

When receipt of cash is deferred, the nominal consideration is split between sales revenue and interest revenue.

An exchange of goods or services for similar items does not generate revenue. An exchange for dissimilar items generates revenue measured at the fair value of the goods or services received.

### Business implications

There are circumstances in which the timing of recognition of revenue requires careful consideration. Examples include: sales with delayed delivery; sales subject to conditions including installation and inspection, and right of return; sale and repurchase agreements; consignment sales; sales to others for resale; multiple element contracts; subscriptions for products or fees for services delivered in parts over time; sales of product with an agreement to provide future services; barter transactions, including capacity swaps; origination fees that are integral to a financial investment; commitment fees received to make a loan; and franchise fees.

# IAS 19

## Employee Benefits

### The Standard

IAS 19 specifies accounting for and disclosure of employee benefits by employers.

However, IFRS 2 *Share-based Payment* specifies accounting and disclosure for employee benefits based on, or in the form of, the entity's equity instruments. Furthermore, reporting by employee benefit plans is not dealt with in IAS 19, but is specified by IAS 26 *Accounting and Reporting by Retirement Benefit Plans*.

Employee benefits are all forms of consideration paid for services of employees. They include:

- short-term benefits such as wages, salaries, paid annual leave and sick leave, profit-sharing and bonuses, and non-monetary benefits (such as medical care, housing, cars, and free or subsidised goods or services).
- post-employment benefits such as pensions, life insurance, and medical care.
- other long-term benefits such as long-service leave, and bonuses and other benefits not payable within 12 months.
- termination benefits such as early retirement and redundancy pay.

A liability is recognised when an employee has provided service in return for benefits to be paid in the future. An expense is recognised as the entity benefits from services provided by employees.

Applied by an employer in accounting for all employee benefits, except those to which IFRS 2 *Share-based Payment* applies

Short-term employee benefits are recognised as an expense as the employee provides services. Leave that does not accumulate (for example, in some jurisdictions, sick leave) is recognised only when the leave is taken. Profit-sharing and bonus payments are recognised when the entity has an obligation to pay. A liability is recognised for unpaid short-term benefits.

Post-employment benefits, including those provided through multi-employer plans, are classified as either defined contribution plans or defined benefit plans. The arrangements may be formal or informal.

Under a defined contribution plan, an entity pays fixed contributions to a separate entity (a fund) and has no obligation to pay further contributions if the fund does not hold sufficient assets to pay employee benefits. All other post-employment benefit plans are defined benefit plans.

Contributions payable to a defined contribution plan are recognised as an expense as the employee provides services in exchange for the contributions.

Defined benefit plans may be unfunded, or wholly or partly funded. For a defined benefit plan, the entity recognises the defined benefit obligation, based on actuarial assumptions, net of the fair value of plan assets. Changes in actuarial assumptions and unexpected changes in the fair value of plan assets result in actuarial gains or losses. Such gains and losses within a maximum of a 10 per cent 'corridor' of the obligation or asset value at the beginning of the reporting period need not be recognised immediately. However, if the entity follows a policy of recognising actuarial gains and losses outside profit or loss in the statement of comprehensive income then it must recognise the full actuarial gain or loss in the period in which they occur.

# IAS 19

## Employee Benefits continued

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For other long-term benefits, such as long-service leave, the entity recognises the defined benefit obligation net of the fair value of plan assets (if any). Actuarial gains and losses and past service costs are recognised immediately.

Termination benefits arise only on termination, rather than during employment. They are recognised as an expense and a liability when the entity is demonstrably committed to the termination and cannot withdraw from it.

### Business implications

There are risks associated with the provision of employee benefits. The employer's obligations under a defined benefit plan are affected by the way in which benefits are calculated (often based on future salary levels) and by the performance of the assets set aside to meet the benefit payments.

Judgement is required to determine whether benefit plans are defined contribution or defined benefit plans. The default category is defined benefit.

The main feature of IAS 19 is the requirement to recognise, as a liability, the obligation to provide post-employment or long-term employee benefits under a defined benefit plan, as a result of service already provided by employees to the entity. The amount of the liability is affected by assumptions, including mortality, employee turnover, age at and date of retirement, rates of return on plan assets, future salary and benefit levels, future medical costs and the discount rate.

Judgement is also required to determine the amount of the entity's obligation for profit-sharing, bonuses and termination benefits, and the obligations for various employment benefits that arise from the entity's informal practices.

## IAS 20

# Accounting for Government Grants and Disclosure of Government Assistance

### The Standard

IAS 20 specifies the accounting for government grants and the disclosure of government assistance from which the entity has directly benefited.

Government grants are transfers of resources to an entity in return for compliance with specified conditions. They include reductions in liabilities to the government and the benefit of a government loan at below market rate of interest. Government assistance is a benefit available to entities that satisfy qualifying criteria.

Government grants are recognised when there is reasonable assurance that the entity will comply with any specified conditions and that the grants will be received. Non-monetary grants are either recognised at fair value or both the asset and the grant are recognised at a nominal amount. Receipt of a grant is not always conclusive evidence that conditions will be fulfilled.

Government grants are recognised in profit or loss in the same periods as the costs they are intended to compensate for, ie they are not recognised directly in equity. If there are no future related costs, a grant is recognised in profit or loss when receivable.

Specifies the accounting and reporting of government grants and the disclosure of other forms of government assistance

Government grants that relate to assets are initially recognised in the statement of financial position as deferred income or as a deduction from the related assets. The grant is then recognised in profit or loss over the life of the asset, by reducing deferred income over that period, or by way of reduced depreciation.

A government grant that becomes repayable is accounted for by reversing any remaining deferred income or increasing any related asset and its accumulated depreciation. Otherwise the repayment is recognised as an expense.

### Business implications

Disclosure of government grants and assistance is designed to facilitate comparison of the entity's financial statements with those of prior periods and of other entities.

The main area of judgement is whether the entity will comply with conditions attached to a government grant.

