

IAS and IFRS

Summary



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IAS 1 – Presentation of Financial Statements

IAS 1 covers the form and content of financial statements. The main components are:

- Statement of Financial Position (SOPF)
- Statement of Profit or Loss and Other Comprehensive Income (P&L and OCI)
- Statement of Changes in Equity
- Statement of Cash Flows
- Notes to the Financial Statements

The entity should identify each financial statement and the notes very clearly. IAS 1 also requires the entity to display the following information:

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

Overall Considerations for Presentation

There are 8 overall considerations for presenting the financial statements:

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

Statement of Financial Position

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

IAS 1 distinguishes between current and non-current assets/liabilities by identifying the term current asset/liability:

1) Current Assets:

- Assets expected to be realized in, or intended for sale and consumption in, the entity's normal operating cycle
- Held primarily for trading
- Due to be realized within 12 months
- Cash or cash equivalents that are not subject to exchange restrictions

2) Current Liabilities:

- Expected to be settled in the entity's normal operating cycle
- Held primarily for trading
- Due to be settled within 12 months
- The entity does not have the right at the end of the reporting period to defer settlement of the liability for at least 12 months

All other assets and liabilities are classified as non-current.

Statement of Profit or Loss

IAS 1 allows income and expense items to be presented either:

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

Key Principles to Memorize:

- The principles underpinning the overall presentation of financial statements are set out in IAS 1 – Presentation of Financial Statements.
- IAS 1 requires that all income and expenses are presented in a statement of profit or loss and other comprehensive income.
- IAS 1 does not allow entities to choose whether to present income and expense in the P&L section or the OCI section of the statement.

- IAS 1 states that unless required or permitted by a specific IFRS standard, all items of income and expense recognized in a period shall be included in the profit or loss section.
- The key implication of an item being presented in OCI rather than P&L is that the item would not be taken into account when measuring earnings per share.
- IAS 1 states that tax related to OCI is either shown as a separate line in the OCI section of the statement or netted off against each component of other comprehensive income and disclosed in the notes to the financial statements.
- Circumstances where items may be excluded from profit or loss for the current year include the correction of errors and the effect of changes in accounting policies (IAS 8).

Expense Analysis

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

Disclosures

IAS 1 specifies disclosures of certain items in certain ways.

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

Disclosures in both IAS 1 and other IFRS standards must be made either as separate line items in the statement or in the notes unless otherwise stated. Disclosures cannot be made in an accompanying commentary or report.

- IAS 1 also requires the disclosure of the amount of dividends paid during the period covered by the financial statements. This is shown either in the statement of changes in equity or in the notes.
- An entity must disclose the judgments made by management in applying the accounting policies that have the most significant effect on the amounts of items recognized in the financial statements.
- An entity must disclose in the notes information regarding key assumptions about the future and sources of measurement uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Statement of Changes in Equity

IAS 1 requires entities to present a statement of changes in equity. The statement must show:

- Total comprehensive income for the period, showing amounts attributable to the parent and non-controlling interests (NCI)
- The effects of any retrospective application of accounting policies or restatements in accordance with IAS 8
- A reconciliation of the opening to closing carrying amount for each component of equity
- An analysis of other comprehensive income

Notes to the Financial Statements

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IFRS 13 Fair Value

IFRS 13 defines fair value as 'the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.' That price would be described as the 'exit price'. The market-based current exit price implies an exchange between unrelated, knowledgeable and willing parties.

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

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

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

- For non-financial assets, the fair value measurement looks at how the asset can be used. It takes into account the ability of a market participant to generate economic benefits by using the asset in its highest and best use.
- Fair value measurement of a liability assumes that the liability is transferred at the measurement date to a market participant, who is then obliged to fulfill the obligation.

Valuation Techniques:

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

- **Level one:** Quoted prices in active markets for identical assets or liabilities that the reporting entity can access at the measurement date.
- **Level two:** Inputs, other than quoted prices included in level 1, that are observable for the asset or liability.
- **Level three:** Unobservable inputs for the asset or liability.

Valuation Approaches:

There are three valuation approaches:

1. **Income approach:** Valuation techniques that convert future amounts to a single current amount.
2. **Market approach:** Valuation techniques that use prices and other relevant information generated by market transactions.
3. **Cost approach:** Valuation techniques that reflect the amount that would be required currently to replace the service capacity of an asset.

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

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IFRS 15: Revenue from Contracts with Customers

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

Under IFRS 15, revenue is recognized when the promised goods and services are transferred to a customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

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

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

Revenue Recognition:

There are five steps to recognize revenue, which are:

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

- **Identify the contract with customer:**

A contract is within the scope of IFRS 15 if all the following criteria have been met:

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

- **Identify separate performance obligations:**

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

- **Determine the transaction price:**

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

- In determining the transaction price, variable considerations are only included where it is highly probable that there will not be a reversal of revenue when any uncertainty associated with the variable consideration is resolved.
- **Allocate the transaction price to the performance obligations:**
Where a contract contains more than one distinct performance obligation, a company allocates the transaction price to all separate performance obligations in proportion to the stand-alone selling price of the goods and services underlying each performance obligation.
- **Recognize revenue when or as a performance obligation is satisfied:**
The entity satisfies a performance obligation by transferring control of a promised good or service to the customer. A performance obligation can be satisfied at a point in time, such as when goods are delivered to the customer, or over time. The amount of revenue recognized is the amount allocated to the performance obligation (the outcome if it can be reasonably measured, or the cost incurred if the outcome cannot be reasonably measured).

IMP: Timing and Measurement of Revenue Summary:

“The timing of the recognition of revenue under IFRS 15 depends on the type of performance obligation (PO) the entity has under the contract. A PO is a distinct promise to transfer goods and services to the customer. IFRS 15 requires that revenue should be recognized when (or as) a particular PO is satisfied.

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

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

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

Contract Costs:

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

Common Types of Transactions:

Warranties

- If a customer has the option to purchase a warranty separately from the product, it constitutes a distinct service and is accounted for as a separate performance obligation.
- If the customer does not have the option to purchase the warranty separately, for instance if it's required by law, that does not give rise to a performance obligation, and the warranty is accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Principal versus Agent

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

- It is a **principal** if it controls the promised goods or services before they are transferred to the customer. Other indications are:
 - (a) It is primarily responsible for fulfilling the contract.
 - (b) It has inventory risk before or after the transfer of control to the customer.
 - (c) It has discretion in establishing prices for the specified goods or services.

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

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

Repurchase Agreements

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

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

Consignment Arrangements

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

Indicators of a consignment arrangement include:

- (a) The product is controlled by the entity until a specified event occurs, such as the product is sold on, or a specified period expires.
- (b) The entity can require the return of the product, or transfer it to another party.
- (c) The customer does not have an unconditional obligation to pay for the product.
 - **If control of the inventory has been transferred to the dealer:**
 - The inventory should be recognized in the dealer's SOFP, together with a corresponding liability to the manufacturer. Any deposit should be deducted from this liability, and the excess classified as a trade payable.
 - **If control of the inventory has not been transferred to the dealer:**
 - The inventory should not be included in the dealer's SOFP until the transfer of control has taken place, and any deposit should be included under 'other receivables'.

Bill and Hold Arrangement

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

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

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

Sale with a Right to Return

When goods are sold with a right of return, an entity should not recognize revenue for goods that it expects to be returned. This will be shown as a refund liability and a deduction from revenue. The entity also recognizes an asset for its right to recover products from customers on settlement of the refund liability.

- **With estimation:**

Dr	Accounts Receivable / Cash	XXX
Cr	Revenue	XX
Cr	Refund Liability (Contra-account to AR)	X

Dr	Cost of Goods Sold	XX
Dr	Right to Recover Asset	X
Cr	Inventory	XXX

- **With no estimation (No revenue recognition):**

Dr	Right to Recover Asset	XXX
Cr	Inventory	XXX

Presentation

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

- **A contract liability:** Arises where a customer has paid an amount of consideration prior to the entity performing by transferring control of related goods or services to the customer.
- **A contract asset:** Arises where the entity has performed but the customer has not yet paid the related consideration, and the entity's right to consideration is conditional on something other than the passage of time, e.g., future performance.
- **A receivable:** Arises where the entity has performed but the customer has not yet paid the related consideration, and the entity's right to consideration is unconditional except for the passage of time.

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

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ASSETS

IAS 36 Impairment of Assets

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

- **Carrying amount:** The amount at which an asset is recognized after deducting any accumulated depreciation (or amortization) and accumulated impairment losses.
- **Impairment loss:** The amount by which the carrying amount of an asset or a cash-generating unit exceeds its recoverable amount.

IAS 36 impairment applies to all tangible, intangible, and financial assets except those covered by IAS 2, IAS 12, IAS 19, IFRS 9, IAS 40, and IFRS 5. This is because those standards already have rules for recognizing and measuring impairment (except for IFRS 5: no impairment).

The basic principle of IAS 36 is: if an asset's carrying amount in the financial statements is higher than its recoverable amount, the asset has suffered an impairment loss and should therefore be reduced in value by the amount of the impairment loss. This amount is written off against profit immediately.

Impairment Loss Indicators:

- **External indicators (4):**
 - A fall in the asset's market value that is more significant than what would normally be expected from the passage of time or normal use.
 - A significant change in the technological, legal, market, or economic environment of the business in which the asset is employed.
 - An increase in market interest rates or market's rates of return on investment likely to affect the discount rate used in calculating value in use.
 - The carrying amount of the entity's net assets is more than its market capitalization.

- **Internal indicators (2):**

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

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

- (a) An intangible asset with an indefinite useful life.
 (b) Goodwill acquired in a business combination.

The Recoverable Amount of an Asset:

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

- An asset's **fair value less costs of disposal** is the price that would be received to sell the asset in an orderly transaction between market participants at the measurement date, less direct disposal costs (restructuring and reorganizing expenses or any costs that have already been recognized in the financial statements as liabilities are not included).
- The **value in use** is the present value of the future cash flows expected to be derived from an asset or cash-generating unit.

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

Accounting Treatment of an Impairment Loss:

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

- The carrying amount should be reduced to its recoverable amount in the SOFP.
- The impairment loss should be recognized immediately in profit or loss.
- **Cost model:**

Dr	Impairment Loss	XX
Cr	Asset (or Accumulated Impairment)	XX

- **Revaluation model:**

Dr	Revaluation Surplus (OCI)	XX
Dr	Impairment Loss (P&L)	X
Cr	Asset	XXX

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

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

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

Reversal of an Impairment Loss:

An annual impairment test should be applied to all assets, including assets that have been impaired in the past. In some cases, the recoverable amount of a previously impaired asset becomes higher than its current carrying amount. In other words, there might have been a reversal of some of the previous impairment loss. In such a case, the carrying amount of the asset should be increased to its new recoverable amount. The asset cannot be revalued to a carrying amount that is higher than its value would have been if the asset had not been impaired originally (i.e., original carrying amount less accumulated depreciation).

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

- **Cost model:**

Dr	Asset	XX
Cr	Recovery of Impairment Loss (P&L)	XX

- **Revaluation model:**

Dr	Asset	XX
Cr	Revaluation Surplus (OCI)	XX

IAS 16 – Property, Plant and Equipment

Property, plant and equipment (PPE) are tangible assets that:

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

Bearer plants are within the scope of IAS 16. They are living plants that:

- Are used in the production or supply of agricultural produce;
- Are expected to bear produce for more than one period; and
- Have a remote likelihood of being sold as agricultural produce.

