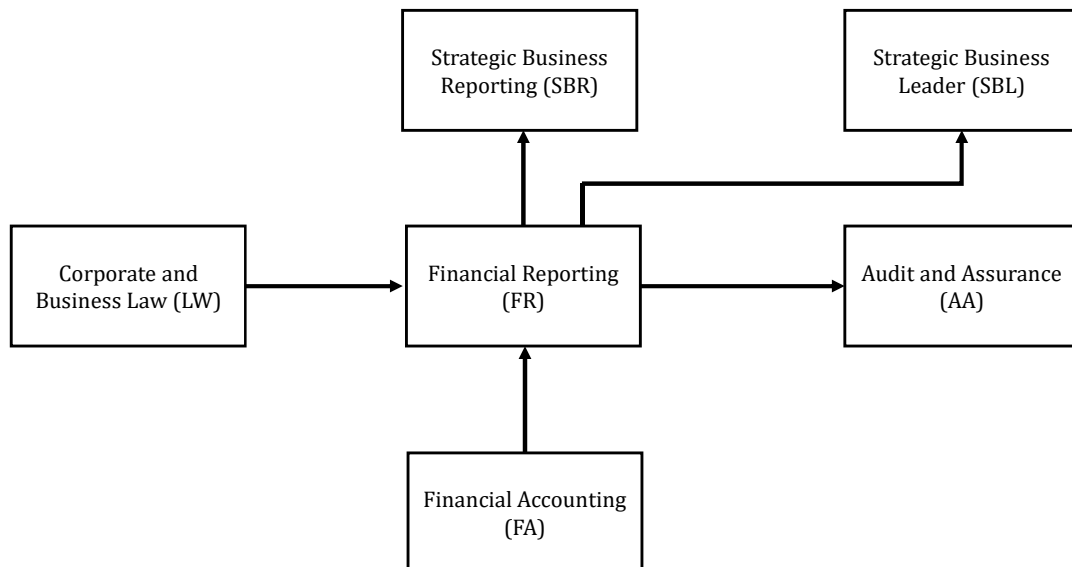


# ACCA Financial Reporting

*Nguyễn Phương Hằng, FCCA, CPA, SIRM*

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## LINK WITH OTHER EXAMS



## SYLLABUS

A	• The conceptual and regulatory framework for financial reporting
B	• Accounting for transactions in financial statements
C	• Analysing and interpreting the financial statements of single entities and group
D	• Preparation of financial statement
E	• Employability and technology skills

## FORMAT OF THE EXAM

Section	Style of question type	Description	Proportion of exam, %
A	Objective test (OT)	15 questions x 2 marks	30
B	Objective test (OT) case	3 questions x 10 marks Each question will contain 5 sub-parts each worth 2 marks	30
C	Constructed Response (Long questions)	2 questions x 20 marks	40
Total			100

Section A and B questions will be selected from **the entire syllabus** and will contain a variety of question types

Section C questions will mainly focus on the following syllabus areas but a minority of marks can be drawn from any other area of the syllabus:

- Analysing and interpreting the financial statements of single entities and groups (syllabus area C)
- Preparation of financial statements (syllabus area D)

## CONTENT

No	Lesson	No	Lesson
1	The conceptual framework	13	Leasing
2	The regulatory framework	14	Provisions and events after the reporting period
3	Tangible non-current assets	15	Inventories and biological assets
4	Intangible assets	16	Taxation
5	Impairment of assets	17	Presentation of published financial statements
6	Revenue and Government Grants	18	Reporting financial performance
7	Introduction to groups	19	Earnings per share
8	The consolidated statement of financial position	20	Interpretation of financial statement
9	The consolidated statement of profit or loss and other comprehensive income	21	Limitations of financial statements and interpretation techniques
10	Accounting for associates	22	Statements of cash flows
11	Change in group structures: disposal	23	Specialised, not-for-profit and public sector entities
12	Financial instruments		

## FR EXAM RESOURCES

Home / Students / Study support resources

← Back to

Study support resources

### Financial Reporting (FR)

#### Exam resources

#### Getting started

• Introduction to Financial Reporting

### Resources



FR essentials on one page

Download PDF



View the specimen exam on the Practice Platform

Launch external site



FR examiner's approach

Read more



Guide to session CBEs

Download PDF

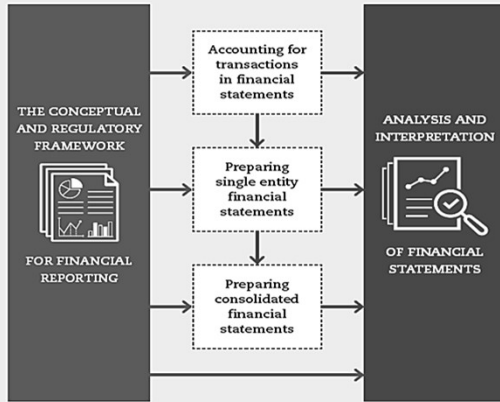
## FR ESSENTIALS



### What is FR about?

Financial Reporting provides you with the skills required to apply accounting standards and the conceptual framework in the preparation of financial statements and how to analyse and interpret those financial statements.

#### FR: An overview



### Steps to success

- ✓ If possible, study with an Approved Learning Partner and use Approved Content
- ✓ Study the whole syllabus
- ✓ Ensure you understand theories and techniques rather than just focus on how to do the calculations
- ✓ Practice exam style and standard questions, to time, using the ACCA Practice Platform
- ✓ Develop your skills in answering constructed response questions
- ✓ Attempt at least two full exams under exam conditions, debrief your answers, then focus your revision on weaker areas



### Key resources

- Examiner approach
- Objective test questions for session CBEs
- Guide to session CBEs
- How to approach performance appraisal questions
- Read the mind of an FR marker
- Examining team guidance
- ACCA Practice Platform
- Analysing a statement of cash flows
- Tell me a story
- Revenue revisited
- Financial instruments
- Examinable documents



### Tackling the exam

#### Section A (30 marks)

- 15 objective test (OT) questions, each worth 2 marks

#### Section B (30 marks)

- Three OT cases with five OT questions worth 2 marks each, 10 marks per case

#### Tips for answering OT questions

- ✓ Read the question carefully
- ✓ Adhere to the rounding instructions for "Fill in the Blank" questions
- ✓ Answer all questions

#### Section C (40 marks)

- Two scenarios which relate to one or more requirement(s)

#### Tips for answering Section C questions

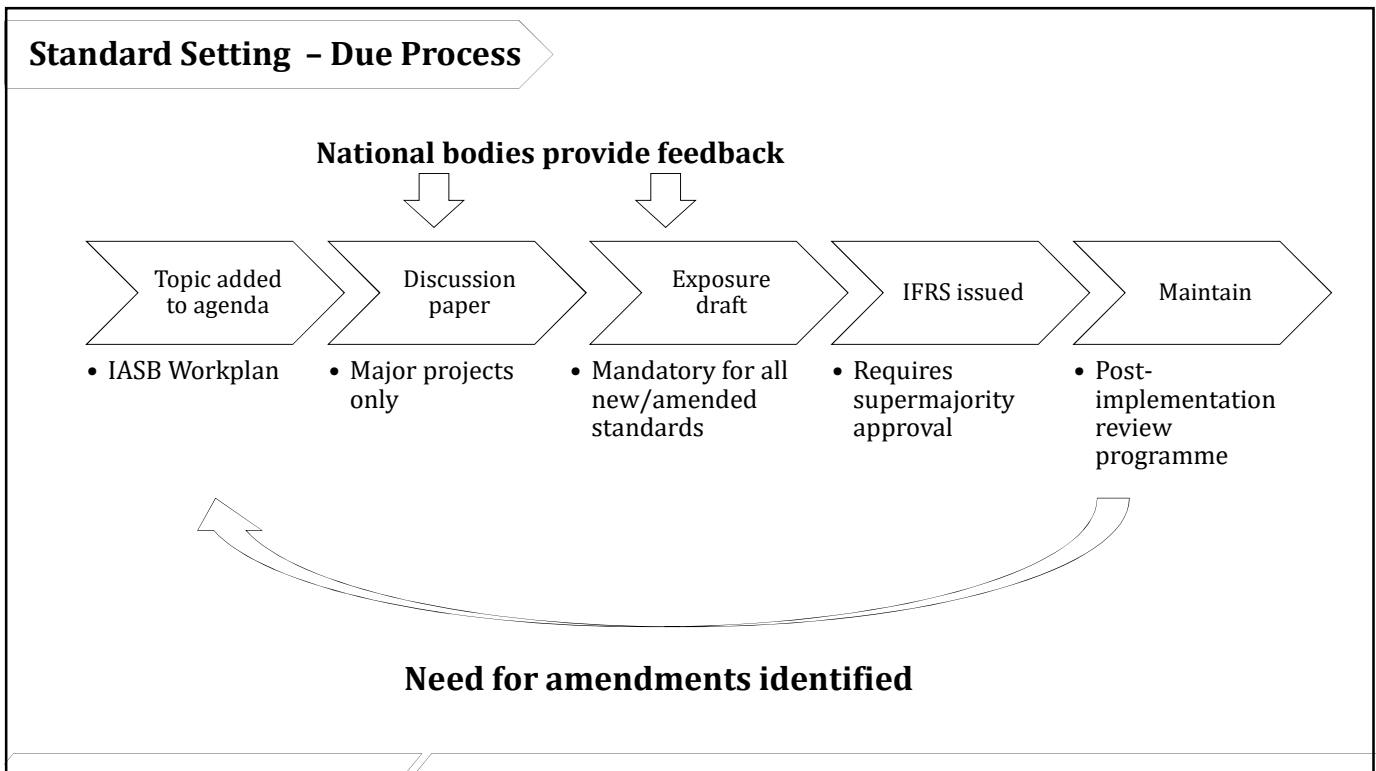
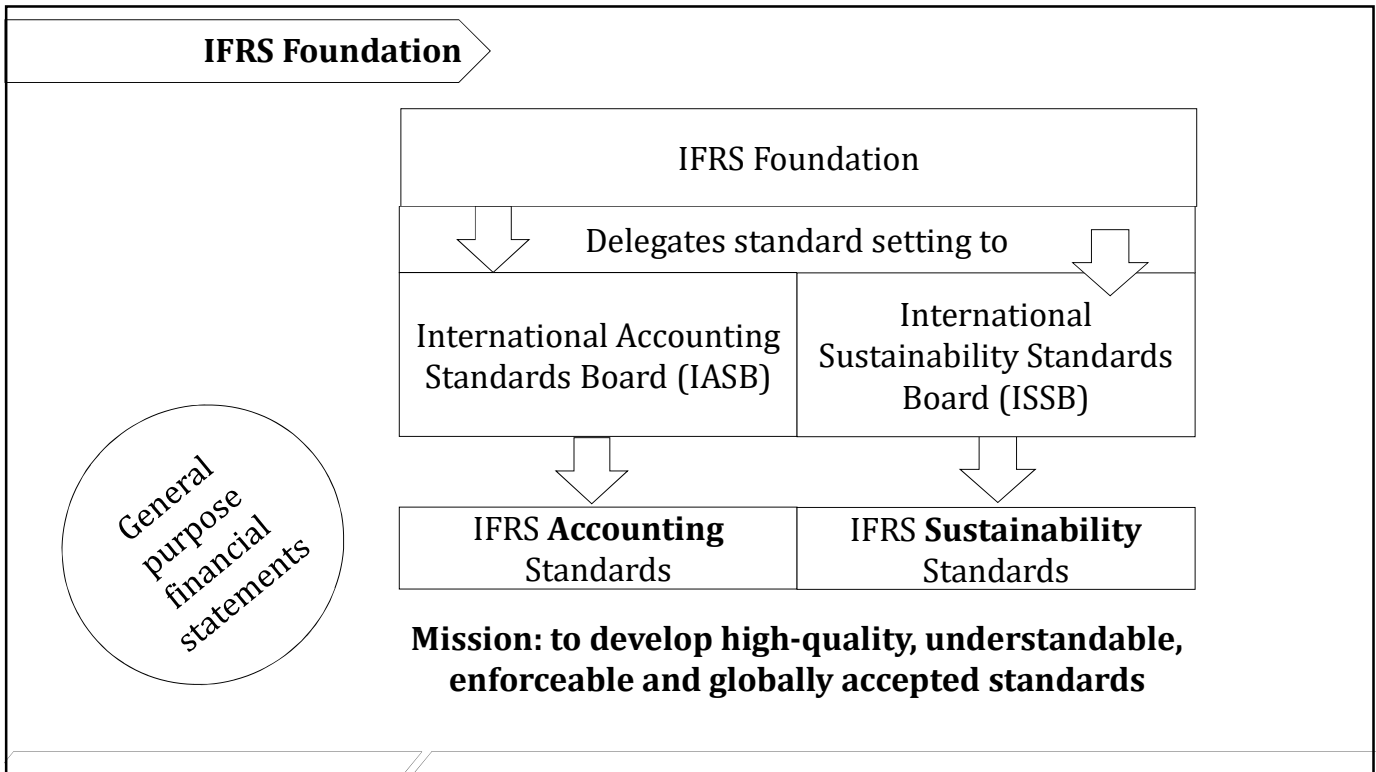
- ✓ Be strict in allocating 36 minutes to each question
- ✓ Always read the requirement(s) first
- ✓ Present all workings – do not simply "plug" results of calculations
- ✓ Structure narrative answers around an answer plan
- ✓ Use headings, make clear statements and avoid repetition
- ✓ Always include a conclusion on the analysis discussion
- ✓ Attempt all requirements