# IAS 21

## The Effects of Changes in Foreign Exchange Rates

### The Standard

An entity may have foreign operations or transactions in foreign currencies. It may present its financial statements in a foreign currency. IAS 21 prescribes how to account for foreign currency transactions and foreign operations, and how to translate financial statements into a presentation currency.

An entity must measure the items in its financial statements in its functional currency. Functional currency is the currency of the primary economic environment in which the entity operates. This is the currency that determines the pricing of transactions, but is not necessarily the currency in which transactions are denominated.

Transactions in a currency other than the functional currency are translated at the spot exchange rate at the date of the transaction (transaction rate).

Monetary assets and liabilities are translated using the spot exchange rate at the end of the reporting period (closing rate). Non-monetary items are translated using the rate at the date their amount (cost or fair value) was determined.

Exchange differences arising on monetary items are recognised as income or expense for the period in which they arise. However, in financial statements that include the foreign operation and the reporting entity (eg consolidated financial statements) exchange differences on monetary items forming part of the net investment in a foreign operation are recognised in other comprehensive income in the statement of comprehensive income and accumulated in a separate component of equity until disposal of the net investment, when they are recycled to profit or loss and the gain or loss on disposal is recognised.

IAS 21 allows an entity to present its financial statements in any currency. If the presentation currency differs from the functional currency, assets and liabilities are translated at the closing rate, and income and expenses are translated at the transaction rates. The average rate for a period can be used if it is a reasonable approximation of the transaction rates. All resulting exchange differences are recognised directly in other comprehensive income.

Specifies how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate into a presentation currency

### Business implications

Judgement may be required to determine the functional currency of an entity.

The functional currency of individual entities in a multinational diversified group may differ. In such cases, the financial statements of individual entities will be translated into a common presentation currency for consolidation.

If the functional currency is the currency of a hyperinflationary economy, the entity must restate its financial statements (in accordance with IAS 29 *Financial Reporting in Hyperinflationary Economies*). It cannot avoid doing so by adopting another currency (for example its parent's functional currency) as its functional currency.

# IAS 23

## Borrowing Costs

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### The Standard

IAS 23 prescribes the accounting treatment for borrowing costs. Borrowing costs are interest and other costs incurred in connection with borrowing.

The Standard requires the capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of an asset that takes a substantial time to get ready for its intended use or sale (*a qualifying asset*). Other borrowing costs are recognised as an expense in the period in which they are incurred.

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are those that would have been avoided if the expenditure on the asset had not been made. They may be borrowing costs incurred on funds borrowed specifically for obtaining a qualifying asset or a calculated amount based on a weighted average borrowing rate applied to expenditure on the asset.

Requires the capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of an asset that takes a substantial time to get ready for its intended use or sale

Capitalisation of borrowing costs takes place during the development of the asset, and ends when the asset is ready for its intended use or sale. When the asset is completed in parts, capitalisation of borrowing costs ceases when each part is ready for intended use or sale.

### Business implications

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset. Capitalising borrowing costs affects profit as the asset is depreciated, or when the asset is sold.

# IAS 24

## Related Party Disclosures

### The Standard

IAS 24 requires disclosures about related parties and the reporting entity's transaction with related parties. The disclosures are required both in consolidated financial statements, and in the separate financial statements of a parent, venturer or investor. It also applies to individual financial statements.

Related party disclosures highlight the possibility that the entity's financial position and profit or loss might have been affected by the existence of related parties and by transactions and outstanding balances with such parties.

A related party may be a person or an entity.

(1) A **person** or a **close member of that person's family** is related to the reporting entity if that person:

- has control, joint control or significant influence over the reporting entity
- is a member of the key management personnel of the reporting entity (or its parent)

(2) An **entity** is related to a reporting entity when:

- they are both members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others)
- one entity is an associate or joint venture of the other entity
- both entities are joint ventures of the same third party

- one entity is a joint venture of a third party and the other is an associate of the third party
- the entity is a post-employment benefit plans for the benefit of employees of the reporting entity or any of its related parties.
- the entity is controlled, jointly controlled or significantly influenced by any of those persons in (1) above
- a person in (1) above has both control or joint control over the reporting entity and also has significant influence over the entity or is a member of the key management personnel of the entity (or its parent)

Disclosure is required of:

- the name of the reporting entity's parent and, if different, its ultimate controlling entity, irrespective of whether there have been transactions between them.
- details of key management personnel compensation in total and by category of benefit.

Aims to ensure that financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties

When there are transactions with related parties, disclosure is required (by category of related party) of:

- the nature of the related party relationship
- details by category of related party of the transactions and outstanding balances, including commitments, to enable users to understand the potential effect of the relationship on the financial statements.

# IAS 24

## Related Party Disclosures continued

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This Standard provides a partial exemption from the disclosure requirements for government related entities in relation to related party transactions with:

- a government that has control, joint control or significant influence over the reporting entity; and
- another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.

Other specified disclosures are required when the partial exemption applies.

### Business implications

Related party relationships are a normal feature of commerce and business.

A related party relationship may affect an entity's profit or loss and financial position. Related parties may enter into transactions that would not be undertaken by unrelated parties.

An entity's profit or loss and financial position may be affected by a related party relationship even if related party transactions do not occur. The mere existence of the relationship may be sufficient to affect transactions between the entity and other parties.

IAS 24 deals with disclosure, but not measurement of related party transactions. There is no requirement to disclose the fair value of related party transactions.

Disclosure about related party transactions can state that the terms are equivalent to those in arm's length transactions, but only if there is evidence for that.

## IAS 26

# Accounting and Reporting by Retirement Benefit Plans

### The Standard

IAS 26 is applicable to the financial statements of retirement benefit plans. Such plans are sometimes referred to as 'pension plans' or 'superannuation schemes'. Accounting for retirement benefits (and other employee benefits) in the financial statements of employers is specified in IAS 19 *Employee Benefits*.