Recognition:

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

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

The asset should be initially measured at cost. Cost of the asset includes its:

1. Purchase price
 2. Import duties
 3. Directly attributable costs of bringing the asset to the location and working condition necessary for its intended use
 4. Unavoidable costs of dismantling the asset
- For very large and specialized items, an apparently single asset should be broken down into its composite parts. This occurs where the different parts have different useful lives and different depreciation rates are applied to each part.
 - Major components or separate parts should be recognized as PPE.
 - Smaller items are sometimes classified as inventory or written off as expenses.
 - Safety and environmental equipment that are necessary for the entity to obtain future economic benefits from its other assets should be recognized as assets and reviewed for impairment along with the original assets.
 - Parts of some items of PPE may require replacement at regular intervals. This cost and expenditure incurred in replacing or renewing it are recognized in full when incurred and added to the carrying amount of the asset. It will be depreciated over its useful life, which may be different from the useful life of other components of the asset. The carrying amount of the item being replaced is derecognized when the replacement takes place.
 - When an asset requires regular overhauls in order to continue to operate, the cost of the overhaul is treated as an additional component and depreciated over the period until the next overhaul.

Subsequent Measurement:

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

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

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

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

Accounting for Revaluation Method:

- When an **increase** in value takes place, IAS 16 requires the increase to be credited to 'Other Comprehensive Income' (OCI) and accumulated in equity under "Revaluation Surplus".

Dr	Asset	XX
Cr	Revaluation Surplus (OCI)	XX

- When a **decrease** in value takes place, IAS 16 requires the decrease to be recognized in OCI up to the balance of any revaluation surplus relating to that asset. Any excess is recognized in profit or loss.

Dr	Revaluation Surplus (OCI)	XX
Dr	Profit or Loss	X
Cr	Asset	XXX

- If the asset had previously suffered a **decrease** in value that was charged to profit or loss, any **increase** in value in a subsequent revaluation should be recognized in profit or loss up to the amount of the previously recognized decrease. Any excess should be recognized in OCI and accumulated in revaluation surplus.

Dr	Asset	XXX
Cr	Profit or Loss	X
Cr	Revaluation Surplus (OCI)	XX

The amount of surplus realized, when an asset has an upward revaluation, is the difference between depreciation charged on the revalued amount and the depreciation that would have been charged on the asset's original cost. This amount can be transferred to retained earnings, but not through profit or loss.

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

Derecognition:

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

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IAS 38 – Intangible Assets

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

- Controlled by the entity as a result of past events
- Something from which the entity expects future economic benefits to flow

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

- Identifiable:** Acquired separately through purchase or it could be rented or sold separately (in order to distinguish it from goodwill).
- Controlled by the entity:** The entity must be able to enjoy the future economic benefits from the asset and prevent access to others from those benefits.

Initial Measurement:

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

- It is probable that future economic benefits that are attributable to the asset will flow to the entity.
- The cost of the asset can be measured reliably.
- If an intangible asset is:

- **Acquired separately** → its cost can usually be measured reliably as its purchase price.
- **Part of a business combination** → the cost of the intangible asset is its fair value at the date of acquisition.
- **Acquired by way of government grant (IAS 20)** → it may be recorded initially either at cost or fair value.
- **Acquired in exchange for another intangible asset** → the cost of the intangible asset is measured at fair value unless:
 - The exchange transaction lacks commercial substance, or
 - The fair value of neither asset can be measured reliably.
 Otherwise, its cost is measured at the carrying amount of the asset given up.

Internally Generated Intangible Assets:

- **Goodwill:** Internally generated goodwill may not be recognized as an asset. IAS 38 specifically prohibits recognition of internally generated goodwill because its cost cannot be measured reliably and it is not identifiable or controlled.
- **Research and Development Costs:**
 - **Research:** Research activities, by definition, do not meet the criteria for recognition under IAS 38. This is because, at the research stage of a project, it cannot be certain that future economic benefits will flow to the entity from the project. Research costs should therefore be written off as an expense as they are incurred.
 - **Development:** Development costs may qualify by definition as intangible assets provided that the following strict criteria can be demonstrated:
 - The technical feasibility of completing the intangible asset so that it will be available for use or sale.
 - The entity's intention to complete the intangible asset and use or sell it.
 - The entity's ability to use or sell the intangible asset.
 - How the intangible asset will generate future economic benefits.
 - The availability of adequate technical, financial, and other resources to complete the development and to use or sell the intangible asset.
 - The entity's ability to reliably measure the expenditure attributable to the intangible asset during its development.

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

***Note:** * If the entity cannot distinguish between research and development, it treats the expenditure on the project as if it were incurred in the research phase.

- **Other Internally Generated Intangible Assets:**

The standard prohibits the recognition of internally generated brands, customer lists, titles, etc. These all fail to meet one or more of the definition and recognition criteria and, in some cases, are indistinguishable from internally generated goodwill.

All expenditures related to other intangibles that do not meet the recognition criteria of an identifiable intangible asset or goodwill should be expensed when incurred. Examples include training and advertising costs. IAS 38 specifically prohibits the capitalization of advertising and promotion expenses as the economic benefits are uncertain and it is beyond the control of the entity.

Subsequent Measurement of Intangible Assets:

The standard allows two methods:

1. **The Cost Model:**
 - Cost less accumulated amortization and impairment losses.
2. **The Revaluation Model:**
 - Measured at fair value at the date of revaluation (same accounting treatment as IAS 16). Can only be used if there is an active market in that type of asset and fair value can be measured reliably. If there is no active market, then the cost model must be used.
 - Revaluation must be made to the entire class of intangible assets at the same time and with such regularity that the carrying amount does not differ materially from its fair value at the end of the reporting period.

Amortization:

An entity should assess the useful life of an intangible asset for amortization purposes, which may be finite or indefinite.

- An intangible asset with a **finite useful life** should be amortized over its expected useful life, and the residual value is assumed to be zero. Amortization starts when the asset is available for use and is recognized in profit or loss. The amortization period and method should be reviewed at each financial year end.

- No amortization is charged for assets held for sale in accordance with IFRS 5 from the earlier date of when the asset is derecognized or classified as held for sale.
- The residual value of an intangible asset with a finite useful life is assumed to be zero unless a third party is committed to buying it at the end of its useful life or there is an active market for that type of asset at the end of its useful life.
- An intangible asset with an **indefinite useful life** should not be amortized. IAS 36 requires this asset to be tested for impairment at least annually. The useful life should be reviewed each year to determine if it is still appropriate to assess its useful life as indefinite. Reassessing the useful life as finite is an indicator that the asset may be impaired and should be tested for impairment.

Disposal/Retirements of Intangible Assets:

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

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IFRS 3 – Business Combinations (Goodwill)

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

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

- Goodwill acquired in a business combination is recognized as an asset and initially measured at cost.
- Subsequent measurement is at cost less any accumulated impairment losses. It is **not amortized**. Instead, it is tested for impairment at least annually, in accordance with IAS 36.
- A gain on a bargain purchase ("negative goodwill") is recognized when the acquirer's interest in the net fair value of identifiable assets, liabilities, and contingent liabilities of the acquired business exceeds the cost of the business combination. It can also arise as a result of errors in measurement. So, before recognizing a gain on bargain purchase, an entity should first reassess the measurement of the acquiree's identifiable net assets. Any gain on bargain purchase remaining should be recognized immediately in profit or loss.

***Note:** * All costs associated with the acquisition must be expensed (P&L) except for costs of issuing debt or equity instruments, which are charged to other components of equity.

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IAS 40 – Investment Property

It is property held to earn rentals or for capital appreciation or both, rather than for:

- Sale in the ordinary course of business (IAS 2), or
- Use in the production or supply of goods and services or for administrative purposes (IAS 16).
- An asset held by an entity as a right-of-use asset under IFRS 16 and leased out under an operating lease is treated as investment property.
- If the entity has not determined the use of its PPE, it is considered held for capital appreciation.
- Some properties may be partly owner-occupied and partly held for investment purposes. Under IAS 40, if they can be sold separately, an entity should account for the portions separately. If the portions cannot be sold separately, the property is investment property only if an insignificant portion is owner-occupied.

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

Recognition:

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

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

Initial Measurement:

Investment properties should be measured initially at cost, including transaction costs.

Subsequent Measurement:

IAS 40 requires an entity to choose between two models, and whichever one it chooses should be applied to all its investment properties.

- **(i) Cost Model:**

It is the same as the cost model in IAS 16. Investment properties should be measured at cost, less any accumulated depreciation and impairment losses. An entity that chooses the cost model should disclose the fair value of its investment property.

- **(ii) Fair Value Model:**

After initial recognition, an entity that chooses the fair value model should measure all of its investment properties at fair value, except those whose fair value cannot be measured reliably. In such cases, it should apply the IAS 16 cost model.

- A gain or loss arising from a change in the fair value of an investment property should be recognized in profit or loss for the period in which it arises.
- Once the entity has chosen the fair value or cost model, it should apply it to all its investment property. It should not change from one model to another unless the change will provide more reliable or relevant information.

Transfers:

Transfers to or from investment property should only be made when there is a change in use.

Transfer From	Transfer To	Accounting Treatment
Investment property	Owner-occupied property or Inventory	The property's cost for subsequent accounting is its fair value at the date of change of use.
Owner-occupied property	Investment property	Treat the difference between carrying amount and fair value at the date in accordance with the revaluation model under IAS 16.

Disposal:

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

- Any gain or loss on disposal is the difference between the net disposal proceeds and the carrying amount of the asset. It should generally be recognized as income or expense in profit or loss.
- Compensation from third parties for investment property that was impaired, lost, or given up shall be recognized in profit or loss when the compensation becomes receivable.

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

IFRS 5 requires:

1. Assets or a group of assets that are 'held for sale' to be presented separately in the statement of financial position.
2. The results of discontinued operations to be presented separately in the statement of profit or loss and other comprehensive income.

This is required so that users of financial statements will be better able to make projections about the financial position, profits, and cash flows of the entity.

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

Classification as Held for Sale:

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

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

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

1. Management must be committed to a plan to sell the asset.
 2. There must be an active program to locate a buyer.
 3. The asset must be marketed for sale at a reasonable price in relation to its current fair value.
 4. The sale is expected to take place within one year from the date of classification.
 5. It is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.
- An asset or disposal group can still be classified as held for sale, even if the sale has not actually taken place within one year. However, the sale's delay must have been caused by events or circumstances beyond the entity's control, and there must be sufficient evidence that the entity is still committed to sell the asset or disposal group. Otherwise, the entity must cease to classify the asset as held for sale.
 - If an entity acquires a disposal group with the intention of selling it, it can classify the asset as held for sale only if the sale is expected to take place within a year and it is highly probable that the other criteria will be met within a short time (3 months).
 - An asset that is to be **abandoned** should not be classified as held for sale, because its carrying amount will be recovered principally through continuing use. A disposal group that is to be abandoned may meet the definition of a discontinued operation and therefore separate disclosure may be required.

Presentation:

- Non-current assets classified as held for sale should be presented separately from other assets in the statement of financial position.
- The liabilities of a disposal group should be presented separately from other liabilities in the statement of financial position.
- Assets and liabilities held for sale should not be offset, and major classes of them should be separately disclosed either on the face of the statement of financial position or in the notes.