7

# Chapter 1

## CONCEPTUAL FRAMEWORK

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## Use of IFRS Accounting Standards

### IFRS Accounting Standards may be used:

- As national requirements e.g. UK, EU, Canada, Ghana, S Africa
- As a basis for national requirements e.g. Hong Kong, Singapore, Malaysia, Australia, New Zealand
- As a benchmark for development of national standards e.g. India, Vietnam
- By large companies through choice e.g. US companies

US has  
not  
adopted  
IFRS

## ISSB

ISSB

- Established November 2021

Responsibility

- Sustainability-related matters

Intention

- Sustainability Disclosure Standards

## Conceptual Framework

### Purpose and Status

IFRS: principles-based reporting system

- To assist the IASB in the development of IFRS Accounting Standards
- To assist preparers to develop accounting policies where there is no IFRS Accounting Standard
- To assist all parties to understand and interpret the Standards

Conceptual Framework is not an IFRS Accounting Standard

## Conceptual Framework

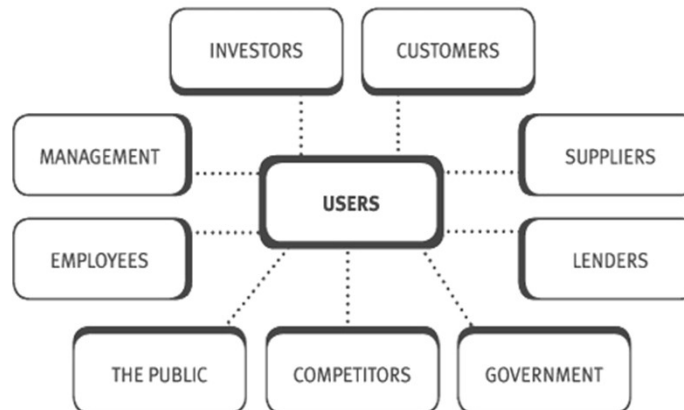
### Contents

Chapter 1	• The objective of general purpose financial reporting
Chapter 2	• Qualitative characteristics of useful information
Chapter 3	• Financial statements and the reporting entity
Chapter 4	• The elements of financial reporting
Chapter 5	• Recognition and derecognition
Chapter 6	• Measurement
Chapter 7	• Presentation and disclosure
Chapter 8	• Concepts of capital and capital maintenance

## Conceptual Framework

### Activity: Users of the financial statements

Who are the users of external financial statements, what information do they require and why?



## Conceptual Framework

### Objective of general purpose financial reporting

To provide **financial information** that is useful to **primary users** in making decisions relating to the provision of resources to the entity

- Economic resources, claims and changes in resources and claims
- Stewardship of management

- Financial position
- Financial performance (accrual accounting)
- Changes in financial position

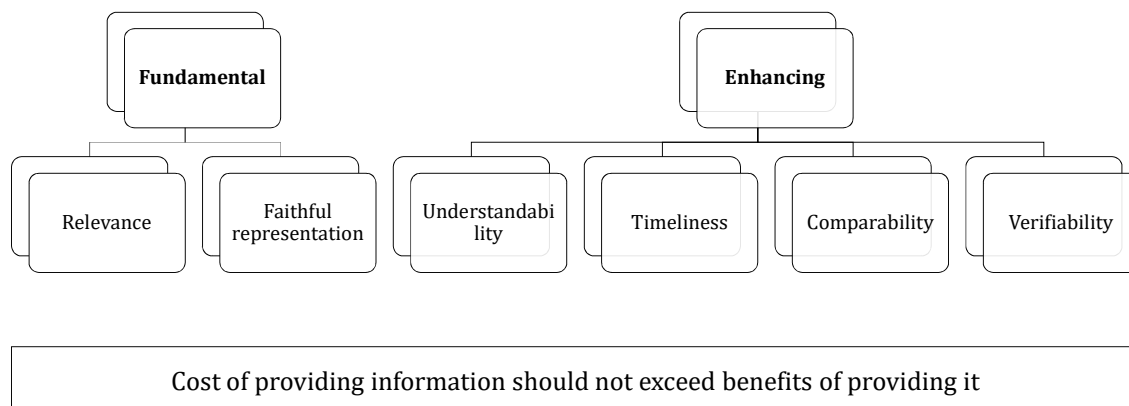
Going  
concern  
assumption

- Investors
- Lenders
- Suppliers



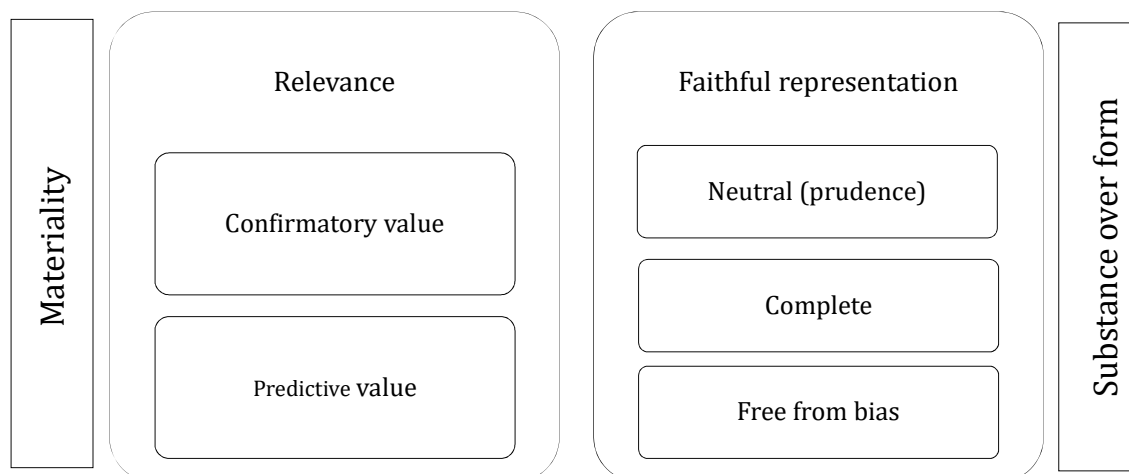
## Conceptual Framework

### Qualitative characteristics of useful information



## Conceptual Framework

### Fundamental Characteristics



## Conceptual Framework

### Enhancing characteristics

#### Comparability

- “Internal” - same entity through time/different entities
- “External” - consistency and disclosure