Retirement benefit plans are formal or informal arrangements providing benefits for employees on or after termination of their employment. Benefits may be an annual income or a lump sum payment or both. Whatever its form or structure, IAS 26 regards a retirement benefit plan as a reporting entity separate from the employer.

Retirement benefit plans may be defined contribution plans or defined benefit plans. In a defined contribution plan, retirement benefits are determined by contributions and investment earnings. In a defined benefit plan, retirement benefits are usually based on the employee's earnings or years of service or both.

This standard is applicable to the financial statements of retirement benefit plans

The information needs of users of the financial statements of defined contribution plans and defined benefit plans are different. IAS 26 therefore prescribes different financial reporting requirements for each type of retirement benefit plan.

IAS 26 requires retirement plan investments to be measured at fair value.

The present value of the expected payments by the retired benefit plan may be measured using current salary levels or projected salary levels up to the time of retirement of the participants.

### Business implications

Judgement is required to determine whether retirement benefit plans are defined contribution or defined benefit plans. Some plans contain characteristics of both. Such hybrid plans are treated as defined benefit plans for the purposes of IAS 26.

A defined benefit plan may be underfunded or overfunded.

The retirement benefit plan report should contain a clear explanation of how promised benefits will be funded.

Retirement benefit plan results will be affected by changes in the market value of investments. Changes in market value also affect the net assets available for benefits. This may require explanation in the plan's annual report.

# IAS 27

## Consolidated and Separate Financial Statements

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### The Standard

IAS 27 addresses consolidated financial statements. It also discusses accounting for investments in subsidiaries, jointly controlled entities and associates, when the investor presents separate financial statements.

An entity that has one or more subsidiaries (a parent) must present consolidated financial statements. A subsidiary is an entity, including an unincorporated entity such as a partnership that is controlled by the parent. The consolidated financial statements include all entities under the parent's control, and are presented as financial statements of a single economic entity.

One exception is that a parent need not prepare consolidated financial statements if it is itself a wholly-owned subsidiary (or a partly owned subsidiary and its other owners have been informed about and do not object to the parent not presenting consolidated financial statements), its securities are not publicly traded or in the process of becoming publicly traded, and its parent publishes IFRS-compliant financial statements that are available to the public.

*Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control is presumed when the parent is entitled to more than half the voting power of another entity. However, judgement in the context of all available information is required to determine whether control exists. Control might also exist when there are other arrangements in place, such as the investor holding instruments convertible into ordinary shares or holding voting rights or governance powers.*

IAS 27 also contemplates that there are circumstances in which one entity can control another entity without owning more than half the voting power. An entity holding a minority interest can control another entity in the absence of any formal arrangements that would give it a majority of the voting rights. For example, control is achievable if the balance of holdings is dispersed and the other shareholders have not organised their interests in such a way that they exercise more votes than the minority holder. This is sometimes referred to as 'de facto control'.

**Aims to enhance the relevance, reliability and comparability of the information that a parent entity provides for a group of entities under its control**

IAS 27 does not provide explicit guidance on the consolidation of special purpose entities. Those entities are created to accomplish a narrow and well-defined objective and are often created with legal arrangements that impose strict and sometimes permanent limits on the decision-making powers of its governing board or similar body. SIC-12 *Consolidation—Special Purpose Entities* (an interpretation of IAS 27) clarifies that a special purpose entity is consolidated when the substance of the relationship between an entity and the special purpose entity indicates that the special purpose entity is controlled by that entity. SIC-12 provides a list of indicators to identify when an entity controls a special purpose entity.

# IAS 27

## Consolidated and Separate Financial Statements continued

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When a parent owns less than 100 per cent of a subsidiary it recognises non-controlling interest. Non-controlling interest is the equity in a subsidiary that is not attributable, directly or indirectly, to the parent. It is presented in the consolidated statement of financial position within equity, separately from the parent shareholders' equity.

In some jurisdictions the investor must present separate financial statements in addition to the consolidated financial statements. If separate financial statements are prepared, IAS 27 requires investments in subsidiaries, jointly controlled entities and associates that are not classified as 'held for sale' to be accounted for either at cost, or in accordance with IFRS 9 *Financial Instruments* or IAS 39 *Financial Instruments: Recognition and Measurement*. The same method is applied to all investments in a particular category. Investments classified as 'held for sale' are accounted for in accordance with IFRS 5.

### Business implications

Judgement in the context of all available information is required to determine whether control exists.

IAS 27 applies to all entities, including venture capital organisations, mutual funds, unit trusts and similar entities.

A subsidiary is not excluded from consolidation because its business activities are dissimilar from those of the other entities within the group.

When the end of the reporting period of the parent and a subsidiary differ the subsidiary usually prepares additional financial statements as of the same date as the parent, for consolidation purposes.

Uniform accounting policies are used in the consolidated financial statements.

# IAS 28

## Investments in Associates

### The Standard

**An associate is any entity over which the investor has significant influence.**

Significant influence is the power to participate in the financial and operating policy decisions of the investee. It is not control (which indicates a subsidiary) or joint control (which indicates an interest in a joint venture).

There is a rebuttable presumption that an investor that holds 20 per cent or more of the voting power of the investee has significant influence over that investee. However, judgement in the context of all available information is required to determine the degree of influence that the investor has over an investee. For example, significant influence might come from representation on the board of directors; participation in policy making, including decisions about dividends; or a close relationship involving transactions between investor and investee, interchange of managerial personnel, or provision of essential technical information even if the investor holds less than 20 per cent of the voting power of the investee.

Associates are accounted for using the equity method. The equity method involves recognising the investment initially at cost, then adjusting for the post-acquisition change in the investor's share of net assets of the associate. A one-line entry in the statement of

comprehensive income presents the investor's share of the associate's profit or loss. There is also a one-line adjustment to the investment in the statement of financial position.

If the associate has losses, equity accounting reduces the carrying amount of the investor's investment. Equity accounting continues until the investment is reduced to zero. The 'investment' includes not only shares in the associate, but also some non-equity interests such as some long-term receivables.