Measurement:

- A non-current asset (or disposal group) that is held for sale should be measured at the **lower of its carrying amount and fair value less costs to sell**. Fair value less costs to sell is equivalent to net realizable value (as there is no value in use for assets held for sale). It should be remeasured at the lower of its carrying amount and fair value less costs to sell at each reporting date at which it is still classified as held for sale.
- An impairment loss should be recognized where fair value less costs to sell is lower than the carrying amount. The impairment loss is charged to profit or loss unless the asset has been previously revalued, in which case impairment should be treated as a decrease in value and accounted for by applying the relevant accounting standard (IAS 16 or IAS 38). IAS 36 does not apply to assets held for sale. Impairment losses of assets held for sale are dealt with under IFRS 5.
- If the fair value less costs to sell increases, then the carrying amount of the asset can be increased, and the resulting gain should not exceed impairment losses previously recognized (under IFRS 5 or IAS 36 before the asset was classified as held for sale).
- **Non-current assets held for sale should not be depreciated**, even if they are still being used by the entity.
- A non-current asset held for sale that is **no longer classified as held for sale** is measured at the **lower of**:
 - (a) Its carrying amount before it was classified as held for sale, adjusted for any depreciation, amortization, or revaluations that would have been recognized had the asset not been classified as held for sale.
 - (b) Its recoverable amount at the date of the decision not to sell.

Disclosures:

- **Non-current assets held for sale (or disposal group):**
In the period in which it has been classified as held for sale, the following should be disclosed:
 - A description of the non-current asset or disposal group.
 - A description of the facts and circumstances of the disposal.
 - Any gain or loss recognized when the item was classified as held for sale.
 - When an asset previously classified as held for sale is no longer held for sale, the entity should disclose a description of the facts and circumstances leading to the decision and its effect on results.

- **Discontinued operations:**

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

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

An entity should present and disclose information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets or disposal groups. This allows users to distinguish between operations which will continue in the future and those which will not.

1. An entity should disclose a **single amount** in the statement of profit or loss comprising the total of:
 - The post-tax profit or loss of discontinued operations.
 - The post-tax gain or loss recognized on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group constituting the discontinued operation.
2. An entity should also disclose an **analysis** of this single amount into:
 - The revenue, expenses, and pre-tax profit or loss of discontinued operations.
 - The related income tax expense.
 - The gain or loss recognized on the measurement to fair value less costs to sell or on the disposal of the assets of the discontinued operations.
 - The related income tax expense.
 - This may be presented either in the statement of profit or loss or in the notes. If presented in the statement of profit or loss, it should be in a section identified as relating to discontinued operations (i.e., separately from continued operations). ***Note:** * This analysis is not required where the discontinued operation is a newly acquired subsidiary that has been classified as held for sale.
3. An entity should disclose the **net cash flows** attributable to the operating, investing, and financing activities of discontinued operations. These disclosures may be presented as separate line items in the statement of cash flows or in the notes.

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

- **Government assistance:** Action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under certain criteria. The forms of government assistance which are excluded from the definition of government grants should be disclosed because of their significance.
- **Government grants:** Assistance by government in the form of a transfer of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

Recognition:

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

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

Even if grants have been received, this does not prove that the conditions have or will be fulfilled. The manner of receipt is irrelevant. In the case of a forgivable loan from government, it should be treated in the same way as a government grant when it is reasonably assured that the entity will meet the relevant terms for forgiveness.

Accounting Treatment:

IAS 20 requires grants to be recognized as income over the relevant periods to match them with the related costs which they have been received to compensate. This should be done on a systematic basis. Grants should not, therefore, be credited directly to equity, as that would be against the accruals concept. It would only be accepted if no other basis was available.

- Where grants are received in relation to a **depreciating asset**, the grant will be recognized over the periods in which the asset is depreciated and in the same proportions.

- In the case of grants for **non-depreciable assets**, the grant should be recognized as income over the periods in which the cost of meeting the obligation is incurred.
- An entity may receive a grant **as compensation for expenses or losses** which it has already incurred or with no future related costs expected. In cases such as these, the grant received should be recognized as income of the period in which it becomes receivable.
- A non-monetary asset may be transferred by the government to the entity as a grant. The fair value of such an asset is usually assessed and this is used to account for both the asset and the grant.

1) Grants Related to Assets:

There are two choices of how government grants related to assets should be shown in the SOFP.

- **(A) Set up the grant as deferred income:**

Dr	Cash	XX
Cr	Deferred Income	XX

At the end of the year (recognize income over useful life):

Dr	Deferred Income	X
Cr	Other Income	X

- **(B) Deduct the grant in arriving at the carrying amount of the asset:**

Dr	Cash	XX
Cr	Asset (or reduce cost)	XX

2) Grants Related to Income:

There are two choices of how they are presented in the profit or loss statement.

- **(A) Present as a separate credit or under a general heading ("Other income"):**

Dr	Cash	XX
Cr	Other Income	XX

- **(B) Deduct from the related expense:**

Dr	Cash	XX
Cr	Related Expense (e.g., wages, research)	XX

Repayment of the Grant:

If a grant must be repaid, it should be accounted for as a revision of an accounting estimate (IAS 8).

- **Repayment of grant related to an asset:** Increase the carrying amount of the asset or reduce the deferred income balance by the amount repayable. The cumulative additional depreciation that would have been recognized to date in the absence of the grant should be immediately recognized as an expense.
- **Repayment of grant related to income:** Apply first against any unamortized deferred income set up in respect of the grant, and any excess should be immediately recognized as an expense.

IAS 41 – Agriculture

- **Agricultural activity:** The management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.
- **Biological asset:** A living animal or plant.
- **Agricultural produce:** The harvested product of an entity's biological assets.

- **Harvest:** The detachment of produce from a biological asset or the cessation of a biological asset's life processes.

***Note:** * Bearer plants (IAS 16), agricultural land (IAS 16/IAS 41), and intangible assets related to agricultural activity (IAS 38) are specifically excluded from the scope of IAS 41.

Recognition Criteria of Biological Assets:

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

Measurement and Presentation of Biological Assets:

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

- If the fair value cannot be determined and is not available, then the biological asset can be measured at cost less accumulated depreciation and impairment losses. This alternative is only allowed on initial recognition.
- IFRS 13 *Fair Value Measurement* requires the fair value of a biological asset to be determined by reference to the principal market for the asset. This may or may not be the most favorable market. Changes to fair value can arise due to both physical changes in the asset and price changes in the market.
- Biological assets are recognized in the statement of financial position as a separate class of assets (neither current nor non-current) at fair value less costs to sell, incorporating the consequences of all biological transformations.
- A gain or loss arising on initial recognition of a biological asset at fair value less costs to sell and from a change in fair value less costs to sell is included in profit or loss in the period in which it arises.

Measurement and Presentation of Agricultural Produce:

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

- Agricultural produce that is harvested for trading and processing activities should be measured at fair value at the date of harvest, and this amount is deemed cost for the application of IAS 2 to consequential inventories.
- Agricultural produce should be classified as inventory in the statement of financial position and disclosed separately either in the statement of financial position or in the notes.

Measurement and Presentation of Government Grants:

Measured at fair value less costs to sell.

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

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

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IAS 2 – Inventories

Inventories are assets:

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

Inventories can include:

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

Cost of Inventories:

The cost of inventories consists of all costs of:

- **Purchase:** Purchase price, import duties, transport, and directly attributable costs of acquisition of finished goods less trade discounts, rebates, and other similar amounts.

- **Conversion:** Directly related costs to units of production, and fixed and variable production overheads.
- **Other costs:** Incurred in bringing the inventories to their present location and condition.

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

- Abnormal amounts of wasted materials, labor, or other production costs
- Storage costs
- Selling costs
- Administrative overheads not incurred to bring inventories to their present location and condition

Cost Formulas:

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

Measurement:

Inventories should be measured at the **lower of cost and net realizable value (NRV)**.

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

- An increase in costs or fall in selling price
- A physical deterioration in the condition of inventory
- Obsolescence of products
- Errors in production or purchasing
- A decision to sell the product at a loss

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

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

Accounting Entries:

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

Dr	Cost of Goods Sold (P&L)	XX
Cr	Inventory	XX

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

Dr	Impairment Loss (P&L)	XX
Cr	Inventory	XX

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

Dr	Inventory	XX
Cr	Reversal of Impairment (P&L)	XX

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IAS 23 – Borrowing Costs

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

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

Dr	Asset (Qualifying)	XX
Cr	Borrowing Costs (or Cash)	XX

- **Qualifying asset:** An asset that necessarily takes a substantial period of time (normally more than one year) to get ready for its intended use or sale.
 - Financial assets and inventories that are manufactured or produced over a short period of time are **not** qualifying assets.
 - Assets that are ready for their intended use or sale when purchased are **not** qualifying assets.
- Where the entity uses a range of debt instruments to finance a wide range of assets, once the relevant borrowings which relate to a specific asset are identified, then the amount of borrowing costs available for capitalization will be the actual borrowing costs incurred on those borrowings during the period less any investment income on the temporary investment of those borrowings.
- A situation may arise where the carrying amount of the qualifying asset exceeds its recoverable amount or net realizable value. In these cases, the carrying amount must be written down. They may be written back in the future.

Commencement of Capitalization:

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

- Expenditure on the asset is being incurred.
- Borrowing costs are being incurred.
- Activities are in progress that are necessary to prepare the asset for its intended use or sale.

Suspension of Capitalization:

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

Cessation of Capitalization:

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

Memorize:

- "IAS 23 looks at the treatment of borrowing costs, particularly where the related borrowings are applied to the construction of certain assets. These are usually called 'self-constructed assets', where an entity builds its own inventory or non-current assets over a substantial period of time."
- "Under the principle of IAS 23, borrowing costs which are directly attributable to the acquisition of an asset should be included as a part of the carrying amount of the asset."
- "Borrowing costs would have been avoided if it weren't for manufacturing the asset. Therefore, interest expense should be capitalized."

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IFRS 6 – Exploration for and Evaluation of Mineral Resources

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

- **Exploration and evaluation expenditures:** Expenditures incurred in connection with the exploration for and evaluation of mineral resources before the technical feasibility and commercial viability of extracting a mineral resource is demonstrable.
- **Exploration and evaluation assets:** Exploration and evaluation expenditures recognized as assets in accordance with the entity's accounting policy.

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

***Note:** * Expenditure related to the development of mineral resources must not be recognized as exploration and evaluation assets under IFRS 6, as they come under IAS 38.

Recognition and Measurement:

- At recognition, exploration and evaluation assets must be measured at **cost**.
Examples of costs included:
 - Acquisition of rights to explore
 - Topographical, geological, geochemical, and geophysical studies
 - Exploratory drilling
 - Trenching
 - Sampling
 - Activities in relation to evaluating the technical feasibility and commercial viability of extracting a mineral resource
 - Costs of any obligations for removal and restoration
- In subsequent measurement, entities must apply the cost model or the revaluation model (refer to IAS 16 or IAS 38).
- Exploration and evaluation assets are classified as tangible or intangible according to the nature of the assets acquired. For example, drilling rights would be intangible; vehicles or drilling rigs would be tangible. The classification must be applied consistently.
- They should no longer be classified as exploration and evaluation assets when the technical feasibility and commercial viability of extracting a mineral resource is demonstrable. Any impairment loss on the assets must be recognized before reclassification.

Impairment:

Exploration and evaluation assets must be assessed for impairment when facts and circumstances suggest that the carrying amount of an asset may exceed its recoverable amount. Any resulting impairment loss must be measured, presented, and disclosed in accordance with IAS 36.

- For impairment purposes, each cash-generating unit or group of units to which an exploration and evaluation asset is allocated must not be larger than an operating segment as determined by IFRS 8.