#### Verifiability

- Knowledgeable, independent observers would reach consensus
- Direct/indirect

#### Timeliness

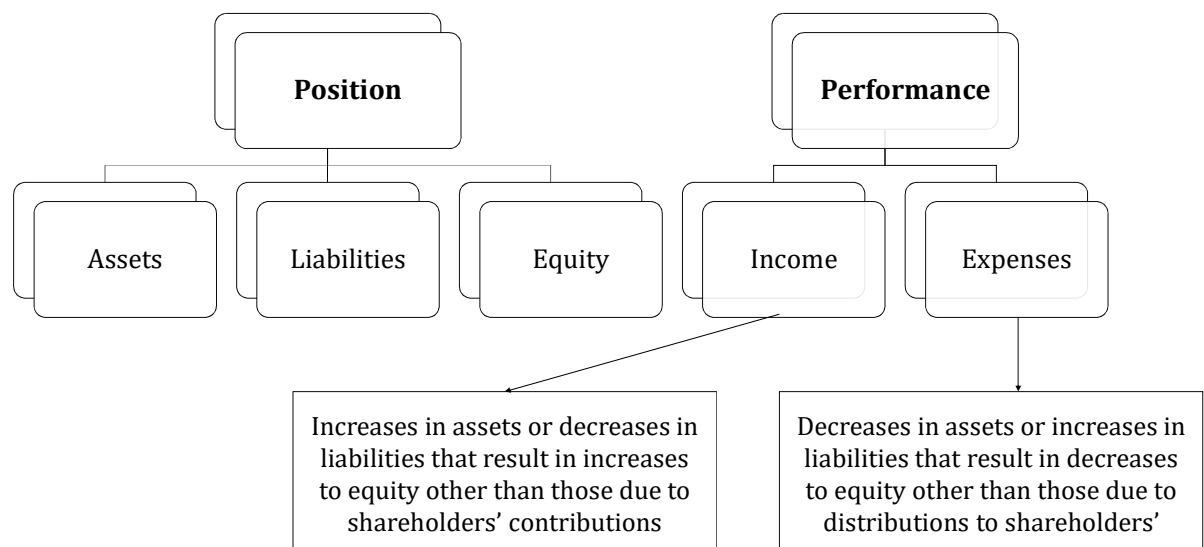
- Users need information in timely fashion to make decisions

#### Understandability

- Clear and concise presentation
- Users assumed to have a reasonable knowledge
- Complex items not excluded

## Conceptual Framework

### Elements of financial reporting



## Conceptual Framework

### Definition of an asset

Present **economic resource** controlled by the entity as a result of past events

Right that has the  
*potential* to produce  
economic benefits

IAS  
38

An asset is a resource:  
(a) controlled by an entity as a result of past events; and  
(b) from which future economic benefits are expected to flow to the entity.

## Conceptual Framework

### Definition of a liability

Present **obligation** to transfer economic resource as a result of past events

Duty or responsibility that  
entity has no practical  
ability to avoid

IAS  
37

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.

## Conceptual Framework

### Accounting assumptions

#### Going concern

- The entity is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future.

It is assumed that the entity has neither the intention nor the necessity of liquidation or of curtailing materially the scale of its operations.

## Conceptual Framework

### Accounting assumptions

Concept assumes → preparing a normal set of accounts; the business will **continue to operate** in approximately the **same manner** for the foreseeable **future** (**at least** the next **12 months**).



Preparing a **normal** set of accounts

#### Unless:

- (i) the entity **is being liquidated** or has ceased trading, or
- (ii) the directors either **intend to liquidate** the entity or to cease trading



**BREAK-UP BASIS**

## Conceptual Framework

### Accounting assumptions

#### GOING- CONCERN ASSUMPTION

- Assets: Net book value
- No provisions for future operating loss

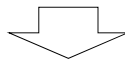
#### BREAK-UP BASIS

- Assets: Scrap Value
- Provisions for future operating loss

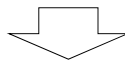
## Conceptual Framework

### Accruals basis

**Accruals basis of accounting:** Items are recognized as assets, liabilities, equity, income and expenses (the elements of financial statements) **when they satisfy the definitions and recognition criteria** for those elements in the Framework. (IAS 1)



Entities → record when revenues or expenses are **earned or incurred** in the accounting period, to which they relate, **not as the cash is paid or received**



Accrual assumption → profit/revenue earned must be matched against the expenditure incurred in earning it. This is the **matching convention**

## Conceptual Framework

### Recognition and derecognition

**Recognise** an element if recognition would provide information that is:

1. Relevant
  - Existence uncertainty
  - Low probability
2. A faithful representation
  - Measurement uncertainty

#### Derecognise:

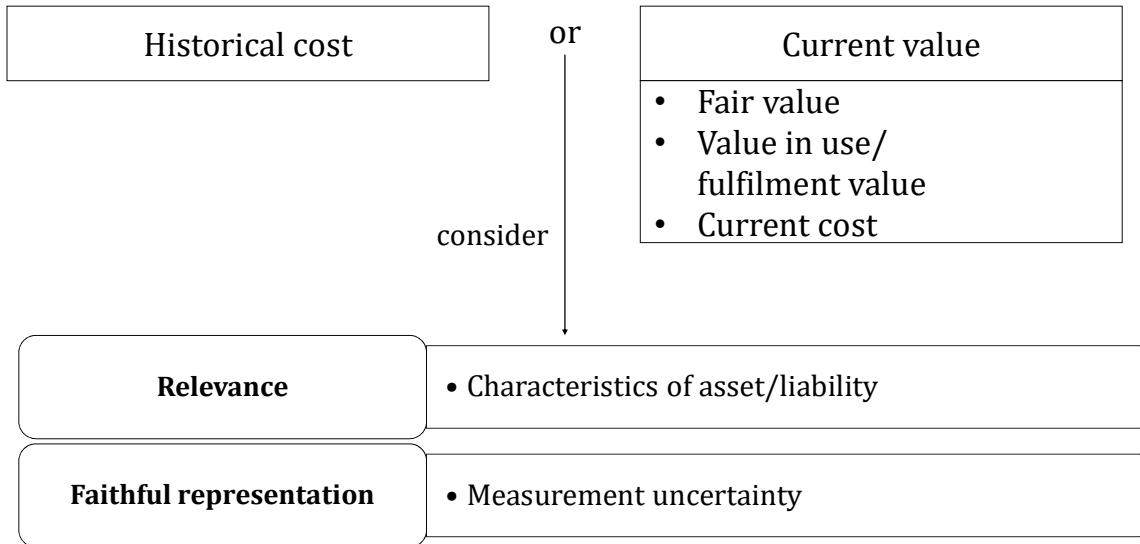
- An **asset** when control is lost
- A **liability** when entity no longer has a present obligation

## Recognition

Item	Recognized in	When
<b>Asset</b>	The statement of financial position	It is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably
<b>Liability</b>	The statement of financial position	It is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably
<b>Equity</b>	The statement of financial position	It is the amount of money that would be returned to a company's shareholders if all of the assets were liquidated and all of the company's debt was paid off
<b>Income</b>	The statement of profit or loss and other comprehensive income	An increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably
<b>Expenses</b>	The statement of profit or loss and other comprehensive income	A decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably

## Conceptual Framework

### Measurement bases



## Conceptual Framework

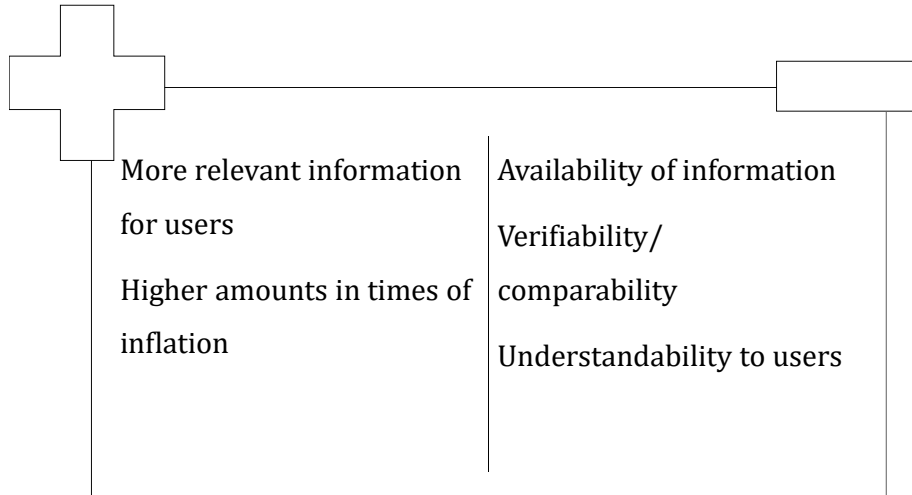
### Activity: Historical Cost

What are the advantages and disadvantages of measuring items at historical cost?

Advantages	Disadvantages
Easy to understand and follow	Current revenue "mis-match" to historical costs
Amounts are reliable	Carrying amounts of assets do not reflect market value
Objective amounts	Reported gains include both holding and operating gains and these are not distinguished
Conservative measures	Does not reflect impacts of inflation
Used globally	

## Conceptual Framework

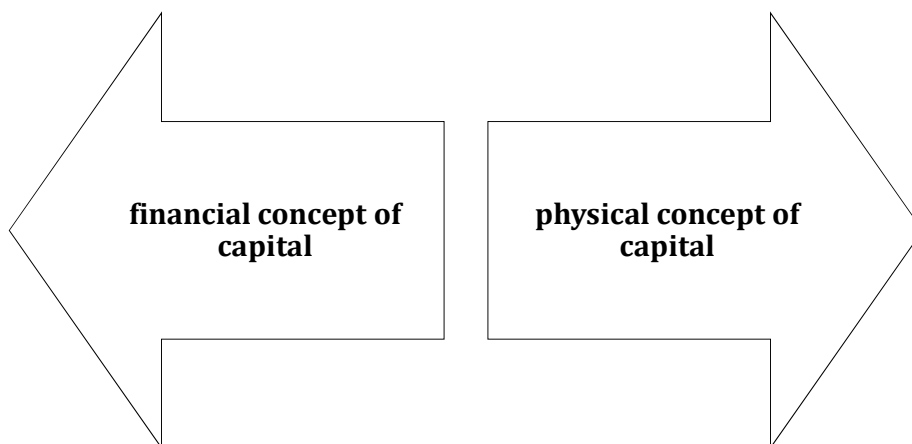
### Current Value Accounting



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## Conceptual Framework

### Concepts of capital and capital maintenance





## Concepts of capital and capital maintenance

<b>Financial capital maintenance</b>	<b>Physical capital maintenance</b>
A profit is earned if the financial (money) amount of the net assets at the end of the period exceeds the net assets at the beginning of the period, excluding distributions to/contributions from holders of equity claims during the period)	A profit is made if the physical productive capacity (or operating capability) of the entity at the end of the period exceeds the physical productive capacity at the beginning of the period (excluding any distributions to/contributions from holders of equity claims during the period) (Conceptual Framework: para. 8.3).