There are several exemptions from the requirement to use the equity method including:

- when investments in associates are held by venture capital organisations, mutual funds, unit trusts and similar entities they can be measured at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments* or IAS 39 *Financial Instruments: Recognition and Measurement*. In such cases, changes in the fair value of such investments are recognised in profit or loss in the period of the change.
- investments classified as 'held for sale' and accounted for in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.

- when the investor is a wholly-owned subsidiary (or a partly owned subsidiary and its other owners have been informed about and do not object to the investor not applying the equity method), its securities are not publicly traded or in the process of becoming publicly traded, and its parent publishes IFRS-compliant financial statements that are available to the public.

When the investor prepares separate financial statements, in addition to the financial statements in which it accounts for associates using the equity method, it accounts for associates in those separate financial statements at cost or in accordance with IFRS 9 and IAS 39.

### Business implications

Investors must exercise judgement in the context of all available information to determine if they have significant influence over an investee.

There is no exemption from equity accounting when severe long-term restrictions impair the associate's ability to transfer funds to the investor. However, the investor should consider whether such restrictions, taken with other factors, indicate that the investor does not have significant influence.

# IAS 29

## Financial Reporting in Hyperinflationary Economies

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### The Standard

IAS 29 applies to any entity whose functional currency is the currency of a hyperinflationary economy.

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

Hyperinflation is not defined in IAS 29. Hyperinflation is indicated by factors such as prices, interest and wages linked to a price index, and cumulative inflation over three years of around 100 per cent.

Financial statements, including comparative information, must be expressed in units of the functional currency current as at the end of the reporting period. Restatement to current units of currency is made using the change in a general price index. The gain or loss on the net monetary position must be included in profit or loss for the period and separately disclosed.

An entity must disclose: the fact that the financial statements have been restated; the price index used for restatement; and whether the financial statements are prepared on the basis of historical costs or current costs.

An entity must measure its results and financial position in its functional currency. However, after restatement, the financial statements may be presented in any currency by translating the results and financial position in accordance with IAS 21.

### Business implications

It is not useful to measure operating results and financial position in the functional currency of a hyperinflationary economy without restatement, because money loses purchasing power at such a rate that comparison of amounts from transactions at different times (even within the same year) is misleading.

An entity whose functional currency is that of a hyperinflationary economy cannot avoid restatement by electing to use a stable currency for measurement purposes.

In some circumstances determining the entity's functional currency may involve professional judgement. Professional judgement may also be required to determine whether an economy is hyperinflationary.

When multiple price indices are available, the entity must restate its financial statements using a general price index that reflects changes in general purchasing power.

Applied to the financial statements of any entity whose functional currency is the currency of a hyperinflationary economy

# IAS 31

## Interests in Joint Ventures

### The Standard

The essential element of a joint venture is a contractual arrangement, which establishes joint control of an economic activity.

Joint control exists only when the strategic financial and operating decisions relating to a joint venture's economic activity require the unanimous consent of all venturers. No single venturer can control the activity unilaterally. However, one venturer may be the operator or manager of the joint venture acting with delegated authority within the strategic, financial and operating policies agreed by the venturers. Joint ventures include jointly controlled operations, jointly controlled assets and jointly controlled entities.

In a *jointly controlled operation*, a venturer uses its own assets in the joint venture and, because it controls those assets, continues to recognise them in its financial statements. The venturer also recognises the liabilities and expenses that it incurs, and its share of income from sales by the joint venture.

In respect of an interest in *jointly controlled assets*, a venturer recognises in its financial statements its share of the jointly controlled assets. It also recognises its share of any jointly incurred liabilities and expenses, other liabilities and expenses it incurs, and income from the sale or use of its share of the output of the joint venture.

### Specifies the accounting and reporting of joint ventures

A venturer recognises its interest in a *jointly controlled entity* using proportionate consolidation or the equity method.

There are exemptions from proportionate consolidation or equity accounting:

- when the investments in jointly controlled entities are held by venture capital organisations, mutual funds, unit trusts and similar entities they can be measured at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments* or IAS 39 *Financial Instruments: Recognition and Measurement*. In such cases changes in the fair value of such investments are recognised in profit or loss in the period of the change.
- when the joint venture interest is classified as 'held for sale' in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. In such cases those interests are accounted for in accordance with that IFRS.

- when the venturer is a wholly-owned subsidiary (or a partly owned subsidiary and its owners have been informed about, and do not object to, the venturer not applying proportionate consolidation or the equity method), its securities are not publicly traded or in the process of becoming publicly traded, and its parent publishes IFRS-compliant consolidated financial statements that are available to the public.

### Business implications

Investors must exercise judgement in the context of all available information to determine if they exert joint control over an investee.

The venturer should consider whether severe long-term restrictions that impair the joint venture's ability to transfer funds to the venturer, taken with other factors, indicate that the venturer does not have joint control.

# IAS 32

## Financial Instruments: Presentation

### The Standard

IAS 32 specifies presentation for financial instruments. The recognition and measurement and the disclosure of financial instruments are the subjects of IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures* respectively.\*

For presentation, financial instruments are classified into financial assets, financial liabilities and equity instruments. Differentiation between a financial liability and equity depends on whether there is an obligation to deliver cash (or some other financial asset). However, exceptions apply. When a transaction will be settled in the issuer's own shares, classification depends on whether the number of shares to be issued is fixed or variable.

A compound financial instrument, such as a convertible note, is split into equity and liability components. When the instrument is issued, the equity component is measured as the difference between the fair value of the compound instrument and the fair value of the liability component.

Financial assets and financial liabilities are offset only when the entity has a legally enforceable right to set off the recognised amounts, and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

### Business implications

Some financial instruments take the legal form of equity, but are liabilities in substance and under IAS 32. For examples, shares with mandatory redemption requirements and units in a mutual fund that are redeemable or can be put to the issuer for cash are classified as liabilities. However, exceptions apply.