Memorize:

- "IFRS 6 states that, in making this determination, entities should consider the degree to which the expenditure can be associated with finding the specific mineral resources it is seeking."
- "IFRS 6 specifically prohibits the inclusion of the cost of development of mineral resources in the exploration and evaluation asset figure. Such expenditure should be accounted for in accordance with IAS 38 – Intangible Assets."

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LIABILITIES

IAS 37 – Provisions, Contingent Liabilities and Contingent Assets

- A **provision** is a liability of uncertain timing or amount.
- A **liability** is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Recognition:

IAS 37 states that a provision should be recognized as a liability in the financial statements when:

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

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

Measurement:

- The amount recognized as a provision should be the **best estimate** of the expenditure required to settle the present obligation at the end of the reporting period. The estimate is determined by the judgment of the entity's management.
- Where the provision being measured involves a **large population of items**, the obligation is estimated by weighting all possible outcomes by their associated probabilities (i.e., expected value).

- Where the provision involves a **single item**, such as the outcome of a legal case, the provision is made in full for the most likely outcome.
- The amount of a provision should be the **present value** of the expenditure required to settle the obligation where the effect of the time value of money is material. An appropriate discount rate should be used.
- Future events which are reasonably expected to occur may affect the measurement of the provision and should be taken into account.
- Gains from the expected disposal of assets should **not** be taken into account in the measurement of a provision.

Subsequent Treatment:

- At the end of each reporting period, a provision should be adjusted to reflect the current best estimate of the expected expenditure.
- A provision should be **derecognized** if the expenditure required to settle the related obligation is no longer probable.
- Only expenditure related to the provision should be offset against it. Setting expenditures against a provision that was originally recognized for another purpose would conceal the impact of two events.

Reimbursements:

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

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

Some Types of Provisions:

- **Warranties:** These are argued to be genuine provisions as, based on past experience, it is probable that some claims will emerge. The nature of the warranty granted will determine whether it should be accounted for under IAS 37 or IFRS 15.
- **Major Repairs:** Under IAS 37, it is no longer possible to recognize a provision for major repairs, as it is a mere intention to carry out repairs, not an obligation.
- **Self-insurance:** Under IAS 37, this kind of provision is no longer justifiable, as the entity has no obligation until a fire or accident occurs. No obligation exists until that time.
- **Environmental Contamination:** If the company has an environmental policy or if the company has broken current environmental legislation, then a provision for environmental damage must be made.
- **Decommissioning or Abandonment Costs:** A legal obligation exists on initial expenditure; therefore, a liability exists immediately. The cost of purchasing the field is not only the cost of the field itself but also the cost of putting it right again. Thus, all costs of decommissioning may be capitalized.

Dr	Property, Plant & Equipment	XX
Cr	Provision for Decommissioning	XX

- **Future Operating Losses:** Provisions are not recognized for future operating losses. They do not meet the definition of a liability or the general recognition criteria.
- **Onerous Contracts:** A contract in which the unavoidable costs of meeting the obligation under the contract exceed the economic benefits expected to be received under it. IAS 37 requires a provision to be recognized for this contract after recognizing any impairment losses for assets related to the contract. The provision should be measured at the lower of the cost of fulfilling the contract and the cost of penalties from failure to fulfill the contract.
- **Restructuring:** A program that is planned and controlled by management and materially changes either the scope of a business undertaken by the entity or the manner in which a business is conducted.
 - For the entity to have an obligation at the end of the reporting date, it must:
 - Have a detailed formal plan for the restructuring.
 - Have raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it. A mere management decision is not normally sufficient.
 - Where the restructuring involves the sale of an operation, IAS 37 states that no obligation arises until the entity has entered into a binding agreement. This is because until this has occurred, the entity will be able to change its mind and withdraw from the sale even if its intentions have been announced publicly.

- A restructuring provision should include only **direct expenditures** arising from the restructuring (those necessary because of the restructuring and not related to the ongoing activities of the business). Costs relating to marketing, new systems/distribution networks, retraining, or relocating existing staff should **not** be included.

Contingent Liabilities and Contingent Assets:

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

- **A contingent liability** is:
 - a) A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
 - b) A present obligation that arises from past events but is not recognized because:
 - i. It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - ii. The amount of the obligation cannot be measured with sufficient reliability.
 - They should not be recognized but should be disclosed. Required disclosures are:
 - Description of the nature of the contingent liability
 - Estimate of its financial effect
 - Indication of the existing uncertainties
 - The possibility of any reimbursement
- **A contingent asset** is a possible asset that arises from past events and whose existence will be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.
 - A contingent asset must **not** be recognized. Only when the realization of the related economic benefits is **virtually certain** should recognition take place. At that point, the asset is no longer a contingent asset.

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IAS 19 – Employee Benefits

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

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

(a) Short-term benefits:

Employee benefits (other than termination benefits) that are expected to be settled wholly before 12 months after the end of the annual reporting period in which the employees render the related service.

- *Examples:* Wages and salaries, social security contributions, paid annual leave, paid sick leave, paid military service, profit shares and bonuses, non-monetary benefits, etc.

(b) Post-employment benefits:

Employee benefits (other than termination and short-term employee benefits) that are payable after the completion of employment.

- *Examples:* Pensions, post-employment medical care, and post-employment insurance.

(c) Other long-term benefits:

All employee benefits other than short-term employee benefits, post-employment benefits, and termination benefits.

- *Examples:* Profit shares, bonuses or deferred compensation payable later than 12 months after the year end, sabbatical leave, long-service benefits, and long-term disability benefits.

(d) Termination benefits:

Employee benefits provided in exchange for the termination of an employee's employment.

- *Examples:* Early retirement payments and redundancy payments.

Short-Term Employee Benefits:

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

- Unpaid short-term employee benefits as at the end of an accounting period should be recognized as an accrued expense.
- Any short-term benefits paid in advance should be recognized as a prepayment.
- The cost should be recognized as an expense in the period when the economic benefit is given, as employment costs.
- Paid short-term employee benefits can be accumulating (e.g., paid holiday leave) or non-accumulating (e.g., maternity/paternity pay). The cost of accumulating paid absence should be measured as the additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period.

- Profit shares or bonuses payable within 12 months after the end of the accounting period should be recognized as an expected cost when the entity has a present obligation to pay it.
- The short-term accumulating paid benefits should be recognized as a cost and a related liability in the year when the entitlement arises. The liability should be released as the carried-forward benefits are used up or after 12 months if they are not used.

Post-Employment Benefits:

There are two types of post-employment benefit plans:

1. **Defined Contribution Plan:** The value of the retirement benefits paid out depends on the value of the plan, which itself depends on the value of the contributions made. The party who makes contributions and receives benefits bears the risk here, since if the value of the plan falls, so do the benefits paid out. Payments are expenses in the year of employment and are accounted for in the same way as salaries.
2. **Defined Benefit Plan:** The value of retirement benefits paid out is defined in advance and is not affected by the value of the plan. The risk here is with the plan operator because if the plan does not have sufficient funds to pay out the defined benefits, then these must be made up for. It requires an entity to set up a separate plan and to record the plan's assets, liabilities, income, and expense. It is common to have a net liability, meaning that the obligation to pay the future pension is bigger than the value of the assets owned by the fund.

Defined Contribution Plans:

- The obligation is measured by the amounts to be contributed for the period.
- There is no actuarial assumption to make.
- No requirement for discounting if the obligation is settled in the current period (less than 12 months).
- Contributions to the plan should be recognized as an expense in the period they are payable.
- Any unpaid contributions due at the end of the period should be recognized as a liability.
- Any excess contributions paid should be recognized as an asset (prepaid expense), but only to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund.

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

Defined Benefit Plans:

Component	Impact on Defined Benefit Obligation	Impact on Plan Asset
Present value of obligation / Fair value of asset	+ (Opening)	+ (Opening)
Interest (market yield)	+	+
Service cost (current and past)	+
Contributions received	+
Benefits paid	-	-
Actuarial remeasurement	+/-	+/-

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

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

Four-Step Method for Defined Benefit Plans:

1. **Measure the deficit or surplus:**

- *The deficit or surplus is:* the present value of the defined benefit obligation less the fair value of the plan assets.
 - a) Use an actuarial technique to estimate the amount of future benefits employees have earned.
 - b) Discount the benefits to arrive at the present value of the defined benefit obligation and the current service cost.
 - c) Deduct the fair value of any plan assets from the present value of the defined benefit obligation.
- 2. **Adjust for the asset ceiling:** The surplus or deficit may have to be adjusted if a net benefit asset has to be restricted by the asset ceiling (the present value of economic benefits available as refunds or reduced future contributions).
- 3. **Determine amounts to be recognized in profit or loss:**
 - a) Current service cost
 - b) Any past service cost and gain or loss on settlement
 - c) Net interest on the net defined benefit liability (asset)
- 4. **Determine re-measurements to be recognized in OCI (not reclassified to P&L):**
 - a) Actuarial gains or losses
 - b) Return on plan assets (excluding amounts included in net interest)
 - c) Any change in the effect of the asset ceiling (excluding amounts included in net interest)

Presentation in Financial Statements:

- **Statement of Financial Position:** The amount recognized as a defined benefit liability (or asset) is:
 - The present value of the defined obligation at year-end, minus
 - The fair value of the plan assets at year-end.
- **Statement of Profit or Loss and Other Comprehensive Income:**
 - Service cost — P&L
 - Net interest on the net defined benefit liability (asset) — P&L
 - Re-measurement of the net defined benefit liability (asset) — OCI (not reclassified to P&L)

***Note:** * If benefits or contributions are paid during the period (other than at the year-end), the interest cost calculation must be pro-rated to account for the timing of the payment.

Other Long-Term Benefits:

The accounting treatment follows that for defined benefit plans, but with a simplification: **re-measurements are recognized in profit or loss**, not OCI. The net total of service cost, net interest, and remeasurement is recognized in P&L.

Termination Benefits:

Benefits provided in exchange for the termination of an employee's employment, resulting from either:

1. An entity's decision to terminate employment before normal retirement date, or
 2. An employee's decision to accept an offer of benefits in exchange for termination.
- Termination benefits are only those paid when employment is terminated at the request of the employer. Benefits paid on retirement or resignation are not termination benefits.
 - Benefits conditional on future service are not termination benefits.

Recognition and Measurement:

Termination benefits should be recognized as an expense and a liability at the **earlier** of:

- The date the entity can no longer withdraw the offer.
- The date the entity recognizes costs for a restructuring (IAS 37) that involves the payment of termination benefits.

Measurement depends on the expected settlement date:

- **Expected to be settled wholly within 12 months:** Apply short-term employee benefit requirements.
- **All other termination benefits:** Apply other long-term employee benefit requirements.

***Note:** * Distinguish between termination benefits (resulting from termination) and enhancements to post-employment benefits (resulting from service). Enhancements to post-employment benefits are accounted for as post-employment benefits.

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ASSETS / LIABILITIES

IFRS 16 – Leases

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

For all other leases, the lessee recognizes a **right-of-use asset** and a **lease liability**. Lessors must classify leases as finance or operating leases.

- **Lease:** A contract, or part of a contract, that conveys the right to use an asset for a period in exchange for consideration.
- **Underlying asset:** The asset that is the subject of the lease.
- **Right to control** depends on the lessee having:
 - a) The right to obtain substantially all economic benefits from use.
 - b) The right to direct the use of the asset.
- **Low-value asset:** Qualifies if (i) the lessee can benefit from its use alone, and (ii) it is not highly dependent on or interrelated with other assets.