## Advantage

### Advantages of a conceptual framework

- (a) Accounting standards are developed on the same theoretical principles - which avoids a haphazard approach to setting standards and should lead to standardised accounting practices.
- (b) The development of accounting standards is less subject to political pressure - pressure on standard setters to adopt a certain approach would only prevail if it was acceptable under the conceptual framework.
- (c) Accounting standards use a consistent approach - eg without a conceptual framework, some standards may concentrate on profit or loss whereas some may concentrate on the valuation of net assets.
- (d) A principles-based approach avoids the need for large volumes of 'rules' to address every scenario. Instead, the same underlying principles can be applied to any scenario.

## Disadvantage

### Disadvantages of conceptual framework

- (a) Financial statements are intended for a variety of users, and it is not certain that a single conceptual framework can be devised which will suit all users.
- (b) Given the diversity of user requirements, there may be a need for a variety of accounting standards, each produced for a different purpose (and with different concepts as a basis).
- (c) It is not clear that a conceptual framework makes the task of preparing and then implementing standards any easier than without a framework

## IFRS 13 Fair Value Measurement

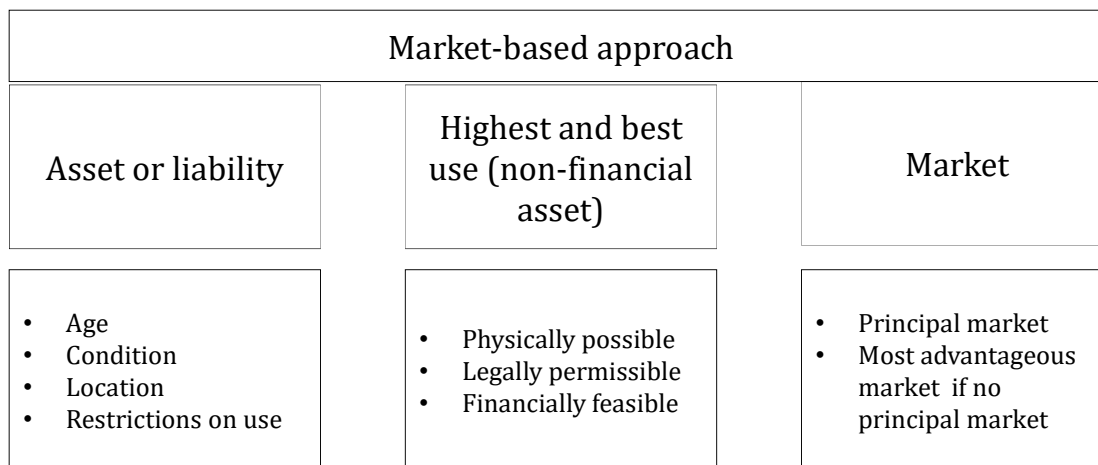
**IFRS 13 is applicable where other standards permit or require an item to be measured at fair value**

### Definition

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.

## IFRS 13 Fair Value Measurement

### Measurement



37

## IFRS 13 Fair Value Measurement

### Activity: Principal or Most Advantageous Market

Jammee has business in two markets, Europe and Asia. Jammee has to place a fair value on an asset it holds for accounting purposes. The market price of the asset in the two markets is \$120 and \$125, respectively.

Details relating to the asset in the two markets are as follows:

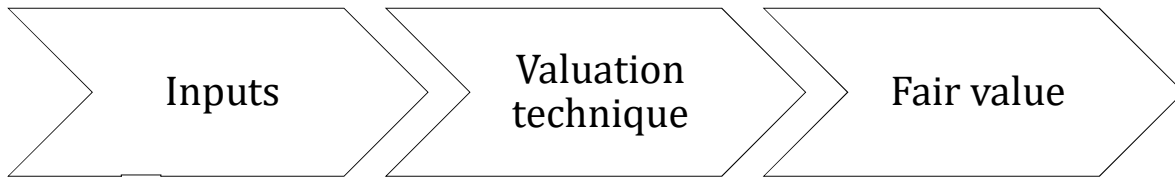
	Europe \$	Asia \$
Market price	120	125
Transaction costs	(5)	(11)
Transport costs	(5)	(2)
	110	112

1. If Europe were the principal market, what is fair value?
2. If neither Europe nor Asia were the principal market, what is fair value?

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## IFRS 13 Fair Value Measurement

### Valuation Methodology



- Maximise observable
- Minimise unobservable

**Market approach** Uses information from a marketplace for identical/comparative items

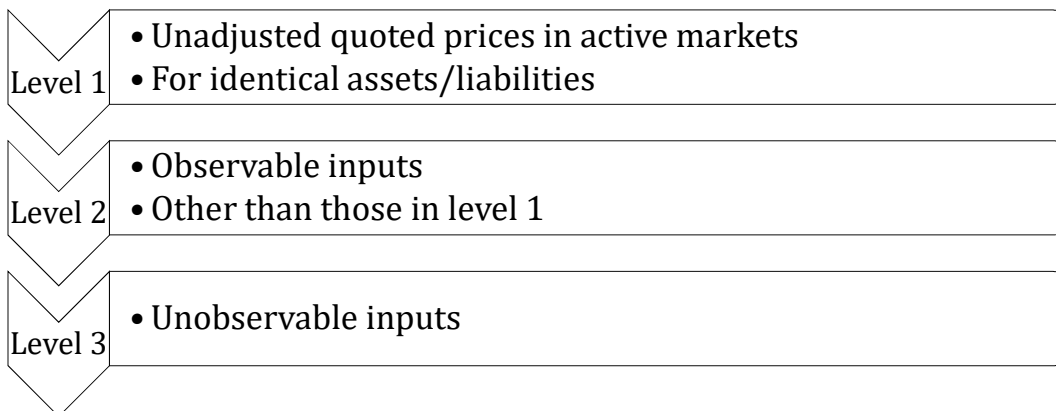
**Cost approach** Reflects amount that would be required to replace service capacity of asset

**Income approach** Discounts future cash flows to present values

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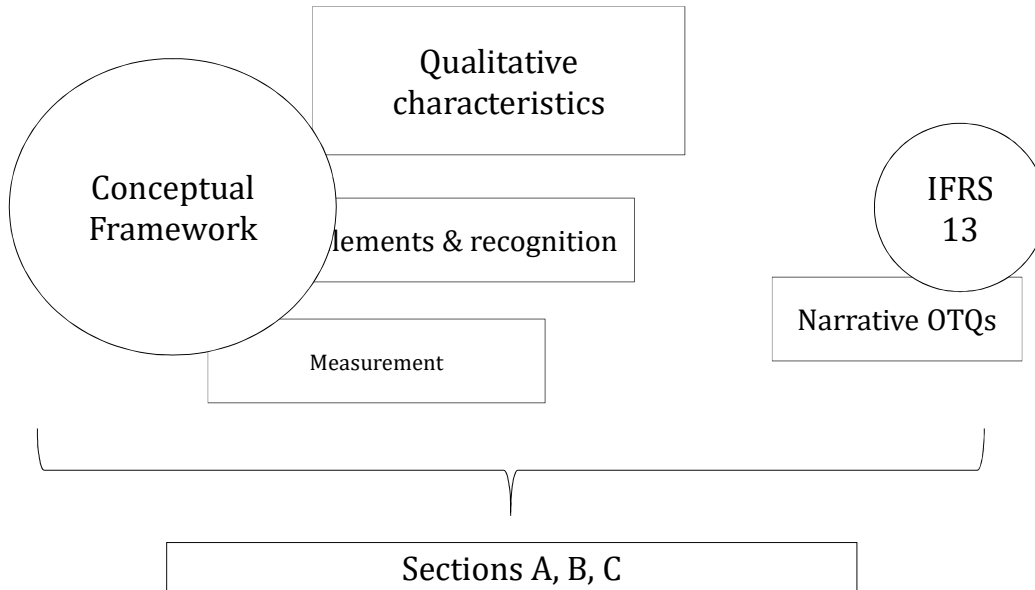
## IFRS 13 Fair Value Measurement

### Inputs to Valuation Techniques



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## Exam focus



41



# THANK YOU

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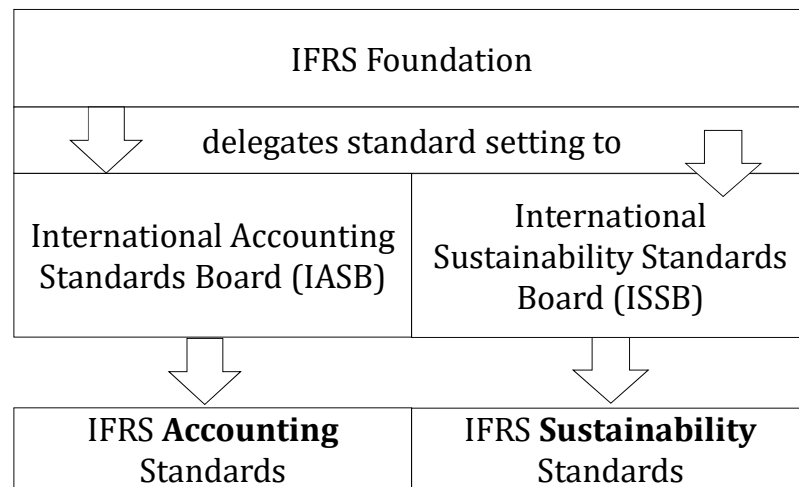