Classification of a financial instrument as a financial liability or equity determines the treatment of the interest, dividends, losses or gains on the financial instrument as items of income or expense, or as changes in equity. Dividends on shares classified as liabilities are recognised as expenses, and affect profit or loss.

Establishes principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and financial liabilities

\* IFRS 9 *Financial Instruments* is the first part of phase 1 of the IASB's project to replace IAS 39. The main phases are: phase 1: *Classification and measurement*; phase 2: *Impairment methodology*; and phase 3: *Hedge accounting*. IFRS 9 specifies how an entity should classify and measure financial assets, including some hybrid contracts. The IASB aims ultimately to replace IAS 39 (with IFRS 9) in its entirety. In the meantime those entities that choose to apply IFRS 9 (it is mandatory only from 1 January 2013) must apply it in conjunction with those parts of IAS 39 that are not yet superseded by IFRS 9.

# IAS 33

## Earnings per Share

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### The Standard

IAS 33 deals with the calculation and presentation of earnings per share (EPS). It applies to entities whose ordinary shares or potential ordinary shares (for example, convertibles, options and warrants) are publicly traded.

An entity must present basic EPS and diluted EPS with equal prominence in the statement of comprehensive income. When an entity presents consolidated financial statements, EPS measures are based on the consolidated profit or loss attributable to ordinary equity holders of the parent.

Dilution is a notional reduction in EPS or a notional increase in loss per share resulting from the assumption that convertible instruments are converted, options or warrants are exercised, or ordinary shares are issued upon the satisfaction of specified conditions.

When the entity also discloses profit or loss from continuing operations, basic EPS and diluted EPS must be presented in respect of continuing operations. Furthermore, an entity that reports a discontinued operation must present basic and diluted amounts per share for the discontinued operation either in the statement of comprehensive income or in the notes.

IAS 33 sets out principles for determining the denominator (the weighted average number of shares outstanding for the period) and the numerator ('earnings') in EPS and diluted EPS calculations. These principles enhance the comparability of an entity's basic and diluted EPS measures through time.

The 'earnings' of two entities subject to identical transactions and events could differ because they have adopted different accounting policies. These differences are not adjusted for when calculating EPS.

The denominators used in the calculation of basic and diluted EPS might be affected by: share issues during the year; shares to be issued upon conversion of a convertible instrument; contingently issuable or returnable shares; bonus issues; share splits and share consolidation; the exercise of options and warrants; contracts that may be settled in shares; and contracts that require an entity to repurchase its own shares (written put options).

The numerators used in the calculation of basic and diluted EPS must be reconciled to profit or loss attributable to the ordinary equity holders of the parent. The denominators in the calculations of basic EPS and diluted EPS must be reconciled to each other.

### Business implications

EPS is an important measure in the analysis of financial statements. It is used, for example, in the calculation of price/earnings ratios and other multiple-based business valuations.

The calculation of diluted EPS takes account only of potential changes to the number of shares that would reduce EPS. It does not include potential changes that would increase EPS.

Consider explanation of EPS and changes in EPS in any management commentary issued with the annual financial statements.

Transactions and agreements may affect basic EPS and diluted EPS.

Specifies principles for the determination and presentation of earnings per share, so as to improve performance comparisons between different entities in the same reporting period and between different reporting periods for the same entity

# IAS 34

## Interim Financial Reporting

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### The Standard

An interim financial report is a complete or condensed set of financial statements for a period shorter than a financial year.

IAS 34 does not specify which entities must publish an interim financial report. That is generally a matter for securities regulation. IAS 34 applies if an entity publishes an interim financial report.

IAS 34 prescribes the minimum content of an interim financial report. It also specifies the accounting recognition and measurement principles applicable to an interim financial report.

The minimum content is a set of condensed financial statements, ie statement of financial position, statement of comprehensive income, statement of cash flows, statement of changes in equity, and selected explanatory material. Generally, information available in the entity's most recent annual report is not repeated or updated in the interim report. The interim report deals with changes since the end of the last annual reporting period.

Specifies the minimum content of an interim financial report and prescribes the principles for recognition and measurement in complete or condensed financial statements for an interim period

The same accounting policies are applied in the interim report as in the most recent annual report. Assets and liabilities are recognised and measured for interim reporting on the basis of information available on a year-to-date basis. While measurements in both annual financial statements and interim financial reports are often based on reasonable estimates, the preparation of interim financial reports will generally require a greater use of estimation methods than annual financial statements.

### Business implications

Timely and reliable interim financial reporting provides information about an entity's capacity to generate earnings and cash flows, and about its financial position.

Users of the interim financial report will obtain a better understanding if management provides commentary about the seasonal or cyclical nature of interim operations.

# IAS 36

## Impairment of Assets

### The Standard

An asset must not be carried in the financial statements at more than the highest amount to be recovered through its use or sale. If the carrying amount exceeds the recoverable amount, the asset is described as impaired. The entity must reduce the carrying amount of the asset to its recoverable amount, and recognise an impairment loss. The standard also applies to groups of assets (known as cash-generating units).

The recoverable amount of the following assets must be assessed each year: intangible assets with indefinite useful lives; intangible assets not yet available for use; goodwill acquired in a business combination. The recoverable amount of other assets is assessed only when there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. Fair value less costs to sell is the arm's length sale price between knowledgeable, willing parties less the costs of disposal.

The value in use of an asset is the expected future cash flows the asset in its current condition will produce, discounted to present value using an appropriate pre-tax discount rate. The value in use of an asset sometimes cannot be determined. In this case, recoverable amount is determined for the smallest group of assets that generates independent cash flows (cash-generating unit). The impairment of goodwill is assessed by considering the recoverable amount of the cash-generating unit(s) to which it is allocated.