Lessee Accounting:

- At the **commencement date**, the lessee recognizes a right-of-use asset and a lease liability.
 - **Lease term:** The non-cancellable period, plus periods covered by an extension option if reasonably certain to be exercised, and periods covered by a termination option if reasonably certain not to be exercised.
- **Lease Liability:**
 - **Initial measurement:** Present value of lease payments not yet paid, discounted using the interest rate implicit in the lease.
 - Lease payments include:
 - Fixed payments (less any lease incentives receivable)
 - Variable payments dependent on an index or rate
 - Amounts expected payable under residual value guarantees
 - Purchase option exercise price if reasonably certain to be exercised
 - **Subsequent measurement:**

Dr	Interest Expense	XX
Cr	Lease Liability	XX
Dr	Lease Liability	XX
Cr	Cash (lease payments)	XX

- **Presentation:** Lease liability should be presented separately from other liabilities or disclosed in the notes. A split between current and non-current is best practice.
- **Consequence:** Finance charges are higher at the start of the lease and decrease over time.
- **Right-of-Use Asset:**
 - **Initial measurement at cost**, including:
 - Initial measurement of the lease liability
 - Lease payments made at/before commencement date (less incentives received)
 - Initial direct costs incurred by the lessee
 - Estimated costs of dismantling, removing, or restoring the asset
 - **Subsequent measurement:** Normally at cost less accumulated depreciation and impairment losses (IAS 16 cost model).
 - **Depreciation:** From commencement date to the earlier of the end of the asset's useful life or the end of the lease term. If ownership is expected to transfer, depreciate over the asset's useful life.
 - **Presentation:** Shown separately under non-current assets or included within the same line item as corresponding owned assets (with disclosure in the notes).

- **Alternative Measurement Models:**

- If the right-of-use asset relates to a class of PPE measured under the revaluation model (IAS 16), it is optional to apply the revaluation model to the right-of-use asset.
- If the right-of-use asset meets the definition of investment property and the lessee uses the fair value model (IAS 40), it is compulsory to apply the fair value model to the right-of-use asset.

Sale and Leaseback:

- **A. Transfer is a sale (meets IFRS 15 criteria):**

- **Step 1:** The seller/lessee measures the right-of-use asset arising from the leaseback at the proportion of the previous carrying amount that relates to the right of use retained.

Formula:	$\text{Carrying amount} \times (\text{PV of lease payments} / \text{Fair value})$
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- **Step 2:** The seller/lessee recognizes only the gain or loss on the sale that relates to the rights transferred to the buyer.

Formula:	$(\text{Fair value} - \text{Carrying amount}) \times (1 - (\text{PV of lease payments} / \text{Fair value}))$
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- The right-of-use asset continues to be depreciated.
- **Adjustments for off-market terms:**
 - Below-market terms: Account for as a prepayment of lease payments.
 - Above-market terms: Account for as additional financing.
- **B. Transfer is not a sale (does not meet IFRS 15 criteria):**
 - The seller continues to recognize the transferred asset.
 - The transfer proceeds are treated as a financial liability (IFRS 9). The transaction is accounted for as a secured loan.

Lessor Accounting:

Lessors classify leases as **finance leases** or **operating leases**.

- **Finance Lease:** A lease that transfers substantially all the risks and rewards incidental to ownership.
- **Operating Lease:** A lease that does not transfer substantially all the risks and rewards incidental to ownership.

Accounting Treatment for Finance Leases:

The amount due from the lessee is recorded as a receivable at the amount of the **net investment in the lease**.

Dr	Lease Receivable	XX
Cr	Asset	X
Cr	Unearned Finance Income	X

- **Gross investment in the lease:** Lease payments receivable + any unguaranteed residual value accruing to the lessor.
- **Net investment in the lease:** Gross investment discounted at the interest rate implicit in the lease.
- **Unearned finance income:** The difference between gross and net investment.
- **Unguaranteed residual value:** The portion of the residual value whose realization by the lessor is not assured.
- **Guaranteed residual value:** For a lessor, the part guaranteed by the lessee or a third party.
- **Review of residual values:** Estimated unguaranteed residual values should be reviewed regularly. A reduction requires revision of the income allocation.
- **Initial direct costs:** Included in the initial measurement of the net investment in the lease (automatically via the implicit interest rate).
- **Manufacturer/Dealer Lessors:**
 - Two types of income: (1) Profit/loss from an outright sale, and (2) Finance income over the lease term.
 - IFRS 16 requires:
 - (i) Recognize selling profit/loss as if it were an outright sale.
 - (ii) If interest rates are artificially low, restrict selling profit to a commercial rate.
 - (iii) Recognize costs of negotiating the lease as an expense when the selling profit is recognized (at the start of the lease term).

Accounting Treatment for Operating Leases:

- The leased asset is recorded as a long-term asset and depreciated over its useful life (consistent with IAS 16).
- Lease income is recognized on a straight-line basis over the lease term, unless another systematic basis is more representative.
- Initial direct costs are added to the carrying amount of the leased asset and amortized over the lease term on the same basis as lease income.
- Lessors must assess the leased asset for impairment under IAS 36.
- A manufacturer or dealer lessor should not recognize any selling profit on entering into an operating lease.

Subleases:

When a lessee (intermediate lessor) subleases an asset to a third party, the intermediate lessor must assess whether the sublease is a finance or operating lease **in the context of the right-of-use asset** (from the head lease), not the underlying asset itself.

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IAS 12 – Income Taxes

- **Current tax:** The amount of income taxes payable in respect of the taxable profit for a period.
- **Taxable profit:** The profit (or loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable if it's a loss).
- **Accounting profit:** The net profit or loss for a period before deducting tax expense.
- **Tax expense (tax income):** The aggregate amount included in the determination of net profit or loss for a period in respect of current tax and deferred tax.

Current Tax:

- IAS 12 requires any unpaid tax in respect of the current or prior periods to be recognized as a liability → **tax liability**.
- Conversely, any excess tax paid in respect of the current or prior periods to be recognized as an asset → **tax asset**.
- IAS 12 also requires recognition as an asset of the benefit relating to any tax loss that can be carried back to recover current tax of a previous period. This is acceptable because it is probable that the benefit will flow to the entity and it can be measured reliably.
- Current tax liabilities (assets) are measured at the amount expected to be paid to (or recovered from) the tax authorities. The tax rates used should be those enacted by the year end.
- Current tax is recognized as income or expense and included in the net profit or loss for the period, except in two cases:
 - a) Tax arising from a business combination which is an acquisition is treated differently.
 - b) A transaction or event which is recognized, in the same or a different period, outside profit or loss, either in other comprehensive income or directly in equity.
- Current tax assets and liabilities can be offset, but this should only happen when:
 - The entity has a legally enforceable right to set off the recognized amounts.
 - The entity intends to settle the amounts on a net basis, or to realize the asset and settle the liability at the same time.
- The tax expense (income) related to the profit or loss for the year should be shown in the profit or loss section of the statement of profit or loss and other comprehensive income.

Deferred Tax:

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

- **Tax base:** The value of an asset or liability for tax purposes. Tax rules determine the tax base.
 - *Memorize:* "The tax base of an asset is the future tax deductions which will be available when the asset generates taxable economic benefits."
 - *Memorize:* "The tax base of a liability is its carrying amount, less the future tax deductions which will be available when the liability is settled."

The Difference Between Current and Deferred Tax:

- **Current tax:** The amount actually payable to the tax authorities in relation to the trading activities of the entity during the period.

- **Deferred tax:** An accounting measure, used to match the tax effects of transactions with their accounting impact and thereby produce less distorted results.
- **Deferred tax liability:** The amount of income taxes payable in future periods in respect of **taxable temporary differences**.
- **Deferred tax asset:** The amount of income taxes recoverable in future periods in respect of:
 - Deductible temporary differences
 - Carry forward of unused tax losses
 - Carry forward of unused tax credits

Temporary Difference:

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

- **Taxable temporary differences:** Differences that will result in taxable amounts in determining taxable profit of future periods when the carrying amount of the asset or liability is recovered or settled. (*Tax to pay in the future* → *Deferred tax liability*)
- **Deductible temporary differences:** Differences that will result in amounts that are deductible in determining taxable profit of future periods when the carrying amount of the asset or liability is recovered or settled. (*Tax saving in the future* → *Deferred tax asset*)

Recognition of Deferred Tax:

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

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

Deferred tax is recognized in the same section of the statement of profit or loss and other comprehensive income as the transaction that gave rise to it.

Revaluation, Impairment Losses, and Inventory Losses:

- **Revaluation:** Under IAS 16, assets may be revalued. If the revaluation does not affect current taxable profits, the tax base is not adjusted. The gain (or loss) between carrying amount and tax base is a temporary difference and gives rise to deferred tax, which is accounted for in OCI for consistency with the revaluation surplus.
- **Impairment Losses:** If an asset suffers an impairment loss, the carrying amount is reduced. If tax relief on the loss is only granted when the asset is sold, the tax base does not change, resulting in a deductible temporary difference and a deferred tax asset.
- **Inventory Losses:** Similarly, losses on inventory that are not tax deductible until the inventory is sold generate a deferred tax asset.

Measurement and Recognition Criteria:

- Deferred tax assets are **only recognized** to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized.
- It is assumed that enough taxable profit will be available if there are sufficient taxable temporary differences which can be offset.
- For unused tax losses or credits, a deferred tax asset may be recognized to the extent that it is probable future taxable profit will be available.
- At each year end, an entity should reassess unrecognized deferred tax assets.

Offsetting and Measurement:

Deferred tax assets and liabilities can only be offset if:

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

Deferred tax assets and liabilities are measured at the tax rates expected to apply to the period when the asset is realized or liability is settled, based on tax rates that have been enacted by the end of the reporting period. They **should not be discounted**.

Deferred Tax and Business Combinations:

- **Fair value adjustments on consolidation:**
IFRS 3 requires assets and liabilities of an acquired subsidiary to be brought in at fair value. This change is not usually reflected in the tax base, so a temporary difference arises.
 - **Deferred tax liability:** Reduces fair value of net assets and increases goodwill.

Dr	Goodwill	XX
Cr	Deferred Tax Liability	XX

- **Deferred tax asset:** Increases fair value of net assets and reduces goodwill.

Dr	Deferred Tax Asset	XX
Cr	Goodwill	XX

- **Undistributed profits of subsidiaries, branches, associates, and joint ventures:**

A subsidiary's profits are recognized in the consolidated financial statements. If they are not taxable in the parent's tax regime until remitted as dividends, a temporary difference arises. A deferred tax liability is recognized unless:

- The parent is able to control the timing of the reversal, and
- It is probable that the temporary difference will not reverse in the foreseeable future.

- **Unrealized profits on intragroup trading:**

When one group entity sells goods to another at a profit, and those goods are still in inventory at year end, the profit is unrealized from the group perspective and is eliminated on consolidation. This adjustment is not usually made to the tax base, so a temporary difference arises.

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Financial Instruments

There are three main accounting standards on financial instruments:

(A) IAS 32 – Financial Instruments: Presentation

Deals with:

- Classification of financial instruments between liabilities and equity.
- Presentation of certain compound instruments.

(B) IFRS 7 – Financial Instruments: Disclosures

Sets out disclosure requirements.

(C) IFRS 9 – Financial Instruments

Covers:

- Recognition and derecognition.
- Measurement of financial instruments.
- Impairment.
- General hedge accounting.