# Chapter 2

## THE REGULATION FRAMEWORK

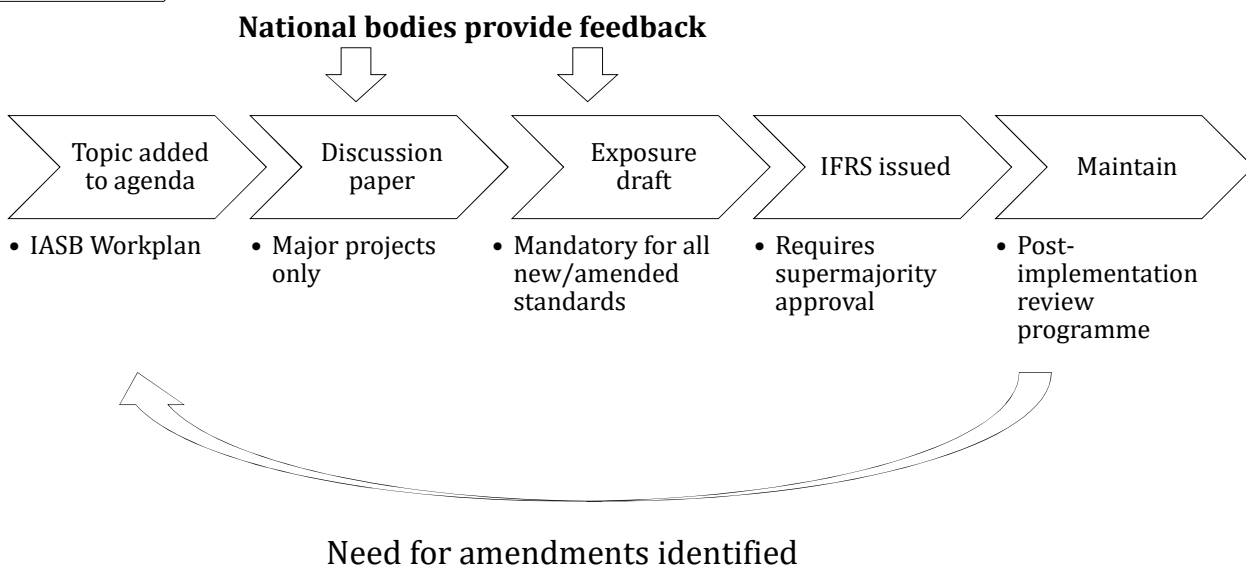
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### IFRS Foundation



**Mission: to develop high-quality, understandable, enforceable and globally accepted standards**

## Standard Setting – Due Process

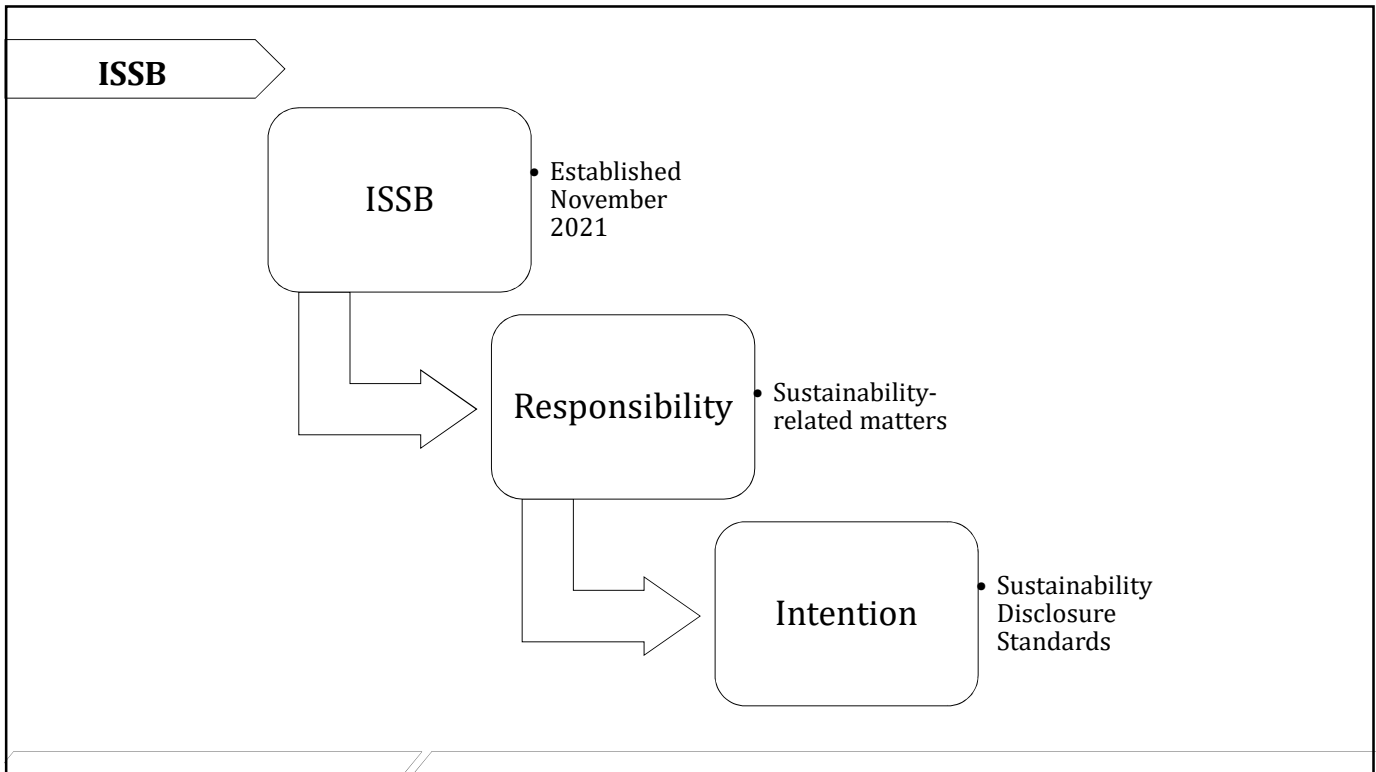


## Use of IFRS Accounting Standards

### IFRS Accounting Standards may be used:

- As national requirements e.g. UK, EU, Canada, Ghana, S Africa
- As a basis for national requirements e.g. Hong Kong, Singapore, Malaysia, Australia, New Zealand
- As a benchmark for development of national standards e.g. India, Vietnam
- By large companies through choice e.g. US companies

US has not adopted IFRS



## The need for a regulation framework

### The need for a regulatory framework

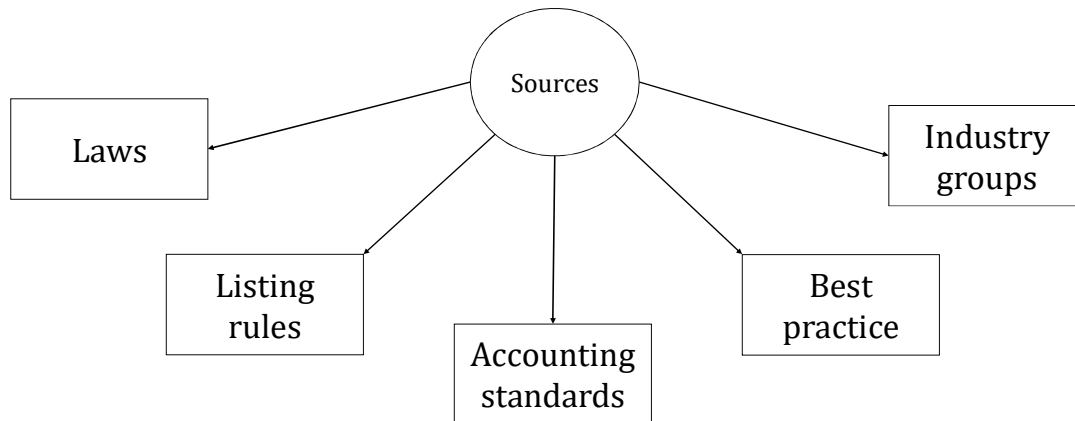
A regulatory framework for accounting is needed for two principal reasons:

- (a) To act as a central source of reference of generally accepted accounting practice (GAAP) in a given market; and
- (b) To designate a system of enforcement of that GAAP to ensure consistency between companies in practice.



## What is GAAP?

GAAP: Generally Accepted Accounting Principles



## Principle base vs rule base

Principles-based Framework	Rules-based Framework
Principles which reflect the initial objectives of financial statements are set	Rules are laid out as events arise, designed to cover all eventualities
All accounting standards then follow these principles	Therefore, accounting standards are a set of rules which companies must follow
Therefore, a principles-based framework is based upon a conceptual framework	

## Accounting standards and choice

### Advantages

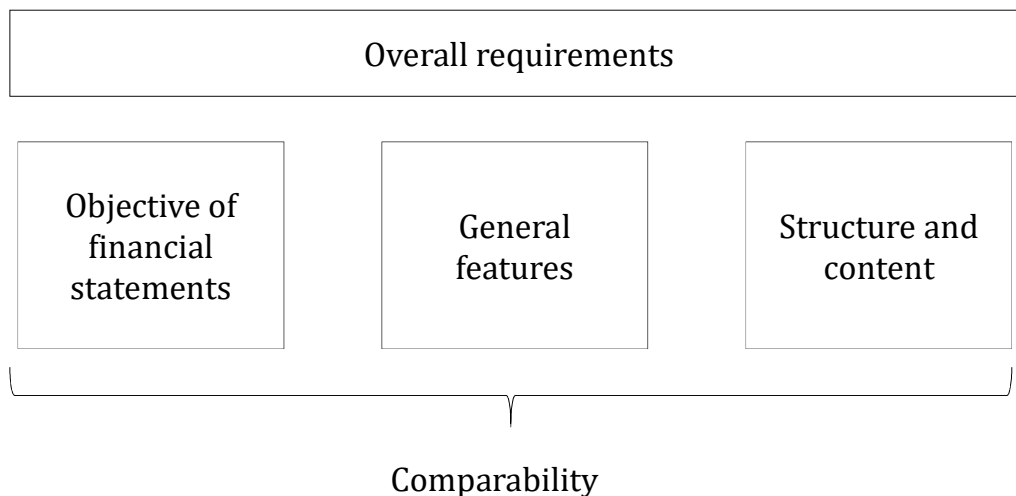
- ✓ In favour of accounting standards (both national and international), the following points can be made.
- ✓ They reduce, even eliminate, confusing variations in the methods used to prepare accounts.
- ✓ They provide a focal point for debate and discussions about accounting practice.
- ✓ They oblige companies to disclose the accounting policies used in the preparation of accounts.
- ✓ They are a less rigid alternative to enforcing conformity by means of legislation.
- ✓ They have obliged companies to disclose more accounting information than they would otherwise have done if accounting standards did not exist. For example, IAS 33 Earnings per Share.