An impairment loss is recognised immediately in the statement of comprehensive income. When an impairment loss is recognised, the carrying amount of the asset (or cash-generating unit) is reduced. In a cash-generating unit, goodwill is reduced first, then other assets are reduced pro rata. The depreciation (amortisation) charge is adjusted in future periods to allocate the asset's revised carrying amount over its remaining useful life.

An impairment loss for goodwill is never reversed. For other assets, when the circumstances that caused the impairment loss are resolved, the reversal of the impairment loss is recognised immediately in the statement of comprehensive income. On reversal, the asset's carrying amount is increased, but it must not exceed the amount that it would have been had there been no impairment loss in prior years. Depreciation (amortisation) is adjusted in future periods.

Specifies the procedures necessary to ensure that assets are carried at no more than the highest amount to be recovered through its use or sale

### Business implications

Impairment might be indicated by: decline in an asset's market value; adverse changes in the technological, market, economic or legal environment; increase in market interest rates; market capitalisation of the entity being less than net asset value; obsolescence or damage of an asset; plans to discontinue or restructure operations; asset under-performance compared with expected return.

Estimating the value in use of an asset involves professional judgement. The valuation inputs should be market-determined, whenever possible.

Disclosure is required of key assumptions and estimates used to measure the recoverable amount of cash-generating units containing goodwill or intangible assets with indefinite useful lives. Disclosure is also required of the adverse effect of reasonably possible changes in those key assumptions.

# IAS 37

## Provisions, Contingent Liabilities and Contingent Assets

### The Standard

This standard distinguishes between provisions and contingent liabilities. A provision is included in the statement of financial position at the best estimate of the expenditure required to settle the obligation at the end of the reporting period.

A contingent liability is not recognised in the statement of financial position. However, unless the possibility of an outflow of economic resources is remote, a contingent liability is disclosed in the notes.

#### Provisions

A provision is a liability of uncertain timing or amount. A liability may be a legal obligation or a constructive obligation. A constructive obligation arises from the entity's actions, through which it has indicated to others that it will accept certain responsibilities, and as a result has created an expectation that it will discharge those responsibilities. Examples of provisions may include: warranty obligations; legal or constructive obligations to clean up contaminated land or restore facilities; and a retailer's policy to refund customers.

A provision is measured at the amount that the entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. Risks and uncertainties are taken into account in the measurement of a provision.

A provision is discounted to its present value.

Aims to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that appropriate disclosures enable users to understand their nature, timing and amount

IAS 37 elaborates on the application of the recognition and measurement requirements for three specific cases:

- future operating losses—a provision cannot be recognised because there is no obligation at the end of the reporting period.
- an onerous contract gives rise to a provision.
- a provision for restructuring costs is recognised only when the entity has a constructive obligation—the main features of the detailed restructuring plan have been announced to those affected by it.

#### Contingent liabilities

Contingent liabilities are possible obligations whose existence will be confirmed by uncertain future events that are not wholly within the control of the entity. (Contingent liabilities also include obligations that are not recognised because their amount cannot be measured reliably or settlement is not probable.) An example of a contingent liability is litigation against the entity when the occurrence of any wrongdoing by the entity is uncertain.

continued

# IAS 37

## Provisions, Contingent Liabilities and Contingent Assets continued

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### Contingent assets

Contingent assets are possible assets the existence of which will be confirmed by the occurrence or non-occurrence of uncertain future events that are not wholly within the control of the entity. Contingent assets are not recognised in the statement of financial position. Contingent assets are disclosed when it is more likely than not that an inflow of benefits will occur. However, when the inflow of benefits is virtually certain an asset is recognised in the statement of financial position, because that asset is no longer considered to be contingent.

### Business implications

IAS 37 restricts the circumstances in which a provision can be recognised. It does not allow a provision to be created for the possibility of something occurring in future. There must be a present obligation (a liability) at the end of the reporting period.

Although provisions are not recognised for future operating losses the expectation of future operating losses triggers an impairment test of the operation's assets. The impairment test may result in the recognition of an impairment loss. Furthermore, the present obligation under an onerous contract is recognised and measured as a provision.

The measurement of a provision requires judgement about the amount, timing and risks of the cash flows required to settle the obligation. Caution is needed in making judgements under conditions of uncertainty. However, uncertainty does not justify the creation of excessive provisions.

# IAS 38

## Intangible Assets

### The Standard

IAS 38 sets out criteria for the recognition and measurement of intangible assets, and requires disclosures about them.

An intangible asset is an identifiable non-monetary asset without physical substance. Such an asset is identifiable when it is separable, or when it arises from contractual or other legal rights. Separable assets can be sold, transferred, licensed etc. Examples of intangible assets include computer software, licences, trademarks, patents, films, copyrights and import quotas. Goodwill acquired in a business combination is accounted for in accordance with IFRS 3 *Business Combinations* and is outside the scope of IAS 38. Internally generated goodwill is within the scope of IAS 38 but is not recognised as an asset because it is not an identifiable resource.

Expenditure for an intangible item is recognised as an expense, unless the item meets the definition of an intangible asset, and:

- it is probable that there will be future economic benefits from the asset; and
- the cost of the asset can be reliably measured.

### Specifies criteria for recognition, measurement and disclosure of intangible assets

The cost of generating an intangible asset internally is often difficult to distinguish from the cost of maintaining or enhancing the entity's operations or goodwill. For this reason, internally generated brands, mastheads, publishing titles, customer lists and similar items are not recognised as intangible assets. The costs of generating other internally generated intangible assets are classified into a research phase and a development phase. Research expenditure is recognised as an expense. Development expenditure that meets specified criteria is recognised as an intangible asset.

Intangible assets are measured initially at cost.

After initial recognition, an entity usually measures an intangible asset at cost less accumulated amortisation. It may choose to measure the asset at fair value, if fair value can be determined by reference to an active market. If an intangible asset is revalued, all assets within that class of intangible assets must be revalued. Valuations must be updated regularly. Revaluation increases are usually credited to other comprehensive income (ie outside profit or loss) in the statement of comprehensive income and accumulated in a separate component of equity called 'revaluation surplus'.