Definitions:

- **Financial instrument:** Any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.
- **Financial asset:** Any asset that is:
 - Cash; or
 - An equity instrument of another entity; or
 - A contractual right to receive cash or another financial asset from another entity; or to exchange financial instruments with another entity under conditions that are potentially favorable.
- **Financial liability:** Any liability that is a contractual obligation:
 - To deliver cash or another financial asset to another entity; or
 - To exchange financial instruments with another entity under conditions that are potentially unfavorable.
- **Equity instrument:** Any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.
- **Derivative:** A financial instrument or other contract with all three of the following characteristics:

- Its value changes in response to a change in an underlying variable (e.g., interest rate, price, index).
- It requires no initial net investment or a smaller investment than similar contracts.
- It is settled at a future date. (Examples: forwards, futures, options, swaps).

Financial instruments include both primary instruments (e.g., receivables, payables, equity securities) and derivative instruments.

***Note:** * The following are **not** financial instruments:

- Physical assets (e.g., inventories, PPE)
- Prepaid expenses
- Deferred revenue and most warranty obligations
- Non-contractual rights/obligations

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IAS 32 – Financial Instruments: Presentation

- Financial instruments should be presented according to their **substance**, not merely their legal form.
- The critical feature of a liability is an obligation to transfer economic benefit.
 - A financial instrument is a **financial liability** if there is a contractual obligation on the issuer to deliver cash or another financial asset, or to exchange instruments under potentially unfavorable conditions.
 - Where this feature is not met, the instrument is an **equity instrument**.
- A financial instrument may have the legal form of equity but be a liability in substance (e.g., redeemable preference shares). Cumulative irredeemable preference shares are also liabilities due to the obligation to pay dividends.
- Classification is made on initial recognition and continues until derecognition.
- **Contingent settlement provisions:** Instruments where settlement depends on uncertain future events should be classified as financial liabilities unless the possibility of settlement is remote.
- If a derivative gives one party a choice over settlement, it is a financial liability unless all alternatives would result in equity.
- **Compound financial instruments:** Instruments containing both a liability and an equity element (e.g., convertible bonds). The component parts are classified separately.

Memorize: "Under IFRS 9, convertible bonds need to be split into their liability and equity component. The liability component is computed by discounting the future amounts payable (assuming the loan is repaid) using the discount rate equivalent to the return that would be required by a lender without any conversion option—the market rate. The resulting equity element will be unchanged and will be presented in the statement of financial position in the equity section of OCE."

- **Treasury shares:** If an entity reacquires its own equity instruments, they are deducted from equity. No gain or loss is recognized in profit or loss on the purchase, sale, issue, or cancellation of an entity's own equity instruments.
- **Interest, Dividends, Gains, and Losses:**
 - Relating to a **financial liability** → recognized in profit or loss.
 - Relating to an **equity instrument** → debited directly to equity.
- **Transaction costs** of an equity transaction are accounted for as a deduction from equity.
- **Offsetting a financial asset and liability:** Permitted only when an entity:
 - Has a legally enforceable right to set off; and
 - Intends to settle on a net basis, or to realize the asset and settle the liability simultaneously.
- **Puttable instruments:** If the holder can require the issuer to redeem the instrument for cash, it should generally be a liability. However, IAS 32 requires classification as equity if certain strict conditions are met (e.g., pro rata share of net assets on liquidation).

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IFRS 7 – Financial Instruments: Disclosures

IFRS 7 requires qualitative and quantitative disclosures about the exposure to risks arising from financial instruments and specifies minimum disclosures about credit risk, liquidity risk, and market risk.

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

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

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IFRS 9 – Financial Instruments

IFRS 9 establishes principles for recognizing and measuring financial assets and liabilities.

Recognition:

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

Derecognition of Financial Assets:

Derecognition is the removal of a previously recognized financial instrument from an entity's statement of financial position. An entity should derecognize an asset when:

1. The contractual rights to the cash flows from the financial asset expire, or
2. The entity transfers the financial asset or substantially all the risks and rewards of ownership to another party.

It is possible for only a part of a financial asset to be derecognized if the part comprises:

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

(e.g., selling the right to receive interest from a bond while retaining the right to receive the principal).

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

Carrying amount allocated to the part derecognized	–	Consideration received for the part derecognized	=	Difference to P&L
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Derecognition of Financial Liabilities:

A financial liability is derecognized when it is extinguished—i.e., when the obligation is discharged, cancelled, or expires. Any gains or losses on derecognition are recognized in profit or loss.

Financial Assets: Initial Measurement:

Financial assets are initially measured at transaction price (fair value of consideration given).

- For assets classified as measured at **amortized cost** or **fair value through other comprehensive income (FVTOCI)**, transaction costs directly attributable to the acquisition are capitalized.
- For assets held at **fair value through profit or loss (FVTPL)**, transaction costs are expensed immediately.

If the transaction price does not equal fair value, the asset should be measured initially at fair value.

Classification of Financial Assets: Memorize

On recognition, IFRS 9 requires financial assets to be classified as measured at:

- **Amortized Cost:**

Where (a) the objective of the business model is to hold assets to collect contractual cash flows, **and** (b) the contractual terms give rise on specific dates to cash flows that are solely payments of principal and interest (SPPI) on the principal outstanding.

- **Fair Value Through Other Comprehensive Income (FVTOCI):**

Where (a) the objective of the business model is both collecting contractual cash flows and selling financial assets, **and** (b) the contractual terms meet the SPPI test.

- **Fair Value Through Profit or Loss (FVTPL):**

All other financial assets must be measured at FVTPL (the default).

- **Designation at FVTPL:** IFRS 9 allows financial assets meeting the criteria for amortized cost or FVTOCI to be designated at FVTPL at initial recognition if doing so eliminates or significantly reduces an accounting mismatch.

If the financial asset is an equity instrument:

- Equity instruments must be measured at fair value (they cannot be amortized cost as they fail the SPPI test).
- However, if an equity instrument is **not held for trading**, an entity can make an **irrevocable election** at initial recognition to measure it at **FVTOCI**. Under this election, only dividends are recognized in profit or loss.

Subsequent Measurement of Financial Assets:

It depends on their classification:

- **Amortized cost:** Using the effective interest method.
- **FVTOCI:** Fair value is established at each period end, and changes in fair value are recognized in OCI.
- **FVTPL:** Fair value is established at each period end, and changes in fair value are recognized in profit or loss.

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

Reclassification of Financial Assets:

Financial assets are reclassified under IFRS 9 when, and only when, an entity changes its business model. Reclassification is applied prospectively from the reclassification date. These rules only apply to debt instruments.

- Reclassification from **amortized cost to fair value** → gain/loss on difference between carrying amount and fair value is recognized in P&L.
- Reclassification from **fair value to amortized cost** → fair value at the date of reclassification becomes the new carrying amount.

Impairment of Financial Assets:

A financial asset is impaired when its carrying amount cannot be reasonably expected to be recovered.

- For assets measured at **FVTPL**, impairment is automatically reflected in the fair value.
- For other financial assets, IFRS 9 requires a loss allowance for **expected credit losses (ECL)**. The loss allowance is recognized in P&L and deducted from the carrying amount of the asset.

Dr	Expected Credit Loss Expense (P&L)	XX
Cr	Allowance for Receivables / Loss Allowance	XX

- A credit loss is the difference between contractually entitled cash flows and expected cash flows.
- Unless credit risk has increased significantly since initial recognition, the loss allowance should be based on **12-month ECL**.
- Where credit risk has increased significantly, the loss allowance should be based on **lifetime ECL**.
- As a simplifying measure for **trade receivables**, IFRS 9 allows the loss allowance to always be measured based on lifetime ECL.
- Doubts about a customer's going concern status are prime facie evidence of impairment, requiring a loss allowance equal to expected losses.

Financial Liabilities:

- **Initial Measurement:**

Financial liabilities are initially measured at transaction price (fair value of consideration received). Transaction costs are deducted for liabilities classified at amortized cost.

- **Subsequent Measurement:**

After initial recognition, all financial liabilities should be measured at **amortized cost**, with the exception of liabilities at **FVTPL** (held for trading, derivatives), which are measured at fair value.

- **Reclassification** of financial liabilities is **not permitted**.

- **Credit Risk:**

For financial liabilities designated as FVTPL, IFRS 9 requires:

- Changes in fair value resulting from **credit risk** should be included in **OCI**.
- The remaining amount of the change in fair value should be included in **profit or loss**.
- This exception does not apply if it creates or enlarges an accounting mismatch.

Embedded Derivatives:

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

- **Financial asset host contract:** The entire hybrid contract is classified and measured under IFRS 9 rules.
- **Other host contract (not a financial asset):** The embedded derivative must be separated and accounted for as a derivative when:
 1. The economic characteristics and risks of the embedded derivative and host are **not closely related**.
 2. A separate instrument with the same terms would meet the definition of a derivative.
 3. The hybrid instrument is **not** measured at FVTPL.

Hedge Accounting:

Before a hedging relationship qualifies for hedge accounting, all of the following conditions must be met:

(a) The hedging relationship consists only of eligible hedging instruments and eligible hedged items.

(b) There must be formal documentation.

(c) The hedging relationship meets all hedge effectiveness criteria:

- An economic relationship exists between the hedged item and hedging instrument.
- The effect of credit risk does not dominate value changes.
- The hedge ratio is consistent with the entity's actual risk management.

There are three types of hedges:

- **Fair Value Hedge:** A hedge of the exposure to changes in fair value of a recognized asset or liability.
 - Gain/loss on the hedging instrument is recognized in **P&L**.
 - Gain/loss on the hedged item attributable to the hedged risk adjusts its carrying amount and is recognized in **P&L**.
- **Cash Flow Hedge:** A hedge of the exposure to variability in cash flows.
 - The effective portion of the gain/loss on the hedging instrument is recorded in **OCI** (and can be recycled to P&L).
 - Any ineffective portion is recorded in **P&L**.
- **Hedge of a Net Investment in a Foreign Operation:** Accounted for similarly to a cash flow hedge.

Hedge Accounting Summary:

Under IFRS 9, a derivative is normally classified as FVTPL. However, when designated as a **cash flow hedge** of a future firm commitment, the effective portion of the change in fair value is recognized in OCI and accumulated in a cash flow hedge reserve. This amount may subsequently be reclassified to profit or loss when the hedged item affects profit or loss.

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REQUIRED FROM LISTED ENTITIES

IFRS 8 – Operating Segments

This is a disclosure standard covering segmental reporting.

- **Scope:** Only entities whose equity or debt securities are publicly traded need to disclose segmental information. In group financial statements, only consolidated information is required.

- **Definition of an Operating Segment: IMP**

A component of an entity:

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

The CODM identifies a function, not necessarily a single person.

- **Aggregation:**

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

- Nature of products/services
- Nature of production process
- Type/class of customer
- Distribution methods
- Nature of regulatory environment (if applicable)

- **Reportable Segment Thresholds:**

An entity must report separately for an operating segment that meets **any one** of the following quantitative thresholds:

(i) Its reported revenue is **10% or more** of the combined revenue of all operating segments.

(ii) Its assets are **10% or more** of the total assets of all operating segments.

(iii) Its absolute reported profit or loss is **10% or more** of the greater of (a) the combined reported profit of all profitable segments, and (b) the combined reported loss of all loss-making segments.

- **75% Test:**

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

- **Other Points:**

- Below-threshold segments may be aggregated to produce a reportable segment if they have similar economic characteristics.
- Segments below the thresholds may still be reported separately if management believes the information is useful.