## Accounting standards and choice

### Disadvantages

- x Many companies are reluctant to disclose information that is not required by national legislation, with some arguing against standardisation and in favour of choice.
- x One method of preparing accounts might be inappropriate in some circumstances.
- x Standards may be subject to lobbying or government pressure (in the case of national standards).
- x Many national standards are not based on a conceptual framework of accounting, although this is the basis for IFRS® Accounting Standards.
- x There may be a trend towards rigidity.
- x There are also political problems, as any international body, whatever its purpose or activity, faces difficulties in attempting to gain international consensus and the IASB is no exception to this. It is complex for the IASB to reconcile the financial reporting situation between economies as diverse as developing countries and sophisticated first-world industrial powers.

## IAS 1 Presentation of Financial Statements



## IAS 1 Presentation of FS

### Objective of Financial Statements

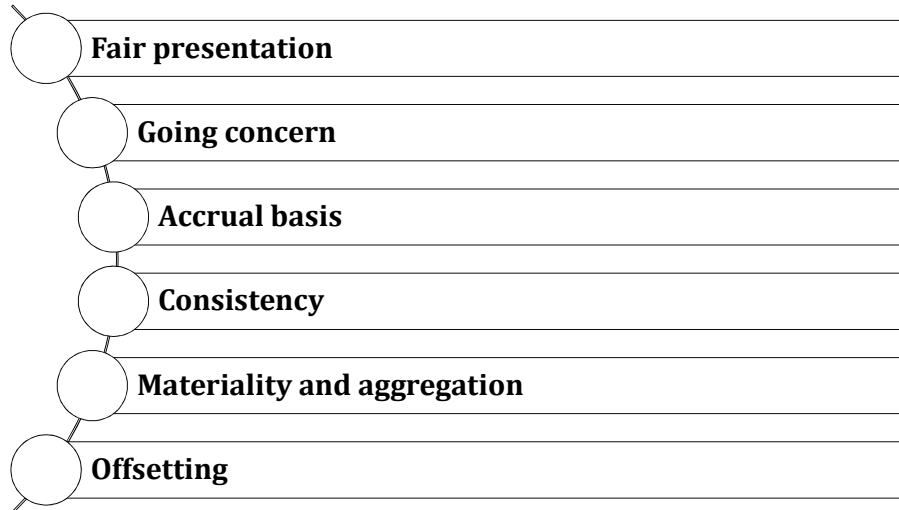
Provide information about:	Provided in:
Financial position	Statement of financial position at end of period
Financial performance	Statement of profit or loss and OCI for the period
	Statement of Changes in equity for the period
Cash flows	Statement of cash flows for the period (IAS 7)

#### PLUS:

- Notes including accounting policies
- Comparatives
- Additional SOFP at start of comparative period where retrospective adjustment has taken place

## IAS 1 Presentation of FS

### General Features



## IAS 1 Presentation of FS

### Statement of Financial Position

Assets = Equity + Liabilities

or

Assets – Liabilities = Equity

#### Minimum line items

- |   |   |
|---|---|
| <ul style="list-style-type: none"><li>• Property, plant and equipment</li><li>• Investment property</li><li>• Intangible assets</li><li>• Financial assets</li><li>• Investments in associates</li><li>• Biological assets (IAS 41)</li><li>• Inventories</li><li>• Trade and other receivables</li><li>• Cash and cash equivalents</li></ul> | <ul style="list-style-type: none"><li>• Assets held for sale</li><li>• Trade and other payables</li><li>• Provisions</li><li>• Financial liabilities</li><li>• Current tax assets/liabilities</li><li>• Deferred tax assets/liabilities</li><li>• Liabilities held for sale</li><li>• Non-controlling interests</li><li>• Issued capital and reserves</li></ul> |
|---|---|

## IAS 1 Presentation of FS

### Current vs Non-current

An asset or liability is classified as "current" when it satisfies **one** of the following criteria:

- its realisation/consumption or settlement is expected:
  - in the normal operating cycle;
  - within 12 months after the reporting period;
- it is held primarily for trading;
- in the case of an asset, it is cash or a cash equivalent (unless it is restricted from being exchanged or used to settle a liability within 12 months);
- in the case of a liability, there is no unconditional right to defer its settlement for at least 12 months after the reporting period.

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

## IAS 1 Presentation of FS

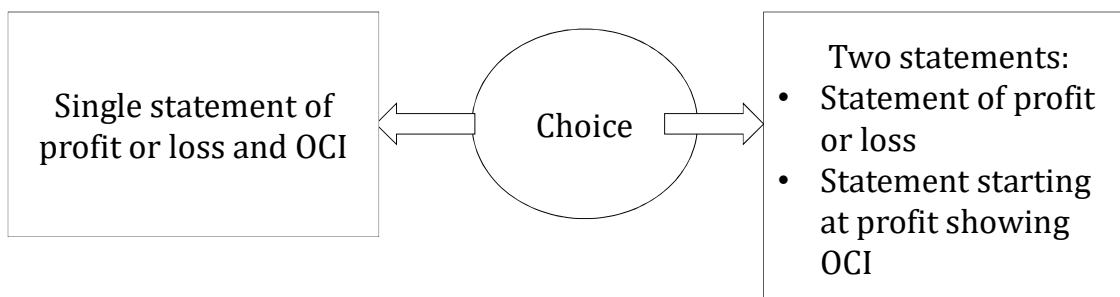
### Activity: Current or Non-current?

Should the following be classified as current or non-current?

- Amounts due from a new customer to whom a company has provided extended credit terms of 15 months as an incentive to purchase goods.
- A mortgage over a property, payable in monthly instalments over 25 years.
- A ship under construction at a shipbuilding company; the ship is expected to take three years to construct.
- Shares that were purchased to sell for a profit as soon as the market price increases.

## IAS 1 Presentation of FS

### Statement of Profit or Loss and OCI



## IAS 1 Presentation of FS

### Profit or loss - Minimum Line Items

- Revenue
- Gains/losses arising from the derecognition of financial assets measured at amortised cost
- Finance costs
- Share of profit of associates determined using the equity method
- Tax expense
- Single line item for the total of discontinued operations
- Profit or loss for the period

## IAS 1 Presentation of FS

### Presentation of Expenses

BY NATURE	\$	BY FUNCTION	\$
Revenue	x	Revenue	x
Other income	x	Cost of sales	(x)
Changes in inventories of finished goods and work in progress	x/(x)	Gross profit/(loss)	x
Work performed by entity and capitalised	x	Other income	x
Raw materials and consumables used	(x)	Distribution costs	(x)
Staff costs	(x)	Administrative expenses	(x)
Depreciation and amortisation expense	(x)	Other expenses	(x)
Other expenses	(x)	Finance cost	(x)
Finance cost	(x)	Share of profit from associates	x
Share of profit from associates	x	Profit before tax	x
Profit before tax	x		

FR will examine

## IAS 1 Presentation of FS

### Other Comprehensive Income

OCI: Specific items of income or expense recognised outside P/L		Present net of tax or gross + tax effects
Revaluation of PPE	Will not be reclassified to profit or loss	
Remeasurement of defined benefit pension		
Exchange differences on overseas operations	May be reclassified to profit or loss	
Cash flow hedges		
Remeasurement of financial assets at FVTOCI	Reclassification depends on type of asset	

## IAS 1 Presentation of FS

### Statement of Changes in Equity

	Attributable to owners of the parent <sup>1</sup>				Non-controlling interest	Total equity
	Share capital	Share premium	Revaluation <sup>2</sup> surplus	Retained earnings		
	\$	\$	\$	\$	\$	\$
Balance at 1 January	x	x	x	x	x	x
Change in accounting policy				(x)	(x)	(x)
Restated balance	x	x	x	x	x	x
<b>Changes in equity for period</b>						
Issue of share capital	x					x
Dividends				(x)		(x)
Total comprehensive income for the year			x	x	x	x
Transfer to retained earnings			(x)	x		
Balance at 31 December	x	x	x	x	x	x

**Items in equity section of SOFP**

Retrospective adjustment (IAS 8)

Transactions with shareholders

Per SoPL and OCI

Reserves transfer

## IAS 1 Presentation of FS

### Notes to the Financial Statements

#### Objectives:

- Present information about basis of preparation and specific accounting policies used
- Disclose information required by IFRS that isn't presented elsewhere
- Provide additional information needed for fair presentation

Notes should be presented in a systematic manner and cross-referenced to the primary FS

Significant accounting policies should be disclosed

Key sources of estimation uncertainty should be disclosed.



## Exam focus

Objective

General  
features

SOFP

SoPL and  
OCI

SOCIE

Mainly OTQs

Preparation of one or  
some certain in  
Section C



Vietsourcing  
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# **Chapter 3**

## **NON – CURRENT ASSETS**

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# **IAS 16**

## **PROPERTY, PLANT AND EQUIPMENT**

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## IAS 16

### Scope

IAS 16 covers all aspects of accounting for property, plant and equipment. This represents items called “tangible” non-current assets.