An intangible asset with a finite useful life is amortised. An intangible asset with an indefinite useful life is not amortised, but is tested annually for impairment.

When an intangible asset is disposed of, the gain or loss on disposal is included in profit or loss.

### Business implications

Expenditure on internally generated intangible items will often be an expense.

There are few active markets for intangible assets. Therefore it will be rare for an intangible asset to be revalued.

# IAS 39

## Financial Instruments: Recognition and Measurement

### The Standard

IAS 39 establishes principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items.\* The presentation and the disclosure of financial instruments are the subjects of IAS 32 *Financial Instruments: Presentation* and IFRS 7 *Financial Instruments: Disclosures* respectively.

#### Recognition and derecognition

A financial instrument is recognised in the financial statements when the entity becomes a party to the financial instrument contract.

An entity removes a financial liability from its statement of financial position when its obligation is extinguished.

An entity removes a financial asset from its statement of financial position when

- its contractual rights to the asset's cash flows expire,
- it has transferred the asset and substantially all the risks and rewards of ownership, or
- it has transferred the asset, and has retained some substantial risks and rewards of ownership, but the other party may sell the asset. The risks and rewards retained are recognised as an asset.

#### Measurement

A financial asset or liability is measured initially at fair value. Subsequent measurement depends on the category of financial instrument. Some categories are measured at amortised cost, and some at fair value. In limited circumstances other measurement bases apply, eg certain financial guarantee contracts.

At amortised cost:

- 'Held to maturity'. Non-derivative financial assets that the entity has the positive intention and ability to hold to maturity.
- 'Loans and receivables'. Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.
- Financial liabilities that are not carried at fair value through profit or loss or otherwise required to be measured in accordance with another measurement basis.

Establishes principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items

At fair value:

- 'At fair value through profit or loss'. This category includes financial assets and financial liabilities held for trading, including derivatives not designated as hedging instruments and financial assets and financial liabilities that the entity has designated for measurement at fair value. All changes in fair value are reported in profit or loss.
- 'Available for sale'. All financial assets that do not fall within one of the other categories. These are measured at fair value. Unrealised changes in fair value are reported in other comprehensive income. Realised changes in fair value (from sale or impairment) are reported in profit or loss at the time of realisation.

\* IFRS 9 *Financial Instruments* is the first part of phase 1 of the IASB's project to replace IAS 39. The main phases are: phase 1: *Classification and measurement*; phase 2: *Impairment methodology*; and phase 3: *Hedge accounting*. IFRS 9 specifies how an entity should classify and measure financial assets, including some hybrid contracts. The IASB aims ultimately to replace IAS 39 (with IFRS 9) in its entirety. In the meantime those entities that choose to apply IFRS 9 (it is mandatory only from 1 January 2013) must apply it in conjunction with those parts of IAS 39 that are not yet superseded by IFRS 9.

## IAS 39

# Financial Instruments: Recognition and Measurement continued

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### Hedge accounting

Hedge accounting recognises the offsetting effects of changes in the fair values or the cash flows of the hedging instrument and the hedged item. Strict conditions must be met before hedge accounting is possible:

- There must be formal designation and documentation of a hedge, including the risk management strategy for the hedge.
- The hedging instrument must be expected to be highly effective in achieving offsetting changes in fair value or cash flows of the hedged item that are attributable to the hedged risk.
- For cash flow hedges, a forecast transaction being hedged must be highly probable.
- Hedge effectiveness must be reliably measurable—ie the fair value or cash flows of the hedged item and the fair value of the hedging instrument can be reliably measured.
- The hedge must be assessed on an ongoing basis and be highly effective.

### Business implications

An entity must recognise *all* financial instruments, including all derivatives. Furthermore, derivatives are measured at fair value (ie are 'marked to market'). However, a derivative that is linked to and must be settled by delivery of unlisted equity instruments whose fair value cannot be reliably measured, is, after initial recognition, measured at cost. Derivatives include forwards, swaps and options. The values of derivatives change in response to changes in variables such as interest rates, foreign exchange rates, financial instrument or commodity prices, or an index. Derivatives require no (or a relatively small) initial net investment compared with other types of contracts that respond similarly to changes in market factors. Before IAS 39 was issued most derivatives were not recognised in the financial statements until settlement.

The mixed measurement model (some items at fair value, others at cost or amortised cost) makes IAS 39 a complicated standard to apply and gives rise to the need for hedge accounting.

Hedge accounting can be used only if the hedge is documented and designated up front, and is demonstrated to be highly effective.

# IAS 40

## Investment Property

### The Standard

Investment property is land or a building (including part of a building) or both, held to earn rentals or for capital appreciation or both. It is not owner-occupied, and is not used in the production or supply of goods and services, or for administration. It is not property that is for sale in the ordinary course of business.

It is not property that is being constructed or developed for future use by the entity as an investment property but may include investment property that is being redeveloped.

Investment property is usually owned. It may be held by a lessee under a finance lease. A property interest held by a lessee under an operating lease also may be classified and accounted for as an investment property if the lessee uses the fair value model. This classification alternative is available on a property-by-property basis.

An investment property is measured initially at cost. The cost of a property interest held under a lease is measured in accordance with IAS 17 *Leases* at the lower of the fair value of the property interest and the present value of the minimum lease payments.

For subsequent measurement an entity must adopt either the fair value model or the cost model for all investment properties. All entities must estimate the fair value of investment property, either for measurement (if the entity uses the fair value model) or for disclosure (if it uses the cost model). Fair value reflects market conditions at the end of the reporting period.

- An entity must adopt either the fair value model or the cost model for all investment properties
- If the cost model is used, the fair value must be disclosed

In the fair value model, investment property is remeasured at the end of each reporting period. Changes in fair value are recognised in profit or loss in the period they occur. Fair value is the price at which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction, without deducting transaction costs.