- **Disclosures Required:**

- Operating segment profit or loss
- Segment assets
- Segment liabilities (if regularly provided to CODM)
- Certain income and expense items
- Revenue derived from products or services
- Geographical information (revenues and non-current assets)

Memorize:

- "The definition of an operating segment is generally based on the entity's business model, which could be different from entity to entity. Disclosures focus on what information management believes is important when running the business."
- "IFRS 8 normally requires entities to give details of revenues by geographical area and by product type and non-current assets by geographical type. However, the above is not required if the information could only be made available at a prohibitive cost."

IAS 33 – Earnings per Share

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

- **Ordinary share:** An equity instrument subordinate to all other classes.
- **Potential ordinary share:** A financial instrument that may entitle its holder to ordinary shares (e.g., convertible debt, options, warrants).

Basic EPS:

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

Basic EPS	=	Profit or Loss Attributable to Ordinary Shareholders / Weighted Average Number of Ordinary Shares
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- **Earnings:** Consolidated profit after tax, NCI, and preference dividends (on shares classified as equity).
- **Weighted Average Number of Shares:**
 - Shares are included from the date consideration is receivable.
 - **Shares issued as purchase consideration:** Included from the acquisition date.
 - **Partly paid shares:** Treated as a fraction of a share to the extent they are entitled to dividends.
 - **Contingently issuable shares:** Included when all conditions for issue are satisfied.

Bonus Issue and Share Split:

Shares are issued to existing shareholders for no additional consideration. The weighted average is calculated as if the bonus shares have always been in issue. The number of shares before the event is adjusted proportionately.

Rights Issue:

A rights issue is an issue of new shares to existing shareholders at a price below current market value, containing a bonus element. The theoretical ex-rights price (TERP) must be calculated.

- **Prior year EPS restated:**

Prior Year EPS	×	(TERP / Fair value per share before rights issue)
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- **Current year weighted average shares:**

(Shares before rights × Fraction of year × (FV before rights / TERP))	+	(Shares after rights × Fraction of year after rights)
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Diluted EPS:

Diluted EPS is calculated by adjusting earnings and the weighted average number of shares for the effects of all **dilutive potential ordinary shares**. It shows the possible effects of future dilution (e.g., from convertibles, options, warrants).

Diluted EPS	=	Adjusted Earnings / Adjusted Weighted Average Shares	(see adjustments below)
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- **Adjusted Earnings (for continuing operations):**
Basic earnings **plus** the post-tax effect of:
 - Dividends on dilutive potential ordinary shares deducted to arrive at basic earnings.
 - Interest recognized in the period for dilutive potential ordinary shares.
 - Any other changes in income/expense that would result from the conversion.
- **Adjusted Weighted Average Shares:**
Basic weighted average shares **plus** the weighted average number of ordinary shares that would be issued on the conversion of all dilutive potential ordinary shares.
- **Dilution Test:** Potential ordinary shares are treated as dilutive only when their conversion would **decrease** net profit per share from continuing operations.

Other Points:

- **Retrospective Adjustment:** Basic and diluted EPS for all periods presented should be adjusted retrospectively for bonus issues, share splits, etc.
- **Events After Reporting Period:** If share changes occur after the reporting date but before authorization, the calculations should be based on the new number, and this fact should be disclosed. EPS amounts are not adjusted for such events.
- **Disclosures:**
 - Reconciliation of numerators (earnings) to net profit or loss.
 - Reconciliation of denominators (weighted average shares) for basic and diluted EPS.
 - Disclosures are still required even if EPS figures are negative.

Presentation:

Basic and diluted EPS should be presented in the statement of profit or loss for each class of ordinary shares.

- If discontinued operations are reported (IFRS 5), EPS should be presented for:
 - Both continuing and discontinued operations.
 - Continuing operations only.
 - Discontinued operations only (can be in the statement or notes).

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OTHER STANDARDS

IAS 21 – The Effects of Changes in Foreign Exchange Rates

There are two distinct types of foreign currency transaction: **conversion** and **translation**.

- **Conversion:** The process of exchanging amounts of one foreign currency for another. Profits or losses on conversion are included in profit or loss for the year in which conversion takes place.
- **Translation:** Required at the end of an accounting period when a local company still holds assets or liabilities in its statement of financial position which were obtained or incurred in a foreign currency.

Definitions:

- **Foreign currency:** A currency other than the functional currency of the entity.
- **Functional currency:** The currency of the primary economic environment in which the entity operates.
- **Presentation currency:** The currency in which the financial statements are presented.

Each entity should determine its functional currency and measure its results and financial position in that currency. An entity can present its financial statements in any currency it chooses.

Determining Functional Currency:

IAS 21 states that an entity should consider the following factors:

- The currency that mainly influences sales prices.
- The currency of the country whose competitive forces and regulations mainly determine sales prices.
- The currency that mainly influences labor, material, and other costs.

For a foreign operation, additional factors include:

- Whether the activities are an extension of the parent.
- The proportion of transactions with the parent.
- Whether cash flows directly affect the parent.
- How the operation is financed.
- If the foreign operation has the **same** functional currency as the parent, it operates as an extension of the parent. Exchange rate changes impact the parent's cash flows.
- If the foreign operation has a **different** functional currency, it operates semi-autonomously. Exchange rate changes affect the parent's net investment, not the individual items held by the operation.

***Note:** * The functional currency can be changed only if there is a change to underlying transactions, events, and conditions. The change is applied prospectively from the date of the change.

Recognition of Foreign Currency Transactions:

- **Initial Recognition:** A foreign currency transaction should be recorded in the functional currency by applying the **spot exchange rate** at the date of the transaction.
- **Subsequent Measurement at Year-End:**
 - **Monetary items:** Report using the **closing rate** (spot rate at year-end).
 - **Non-monetary items at historical cost:** Report using the exchange rate at the **date of the transaction**.
 - **Non-monetary items at fair value:** Report using the exchange rate that existed when the **fair value was measured**.

Exchange Differences:

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

- Exchange differences should be recognized in **profit or loss** in the period in which they arise.
- If a transaction is settled in a subsequent period, the exchange difference recognized in each intervening period is determined by the change in exchange rates during that period.
- Where a monetary item has not been settled at year-end, it is restated using the closing rate, and any gain or loss is taken to profit or loss.

- When a gain or loss on a **non-monetary item** is recognized in OCI (e.g., revaluation surplus), any related exchange differences should also be recognized in **OCI**.
- **Ready to test your knowledge of the standard? Take a quiz on the standard above at [finprepacademy.com](https://www.finprepacademy.com)**

IFRS 2 – Share-Based Payment

- **Share-based payment transaction:** A transaction in which the entity (1) receives goods or services as consideration for its equity instruments, or (2) acquires goods or services by incurring liabilities based on the price of its shares or other equity instruments.

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

1. **Equity-settled share-based payment:** The entity receives goods or services as consideration for its equity instruments.
2. **Cash-settled share-based payment:** The entity acquires goods or services by incurring liabilities based on the price of its shares.
3. **Transactions with a choice of settlement:** The terms provide either the entity or the supplier with a choice of settling in cash or by issuing equity instruments.

Vesting:

- **Vesting conditions:** Conditions that determine whether the entity receives the services that entitle the counterparty to receive cash, other assets, or equity instruments (service conditions or performance conditions).
- **Vesting period:** The period during which all vesting conditions are to be satisfied.
- **Service conditions:** Require a specified period of service. The payment is recognized over that period.
- **Performance conditions (non-market):** Conditions like achieving a specific growth in profit. The amount recognized is based on the best available estimate of the number of instruments expected to vest, revised at each period end.
- **Market-based conditions:** Taken into account when measuring the fair value of the share-based payment at the grant date (for equity-settled) or at year-end (for cash-settled).
- **Non-market conditions:** Reflected in the calculation of the number of options expected to vest.

Recognition:

An entity should recognize goods or services received when it obtains the goods or as the services are received. They are recognized as expenses unless they qualify for recognition as an asset.

- **Equity-settled:**

Dr	Expense (or Asset)	XX
Cr	Equity	XX

- **Cash-settled:**

Dr	Expense (or Asset)	XX
Cr	Liability	XX

Equity-Settled Share-Based Payment Transactions:

- **General Principle:** Measure goods or services at their fair value.
- **Transaction with parties other than employees:** Measure at the fair value of goods/services received. If this cannot be measured reliably, use the fair value of the equity instruments granted, measured at the date goods/services are obtained.
- **Transaction with employees:** Measure the fair value of employee services by reference to the fair value of the equity instruments granted. The fair value of those equity instruments should be measured at the **grant date**.
- **Vesting Immediately:** It is presumed services have been received. Recognize services in full on the grant date.
- **Vesting over a Period:** Recognize services as they are rendered during the vesting period. The amount recognized is based on the best available estimate of the number of equity instruments expected to vest, in proportion to the elapsed vesting period. This estimate is revised at each period end. On vesting date, the estimate is revised to equal the number that actually vest.

Recognition Formula	=	No. of employees	×	No. of shares/options	×	Fair value per share/option	×	(Period elapsed / Total vesting period)
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Modification, Cancellation, and Reissuance:

- **Modification:** If modifications increase the fair value (e.g., repricing), the incremental increase must be recognized over the remaining vesting period.
- **Cancellation and Reissuance:** Treated the same as a modification. Cancellations by the employee result in an accelerated charge to profit or loss for the unamortized balance.

Cash-Settled Share-Based Transactions:

- Examples: Share appreciation rights.
- The entity measures goods/services acquired and the liability incurred at the fair value of the liability.
- The fair value is remeasured at each reporting date until settlement. Any changes in fair value are recognized in **profit or loss** for the period.

Share-Based Payment with a Choice of Settlement:

- **Entity has the choice:**
 - If a present obligation to settle in cash exists → treat as **cash-settled**.
 - Otherwise → treat as **equity-settled**.
- **Counterparty has the choice:** The entity has granted a **compound financial instrument**.
 - **Debt component:** Treated as a cash-settled transaction.
 - **Equity component:** Measured as the residual value at grant date.

Equity Component	=	Fair value of shares alternative at grant date	-	Fair value of cash alternative at grant date
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Once established, each component is accounted for as a cash-settled or equity-settled scheme respectively.

Deferred Tax Implications:

A temporary difference arises when an expense is recognized under IFRS 2, but a tax deduction is not received until the options are exercised (at the share price on that date).

- **Temporary Difference** = Carrying amount of share-based payment expense – Tax base.
- **Deferred Tax Asset** = Temporary Difference × Tax Rate.
- If the tax deduction exceeds the cumulative remuneration expense, the excess is recognized **directly in equity**.

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IFRS 1 – First-Time Adoption of International Financial Reporting Standards

IFRS 1 gives guidance to entities applying IFRS for the first time.

- An entity applies IFRS 1 in its **first IFRS financial statements** (the first annual financial statements with an explicit and unreserved statement of compliance with IFRS).
- An entity prepares and presents an **opening IFRS statement of financial position** at the **date of transition to IFRS** (the beginning of the earliest comparative period presented). This is the starting point for IFRS accounting.
- IAS 1 requires the presentation of at least three statements of financial position and two of each of the other statements.
- Preparation involves adjusting amounts reported under previous GAAP. All adjustments are recognized directly in **retained earnings** (or another equity category), not in profit or loss. There are some exceptions (e.g., business combinations, hedging).

Disclosures:

(a) A reconciliation of previous GAAP equity to IFRS standards at the date of transition and for the most recent period presented under previous GAAP.