IAS 16 does not apply to:

- ✓ assets classified as held for sale in accordance with IFRS 5
- ✓ exploration and evaluation assets (IFRS 6)
- ✓ biological assets related to agricultural activity (see IAS 41) or
- ✓ mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources

## IAS 16

### Recognition PPE

it is probable that future economic benefits associated with the item will flow to the entity; and

the cost of the item can be measured reliably.

## IAS 16

### Measurement of PPE

#### Initial measurement

#### At cost

The cost of an item of property, plant and equipment **comprises**:

- ✓ Purchase price, less any trade discount or rebate
- ✓ Initial **estimate** of the costs of dismantling and removing the item and restoring the site on which it is located.
- ✓ Directly attributable costs of bringing the asset to working condition for its intended use:
  - Cost of site preparation
  - Initial delivery and handling costs
  - Installation costs
  - Professional fees (architects, engineers)

## IAS 16

### Measurement of PPE

#### At cost

- If **exchange or part exchange of assets** occurs frequently for items of property, plant and equipment → the **cost** of an item obtained through (part) exchange is **the fair value** of the **asset received** unless this cannot be measured reliably.

## IAS 16

### Activity Initial Cost

On 1 October 20X6, Omega began the construction of a new factory. Costs relating to the factory, incurred in the year ended 30 September 20X7, are as follows:

	<b>\$000</b>
Purchase of the land	10,000
Costs of dismantling existing structures on the site	500
Purchase of materials to construct the factory	6,000
Employment costs (Note 1)	1,800
Production overheads directly related to the construction (Note 2)	1,200
Allocated general administrative overheads	600
Architects' and consultants' fees directly related to the construction	400
Costs of relocating staff who are to work at the new factory	300
Costs relating to the formal opening of the factory	200
Interest on loan to partly finance the construction of the factory (Note 3)	1,200

**Note 1:** The factory was constructed in the eight months ended 31 May 20X7. It was brought into use on 30 June 20X7. The employment costs are for the nine months to 30 June 20X7.

**Note 2:** The production overheads were incurred in the eight months ended 31 May 20X7. They included an abnormal cost of \$200,000, caused by the need to rectify damage resulting from a gas leak.

**Note 3:** Omega received the loan of \$12m on 1 October 20X6. The loan carries a rate of interest of 10% per annum.

**Note 4:** The factory has an expected useful life of 20 years. At that time the factory will be demolished and the site returned to its original condition. This is a legal obligation that arose on signing the contract to purchase the land. The expected costs of fulfilling this obligation are \$2m. An appropriate annual discount rate is 8%. The present value of \$1 in 20 years' time is 21.5 cents.

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## IAS 16

### Measurement of PPE

#### At cost

Should be  
recognized as  
expenses!!!



Costs are **not part** of the cost of property, plant or equipment:

- Expenses of operations that are incidental to the construction or development of the item
- Administration and other general overhead costs
- Start-up and similar pre-production costs
- Initial operating losses before the asset reaches planned performance

## IAS 16

### Measurement of PPE

#### Subsequent expenditure



- Added to the carrying amount **of the asset but only** subsequent expenditure which ***improves condition*** of asset beyond the previous performance (probable future economic benefits) should be ***recognized as assets***. Some examples of such improvements:
  - **Modification** of an item of plant to extend its useful life, including increased capacity
  - **Upgrade** of machine parts to improve the quality of output

*Other subsequent expenditures (repair, maintenances...)*  
→ ***recognized as an expenses***

## IAS 16

### Measurement of PPE

#### Subsequent expenditure

#### Cost model

Carry the asset at its **cost less accumulated depreciation and any accumulated impairment losses**

#### 2 Options



#### Revaluation model

Carry the asset at a revalue amount: **fair value less any subsequent accumulated depreciation and any accumulated impairment losses.**

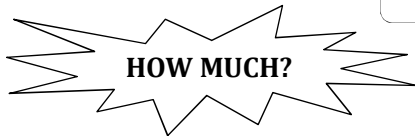
## IAS 16

### Depreciation

Depreciation is the **allocation** of the depreciable amount of an asset **over its estimated useful life**.



charge to net profit and loss for the period



Depreciation charged in the period =  $(\text{Cost} - \text{Residual value}) / \text{useful life}$

**Depreciable amount**

## IAS 16

### Depreciation

#### When?

- Depreciation **begins when** the asset is **available for use** and continues **until the asset is derecognized, even if it is idle**.

#### How long?

- Useful life is either:
  - Period over which depreciable asset is expected to be used, or
  - Numbers of production or similar units expected to be obtained from the asset
  - Consider the physical wear and tear, obsolescence, other legal or limits on the use of the assets.

## IAS 16

### Example: Changes in Estimates

An asset was acquired at a cost of \$200,000 and depreciation commenced over 25 years to a residual value of nil. Five years later it was determined that the asset did have a residual value, estimated at \$15,000. It was also determined that the total useful life was five years shorter than initially thought.

Answer:

Carrying amount at date of change:  $\$200,000 \times 20/25 \text{ years} = \$160,000$

New depreciable amount:  $\$160,000 - \$15,000 = \$145,000$

New remaining useful life:  $20 - 5 \text{ years} = 15 \text{ years}$

Therefore, new annual depreciation expense is  $\$145,000/15 \text{ years} = \$9,667$

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## IAS 16

### Depreciation method

Straight line  
method

The reducing  
balance method

Sum of digit  
method

#### Requirements:

- ✓ Depreciation: systematic basis over its useful life
- ✓ The depreciable method should reflect the pattern in which the asset's economic benefits are consumed by the entity.
- ✓ A review of the useful life of property, plant and equipment should be carried out at least annually.
- ✓ The depreciation method should also be reviewed periodically and if there has been a significant change in the expected economic benefits from those assets, the method should be changed to suit this changed pattern and taken into account as change in accounting estimate.



## IAS 16

### Depreciation method

#### Straight line method

The total depreciable amount is charged in **equal instalments to each accounting period** over expected useful life of asset

## IAS 16

### Depreciation method

#### The reducing balance method

The reducing balance method of depreciation calculates the annual depreciation charge as a **fixed percentage of Net book value of the asset**.

Depreciation of this year = % \* NBV of last period  
Accumulated end of this year = Accumulated of past period + depreciation charge in this year

## IAS 16

### The reducing balance method

**Example:** Non-current asset cost is \$10,000. Its expected useful life is 3 years and its estimated residual value is \$2,160. Company wishes to use reducing balance of 40%. What is NBV of asset @ the end of year 1, year 2, year 3?

		Acc dep
Asset at cost	10,000	
Depr end y1 (10,000*40%)	(4,000)	4,000
NBV at end of year 1	6,000	
Depr end y2 (6,000*40%)	(2,400)	6,400 (4,000 + 2,400)
NBV at end of year 2	3,600	
Depr end y3 (3,600 *40%)	(1,440)	7,840 (6,400 + 1,440)
<b>NBV at end of year 3</b>	<b>2,160</b>	

**Note for reducing balance method: Do not deduct** the residual value from the cost before depreciating. Instead, we depreciate the asset using the percentage given, **until we reach the residual value, and then we stop depreciating.**

→ There are different ways to apply the reducing balance method when the asset has a residual value. However, the method mentioned above is the one **preferred by the examiner.**

## IAS 16

### The reducing balance method

**Example:** Same example above but residual value = 3,000

		Acc dep
Asset at cost	10,000	
Depr end y1 (10,000*40%)	(4,000)	4,000
NBV at end of year 1	6,000	
Depr end y2 (6,000*40%)	(2,400)	6,400 (4,000 + 2,400)
NBV at end of year 2	3,600	
Depr end y3 = lower [(3,600 *40%) and (NBV - residual value)]	(600)	7,000 (6,400 + 600)
<b>NBV at end of year 3</b>	<b>3,000</b>	

Depreciate until NBV = Residual value → Normally, at the end of useful life we will depreciate with the amount = NBV - residual value

## IAS 16

### Sum of digit method

This method is similar to Reducing balance method, only different is the percentage.

**Example:** ABC Co purchases a non-current asset for \$10,000 on 1 Jan 2006. Useful life is 5 years, residual value is \$1,000. What is depreciation charge for each year?

**Solution:** The sum of digit = 5 year + 4yr +3yr +2yr+1yr = 15.

Year	Calculation	Dep. charge	Accum. Depr
2001	$5/15*(10,000-1,000)$	3,000	3,000
2002	$4/15*9,000$	2,400	5,400
2003	$3/15*9,000$	1,800	7,200
2004	$2/15*9,000$	1,200	8,400
2005	$1/15*9,000$	600	9,000

**NOTE:** Sum of digit = number of ALL years sum together  
There is always **same NBV to use** when calculate the allocation of depreciation (i.e. 9,000)

## IAS 16

### Note to depreciation

- Depreciation method should **apply consistency** from year to year
- **Change** in depreciation method
- Change useful life → Change accounting estimation →  
the **remaining life** will be used for **remaining NBV**.