In the cost model, investment property is measured at cost less accumulated depreciation and any accumulated impairment losses.

Gains and losses on disposal are recognised in profit or loss.

### Business implications

When a property interest held by a lessee under an operating lease is classified as an investment property, the fair value model must be used for all investment property. Limited exceptions apply.

IAS 40 encourages but does not require fair value to be determined on the basis of a valuation by an independent valuer who has a relevant professional qualification and experience.

The choice of fair value or cost will affect the timing of the recognition of changes in the fair value of investment property in the entity's profit or loss.

Entities may change accounting policies if this will result in a more appropriate presentation. IAS 40 indicates that changing from the fair value model to the cost model is unlikely to be appropriate.

# IAS 41

## Agriculture

### The Standard

IAS 41 prescribes the accounting treatment, financial statement presentation and disclosures related to agricultural activity. Agricultural activity is the management of the biological transformation of living animals or plants (biological assets) and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.

IAS 41 establishes the accounting treatment for biological assets during their growth, degeneration, production and procreation, and for the initial measurement of agricultural produce at the point of harvest. It does not address the processing of agricultural produce after harvest (eg processing grapes into wine, or wool into yarn). The standard contains the following accounting requirements:

- Biological assets are measured at fair value less costs to sell.
- Agricultural produce at the point of harvest is also measured at fair value less costs to sell.
- Changes in the value of biological assets are included in profit or loss.
- Biological assets that are attached to land (eg trees in a plantation forest) are measured separately from the land.

Biological assets and agricultural produce at the point of harvest are measured at fair value less costs to sell

The fair value of a biological asset or agricultural produce is its market price less any costs to get the asset to market. Costs to sell include commissions, levies and transfer taxes and duties.

IAS 41 differs from IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* with regard to the recognition of government grants. Unconditional grants related to biological assets measured at fair value less costs to sell are recognised as income when the grant becomes receivable. Conditional grants are recognised as income only when the conditions attaching to the grant are met.

### Business implications

For an entity involved in agricultural activity, a change in the physical attributes of a living animal or plant enhances or diminishes economic benefits. In a pure historical cost accounting model, benefits are not recognised until harvest and sale, which in the case of forestry can be 30 years after planting. In contrast, the fair value model recognises and measures biological growth as it occurs.

Usually there are active markets for biological assets and agricultural produce. In some circumstances, market determined prices or values may not be available, and fair value will need to be determined using a valuation technique such as the present value of expected net cash flows. Professional judgement is required in estimating net cash flows, and in determining the appropriate discount rate.

# IFRS for SMEs

## The Standard

The *International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities (SMEs)* is intended for the general purpose financial statements of entities that do not have public accountability. The *IFRS for SMEs* is built on the foundation of full IFRSs, but with simplifications that reflect SMEs' capabilities, the needs of the users of SMEs' general purpose financial statements and cost benefit considerations.

Entities that typically have public accountability (and therefore cannot claim compliance with the *IFRS for SMEs*) include publicly traded entities and entities that hold deposits in a fiduciary capacity for a broad group of outsiders as a primary business (typically banks and insurance companies). If a publicly accountable entity uses the *IFRS for SMEs*, its financial statements must not be described as conforming to the *IFRS for SMEs*—even if law or regulation in its jurisdiction permits or requires its use by a publicly accountable entity.

A subsidiary whose parent uses full IFRSs is not prohibited from using the *IFRS for SMEs* in its own financial statements if that subsidiary by itself does not have public accountability.

## Built on the foundation of full IFRSs, but with simplifications that reflect SME's capabilities, user needs and cost benefit considerations

In the *IFRS for SMEs* many of the principles for recognising and measuring assets, liabilities, income and expenses taken from full IFRSs have been simplified, including:

- recognising all borrowing costs and development costs as expenses when incurred
- reducing the categories of financial assets, with most basic financial instruments measured using a historical cost model
- amortising goodwill and indefinite life intangible assets
- permitting the cost model for investments in associates and joint ventures

- eliminating the option to use the revaluation model for property, plant and equipment and intangible assets
- removing the 'corridor approach' of accounting for actuarial gains and losses from the accounting for pension and medical plans and providing a simplified method of calculating the defined benefit obligation
- requiring one method of accounting for government grants
- inserting 'undue cost or effort' criterion in a number of places.

The *IFRS for SMEs* also required substantially fewer disclosures (roughly 10 per cent of the disclosures in full IFRSs).

## IFRS for SMEs continued

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### Business implications

The *IFRS for SMEs* provides an internationally recognised stable platform for SME reporting:

- Within a year of its issue, the staff is aware of over 60 countries that require or permit its use (or are considering doing so in the next three years).
- The IASB expects to propose amendments to the *IFRS for SMEs* by publishing an omnibus exposure draft approximately once every three years or so.

SMEs are expected to benefit from the *IFRS for SMEs* through:

- improved access to credit and venture capital
- improved comparability with other companies in its jurisdiction and across borders

- improved quality of financial information as compared to many local SME GAAPs
- reduced burden of compliance
- standardised computer systems and streamlined consolidation procedures (for multinational groups)
- international benchmarking information
- availability of textbooks, training and application software.

International Financial Reporting Standards (IFRSs®)  
A Briefing for Chief Executives, Audit Committees & Boards of Directors  
provides summaries of all the Standards in non-technical language.

These concise and easy to use briefing notes have been specially prepared for Chief Executives, members of Audit Committees, Boards of Directors and others who want a broad overview of International Financial Reporting Standards (IFRSs) including International Accounting Standards (IASs) and of the business implications of implementing them.

For those who require more detailed information the full text of the official authoritative pronouncements issued by the International Accounting Standards Board (IASB) is also available from the IFRS Foundation, both electronically and in printed form. The complete text features all International Financial Reporting Standards (IFRSs), including International Accounting Standards (IASs) and official Interpretations of the Standards, together with the IASB's supporting documentation – bases for conclusions, implementation guidance and illustrative examples.

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