(b) A reconciliation of profit for the most recent period presented under previous GAAP.

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IAS 24 – Related Party Disclosures

IAS 24 is primarily a disclosure standard. It ensures that financial statements contain necessary disclosures about related party relationships and transactions, as the assumption of arm's length dealings may not be present.

- The standard requires disclosure of related party transactions and outstanding balances in separate financial statements of a parent and in consolidated financial statements when transactions are with other entities in a group. (Intragroup transactions and balances are eliminated on consolidation).

Definitions:

- **Related party:** A person or entity that is related to the entity preparing its financial statements.
- **Related party transaction:** A transfer of resources, services, or obligations between related parties, regardless of whether a price is charged.
- **Key management personnel:** Persons having authority and responsibility for planning, directing, and controlling the activities of the entity, directly or indirectly, including any director.
- **Joint control:** The contractually agreed sharing of control of an arrangement, requiring unanimous consent for decisions about relevant activities.

The following are NOT related parties:

- (a) Two entities simply because they have the same director or key management in common.
- (b) Two ventures simply because they share joint control over a joint venture.
- (c) Other bodies, simply as a result of their role in normal business dealings (e.g., providers of finance, trade unions, public utilities).
- (d) A single customer, supplier, etc., with whom the entity transacts a significant volume of business, simply by virtue of the resulting economic dependence.

Government-Related Entities:

If a transaction is with a government that controls, jointly controls, or significantly influences the reporting entity, or with another entity related by virtue of the same government, certain disclosures need not be made. Instead, the entity should disclose:

1. The name of the government and the nature of the relationship.
2. Information to understand the effect of the transactions, including:
 - (i) The nature and amount of each individually significant transaction, and
 - (ii) For collectively significant transactions, a qualitative or quantitative indication of their extent.

Key Disclosure Requirements:

- Relationships between parents and subsidiaries must be disclosed irrespective of whether any transactions have taken place.
- Similar items may be aggregated if it does not affect the user's understanding.
- A related party transaction should only be disclosed as being at 'arm's length' if the entity can prove it.

Memorize:

- "IAS 24 requires that the existence of all related party relationships be disclosed together with details of any transactions and outstanding balances."
- "IAS 24 regards related party relationships as material by their nature. So, the fact that the transaction is financially insignificant and ordinary is not relevant in terms of requiring disclosure."
- "Related parties are generally characterized by the presence of control or influence between two parties."
- "Close family member to a key management personnel" (is a related party).

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Reporting for Small and Medium-Sized Entities (SMEs)

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

1. 'Simple' ones for small companies with fewer regulations and disclosure requirements.
2. 'Complicated' ones for larger companies with extensive and detailed requirements.

There are two approaches to overcome this divide:

- **Differential reporting:** Producing new reduced standards specifically for smaller companies, such as the IFRS for SMEs.
- **Providing exemptions for smaller companies** from some of the requirements of existing standards.

Differential Reporting:

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

Exemptions from IFRS Standards:

Some IFRS standards are not applicable to small company accounts (e.g., a company with equity not quoted on a stock exchange doesn't have to comply with IAS 33). Other standards are "core" (e.g., revenue, inventory, PPE, income taxes) and small companies would be required to follow all or most of their rules. For more complicated standards, small companies would face very brief general obligations.

- If the **cost of compliance exceeds the benefits** to users, an entity may decide not to follow an IFRS standard. This applies to all entities.
- IFRS standards apply to **material items**. For smaller entities, an amount that is very small in monetary terms may still be material if its omission would mislead users.

IFRS for SMEs: Key Principles

- It is suitable for all entities **except** (1) those whose securities are publicly traded, and (2) financial institutions such as banks and insurance companies.
- It is revised only once every three years to reduce the reporting burden.
- There are **no quantitative thresholds** for qualification; it is determined by a test of public accountability.
- An entity must apply **either** the IFRS for SMEs **or** full IFRS standards; it cannot pick and choose from both.

Aims and Simplifications of IFRS for SMEs:

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

Advantages of IFRS for SMEs:

1. It is virtually a 'one-stop shop'.
2. Structured according to topics, making it practical to use.
3. Written in an accessible style.
4. Considerable reduction in disclosure requirements.
5. Guidance not relevant to private entities is excluded.

Disadvantages of IFRS for SMEs:

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

Accounting Policies under IFRS for SMEs:

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

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

Comparison: IFRS for SMEs vs. Full IFRS Standards

Area	IFRS for SMEs	Full IFRSs
Presentation & Disclosure	Combined statement of profit or loss and OCI and statement of changes in equity permitted (where no OCI nor equity movements other than profit or loss, dividends and/or prior period adjustments).	Not permitted.
	Segment disclosures and earnings per share not required. Other disclosures reduced significantly versus full IFRS.	Required (as full IFRS Standards apply only to publicly quoted companies).
Investment Property	Fair value through profit or loss (where fair value can be measured without undue cost or effort, otherwise accounted for as PPE under cost-depreciation-impairment model).	Fair value model, or Cost model (accounting policy choice).
Intangible Assets	All intangibles (including goodwill) are amortized. Useful life cannot exceed ten years if it cannot be established reliably. Revaluation model not permitted. All internally generated research and development expenditure is expensed.	Only amortized if finite useful life. No specific limit on useful life. Revaluations permitted where an active market exists. Capitalized when the development expenditure criteria are met.
Separate Financial Statements of Investor	Investments in subsidiaries, associates, and joint ventures can be held at cost (less any impairment) or fair value through profit or loss .	Cost or under IFRS 9 (fair value through profit or loss, or fair value through OCI if an irrevocable election was made on purchase).
Consolidated and Separate Financial Statements	Investments in associates and joint ventures can remain at that same value or be equity accounted . Only partial goodwill allowed (NCI cannot be measured at full fair value). Goodwill is amortized. Exchange differences on translating a foreign operation are recognized in OCI and not subsequently reclassified to profit or loss.	Associates and joint ventures are equity accounted . Choice of full or partial goodwill method. Goodwill is not amortized but subject to compulsory annual impairment test. Exchange differences are recognized in OCI and reclassified to profit or loss on disposal of the foreign operation.
Government Grants	No specified future performance conditions: Recognize as income when the grant is receivable. Otherwise: Recognize as income when performance conditions are met.	Grants related to income recognized in P&L over the period to match related costs. Grants related to assets either: (a) presented as deferred income, or (b) deducted in arriving at the carrying amount of the asset.
Borrowing Costs	Expensed when incurred.	Capitalized (when they relate to a qualifying asset being constructed).
Revenue	Goods: when significant risks and rewards of ownership transferred (and no continuing managerial involvement nor effective control). Services: stage of completion.	When performance obligation is satisfied (IFRS 15 five-step approach).
Financial Instruments	Amortized Cost: All 'basic' financial instruments other than those publicly traded or whose fair value can be measured	Amortized Cost: Financial assets where the business model is to hold to collect

Area	IFRS for SMEs	Full IFRSs
	reliably. Cost: Unquoted investments in equity instruments (where fair value not reliably measurable). Fair Value through P&L: All other financial instruments. SMEs can also choose to use the IAS 39 rules (limiting disclosures to those required for SMEs).	contractual cash flows and the cash flows are SPPI. Cost: Also the case. Fair Value through P&L: All other financial assets. Financial liabilities held for trading or part of a group evaluated on a fair value basis. Fair Value through OCI: (1) Investments in equity instruments not held for trading where an irrevocable election is made at inception; (2) Financial assets where the business model is both to collect contractual cash flows and to sell.

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IAS 10 – Events After the Reporting Period

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

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

Accounting Treatment:

- An entity **shall adjust** the amounts recognized in the financial statements to reflect adjusting events.
- An entity **shall not adjust** for non-adjusting events.

Examples of Adjusting Events:

- Sale of inventory after the reporting period for less than its carrying value at the year-end.
- Amounts received or paid in respect of legal claims which were in negotiation at the year-end.
- Discovery of error or fraud which shows that the financial statements were incorrect.

***Note:** * In relation to **going concern**, if operating results and financial position have deteriorated after the reporting period, it may be necessary to reconsider whether the going concern assumption is appropriate.

Examples of Non-Adjusting Events:

- Major purchase or disposal of an asset.
- Acquisition of, or disposal of, a subsidiary after the year-end.
- Destruction of a production plant by fire after the reporting period.

Disclosure of Non-Adjusting Events:

While they may be non-adjusting, some events will require disclosure. For example, where the value of an investment falls between the end of the reporting period and the date the financial statements are authorized for issue. The fall in value represents circumstances during the current period, so it is not appropriate to adjust the value, but disclosure is required.

Disclosure Rule: Disclosure should be made if non-disclosure would hinder the user's ability to make proper evaluations and decisions based on the financial statements.

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

Accounting Policies:

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

- **Determination:** Accounting policies are determined by applying the relevant IFRS standard and considering any relevant implementation guidance.
- **Where no IFRS applies:** Management should use its judgment to develop a policy that results in relevant and reliable information. Management should refer to:
 - The requirements and guidance in IFRS standards dealing with similar and related issues.
 - The definitions, recognition criteria, and measurement concepts for assets, liabilities, and expenses in the Conceptual Framework.
- **Consistency:** An entity must select and apply its accounting policies consistently for similar transactions, unless an IFRS standard specifically requires or permits categorization.

Changes in Accounting Policies:

The same accounting policies are usually adopted from period to period. Changes are rare and should be made only if:

1. The change is required by an IFRS standard; or
2. The change will result in a more appropriate presentation (more reliable and relevant information).

***Note:** * Adopting a policy for a new type of transaction or for transactions that did not occur previously does **not** constitute a change in accounting policy.

- **Application:** A change in accounting policy must be applied **retrospectively** (applied from the earliest date such transactions occurred). Prospective application is not allowed unless it is impracticable to determine the cumulative effect.
- **New IFRS Standards:** When a new IFRS is adopted, any transitional provisions in the new standard itself must be followed.

Disclosures Required for a Change in Accounting Policy (if material):

- The nature of the change.
- The reason why the change provides more reliable and relevant information.
- The amount of adjustment relating to periods before those presented.
- For the current period and each prior period presented, the amount of adjustment for each financial statement line item affected, and for basic and diluted EPS (if applicable).
- If retrospective application is impracticable, the circumstances and a description of how and from when the change has been applied.

Changes in Accounting Estimates:

Accounting estimates are monetary amounts in financial statements that are subject to measurement uncertainty (e.g., bad debts, useful life of an asset, inventory obsolescence).

- **Application:** Changes in accounting estimates are **not applied retrospectively**. The effect of the change should be included in net profit or loss:
 - In the period of the change (if the change affects that period only).
 - In the period of the change and future periods (if the change affects both).

Errors:

Prior period errors are errors discovered in a current period that relate to a prior period. They must be corrected **retrospectively**.

Treatment of Material Prior Period Errors:

1. Restate the comparative amounts for the prior period(s) in which the error occurred; or
2. If the error occurred before the earliest prior period presented, restate the opening balances of assets, liabilities, and equity for that period.

The financial statements are presented **as if the error had never occurred**.

***Note:** * Only when it is impracticable to determine the cumulative effect of an error can an entity correct an error **prospectively**.

Disclosures Required for Prior Period Errors:

- The nature of the prior period error.
- The amount of correction at the beginning of the earliest prior period presented.
- For each prior period, the amount of correction for each financial statement line item affected, and for basic and diluted EPS (if applicable).
- If retrospective restatement is impracticable, the circumstances and a description of how and from when the error has been corrected.

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