**Example:**

If ABC Co has asset cost \$12,000, useful life is 4 yrs, after 2 year and now want to move to useful life 7 yrs

**Solution:**

After 2 years → NBV =  $12,000 - ((12,000/4)*2) = 6,000$

If move to 7 years → more 5 years to come, new depreciation is =  $6,000/5 = \$1,200$  (DO NOT DIVIDE TO 7 because no Retrospective permitted)

## IAS 16

### Complex assets

These are assets which are made up of separate components. Each component is separately depreciated over its useful life (IAS 16). An example which appeared in a recent examination was that of an aircraft. An aircraft could be considered as having the following components:

	<b>Cost</b>	<b>Useful life</b>
	\$'000	
<b>Fuselage</b>	20,000	20 years
<b>Undercarriage</b>	5,000	500 landings
<b>Engines</b>	8,000	1,600 flying hours

Depreciation at the end of the first year, in which 150 flights totaling 400 hours were made would be:

	<b>Cost</b>
	\$'000
<b>Fuselage</b>	1,000
<b>Undercarriage (5,000 x 150/500)</b>	1,500
<b>Engines (8,000 x 400/1,600)</b>	<u>2,000</u>
	<u>4,500</u>

## IAS 16

### Revaluation model

#### KEY PRINCIPLES OF REVALUATION MODEL

Revaluations should be carried out **regularly**

The **entire class of assets** to which that asset belongs **should be revalued**

**Depreciation** is charged on the **revalued amount**

Revaluation → increase in value → credit to **other comprehensive income** and **accumulated in equity** under the heading "**revaluation surplus**"  
**Unless** it represents the **reversal of a revaluation decrease** of the same asset **previously recognised as an expense**, in which case it **should be recognised in PL**

## IAS 16

### Revaluation model

#### KEY PRINCIPLES OF REVALUATION MODEL

Revaluation → Decrease in value → Recognize as an **expense to the extent that it exceeds any amount previously credited to the revaluation surplus** relating to the **same asset**.

When a revalued asset is **disposed** of, *any revaluation surplus **may be transferred directly to retained earnings, or** it may be left in equity under the heading revaluation surplus*. The transfer to retained earnings **should not** be made through profit or loss.

## IAS 16

### Revaluation model

Restate asset from cost to valuation.

Remove any existing accumulated depreciation provision.

Include increase in Other Comprehensive Income, at the bottom of the statement of profit or loss.

## IAS 16

### Recognising a Revaluation

Upwards

- Recognise in OCI:
  - Dr PPE
  - Cr OCI (revaluation reserve)
- Unless reversing a previous downwards revaluation in P/L:
  - Dr PPE
  - Cr P/L (= previous expense)
  - Cr OCI (revaluation reserve)

Downwards

- Recognise in profit or loss
  - Dr P/L
  - Cr PPE
- Unless reversing a previous upwards revaluation in P/L:
  - Dr OCI (revaluation reserve)
  - Dr P/L
  - Cr PPE

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## IAS 16

### Example: Revaluation

An asset was purchased for \$100 on 1 January 20X1. The entity adopted the revaluation model for subsequent measurement of the asset.

	Asset	Revaluation surplus	Profit or loss	
1.1.20X1	100	-		
Increase	<u>20</u>	<u>20 Cr</u>	-	Dr PPE 20      Cr OCI 20
	<u>120</u>	<u>20 Cr</u>		
1.1.20X2	120	20 Cr		
Decrease	<u>(15)</u>	<u>(15) Dr</u>	-	Dr OCI 15      Cr PPE 15
	<u>105</u>	<u>5 Cr</u>		
1.1.20X3	105	5 Cr		
Decrease	<u>(9)</u>	<u>(5) Dr</u>	4 Dr	Dr OCI 5      Cr PPE 9 Dr P/L 4
	<u>96</u>	<u>-</u>		
1.1.20X4	96	-		
Increase	<u>15</u>	<u>11 Cr</u>	4 Cr	Dr PPE 15      Cr P/L 4 Cr OCI 11
	<u>111</u>	<u>11 Cr</u>		

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## IAS 16

### Example: Revaluation and Depreciation

	\$
Cost	1,000
Accumulated depreciation	(250)
Carrying amount	750

Revalue to \$1,100

Dr Cost	\$100
Dr Acc'd depreciation	\$250
Cr OCI	\$350

Revalue to \$900

Dr Acc'd depreciation	\$250
Cr Cost	\$100
Cr OCI	\$150

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## IAS 16

### Revaluation model

#### **Example:**

Premises cost \$30,000, land cost \$20,000. Useful life is 30 years. After the end of 5 years, ABC Co decided to revalue assets as follow: Premises is \$75,000, land is \$75,000. How such revaluation was treated?

#### **Solution:**

##### **Before revaluation:**

Premises \$30,000 → depr over 30yr → depreciation per annum = \$1,000  
 Land \$20,000 → no depreciation  
 End of 5 years → Premises + land =  $(30,000 - (30,000/30)*5\text{yrs}) + 20,000 = \$45,000$

The gain on revaluation is recognized in the **Statement of Comprehensive Income** (under **other comprehensive income**), but not in the Income Statement as it has not been realized.

##### **After revaluation:**

Premises + land = \$75,000 + \$75,000 = 150,000  
 NBV before revalue 45,000  
 Increase revaluation amount 105,000

**After the revaluation**, depreciation of the building will be charged at the new rate:  
 $\$75,000/25 \text{ years} = \$3,000 \text{ per year.}$

##### **Double entry:**

Dr	Non-current asset	105,000
Cr	Revaluation reserve	105,000

## IAS 16

### Revaluation model

**Example:**

Premises cost \$30,000, land cost \$20,000. Useful life is 30 years. After the end of 5 years, ABC Co decided to revalue assets as follow: Premises is \$75,000, land is \$75,000. How such revaluation was treated?

**Solution:**

If asset are sold at carrying amount of \$150'000, the profit would be **realized but** The transfer of Revaluation Surplus **to retained earnings** should not be made through profit or loss.

**Accounting entries:**

Dr	Cash	150,000	
Cr	Non-current asset	150,000	
Dr	Revaluation reserve	105,000	
Cr	RE	105,000	

## IAS 16

### Revaluation model

**Example:**

Premises cost \$30,000, land cost \$20,000. Useful life is 30 years. After the end of 5 years, ABC Co decided to revalue assets as follow: Premises is \$75,000, land is \$75,000. How such revaluation was treated?

**Excess depreciation**

- The difference between the new depreciation charge based on the revalued carrying amount and the old depreciation charge based on the original cost of the asset is known as the **excess depreciation**.
- IAS 16 allows entities to transfer an amount equal to the excess depreciation from the **revaluation surplus to retained earnings** in the equity section of the SOFP, **if they wish to do so**.

Dr	Depreciation expense (IS)	\$3'000	to record new
Cr	Acc. Depreciation account (BS)	\$3'000	annual depreciation
Dr	Revaluation Surplus	\$2'000	to record transfer
Cr	RE	\$2'000	of excess dep.



## IAS 16

### Revaluation model

**Example:**

Premises cost \$30,000, land cost \$20,000. Useful life is 30 years. After the end of 5 years, ABC Co decided to revalue assets as follow: Premises is \$75,000, land is \$75,000. How such revaluation was treated?

**Revaluation downwards**

Example as above. The carrying amount of the building five years after the revaluation is \$60'000 ( $75'000 - 3'000 \times 5$ ). The market value of the building has fallen to \$40'000. We assume that the entity does not transfer the excess depreciation from revaluation surplus to REs.

Dr	Revaluation surplus	\$20'000	Less than Reserve surplus: 105'000
	Building - acc. Depreciation	\$15'000	
Cr	Building - cost	\$35'000	

In case: the decrease amount =  $110'000 > 105'000$

→ Dr Revaluation reserve: maximum = 105'000

→ Dr Expense =  $110'000 - 105'000 = 5'000$  (the excess amount of Revaluation Surplus)

## IAS 16

### Derecognition of PPE

On disposal

No future economic benefits expected

GAIN or LOSS

= Net Disposal Proceeds

- Carrying Amount



**Gain or loss are included in Profit or Loss, but not as Revenue**

# IAS 40

## INVESTMENT PROPERTY

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### IAS 40

#### Definition

- **Investment property** is property (land or a building or part of a building or both) held (by the owner or by the lessee under a finance lease) to **earn rentals** or for **capital appreciation** or both, rather than for:
  - a) use in the production or supply of goods or services or for administrative purposes;  
or
  - b) sale in the ordinary course of business.
- **Owner-occupied property** is property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes.

## IAS 40

### Definition

Property description	Meets definition of investment property
Owned by the company and leased out under an operating lease	√
Held under a finance lease and leased out under an operating lease	√
Held under a finance lease and to be leased out in the future under an operating lease	√
Held under a finance lease and leased out under a finance lease	X
Owned by the company and leased out under a finance lease	X
Owner-occupied property used in the production or supply of goods, services or for administrative purposes	X
Held for sale in the ordinary course of business	X
Held under operating lease	X
A property comprising a piece of land and a building constructed on it leased out to a third party	operating lease, unless expected to pass to lessee at end of lease
Property partly owner-occupied and partly leased out under an operating lease	the 2 portions accounted for separately if they can be sold separately; if not, to be treated as PPE, unless the owner-occupied portion is insignificant.

## IAS 40

### Initial measurement

- An investment property shall be measured initially at its cost.
- Cost includes purchase price and directly attributable expenditure such as professional fees for legal services, property transfer taxes and other transaction costs.
- For self-constructed investment properties, cost is the cost at the date when the construction or development is complete.

## IAS 40

### Subsequent measurement

#### FAIR VALUE MODEL

- Investment property is measured at fair value at the end of the reporting period
- Any resulting gain or loss is included in profit or loss for the period
- The investment property is not depreciated

#### COST MODEL

- Carry the asset at its historic cost less
- Depreciation and
  - Any accumulated impairment loss

## IAS 40

### Subsequent measurement

#### Subsequent measurement - Special case

- When a property interest **held by a lessee under an operating lease is classified as an investment property**, treatment is **not elective**. The **fair value model is to be applied**.
- **Property held under an operating lease.** A property interest that is held by a lessee under an operating lease **may be** classified and accounted for as investment property provided that:
  - the rest of the definition of investment property is met
  - the operating lease is accounted for as if it were a finance lease in accordance with IAS Leases
  - the lessee uses the fair value model set out in this Standard for the asset recognised

## IAS 40

### Subsequent measurement

#### Subsequent measurement

- If an entity has previously measured an investment property at fair value, it shall continue to measure the property at fair value until disposal even if comparable market transactions become less frequent or market prices become less readily available.

## IAS 40

### Transfers

Transfers when, and only when, there is a change in use, evidenced by:

- commencement of owner-occupation, for a transfer from investment property to owner-occupied property;
- commencement of development with a view to sale, for a transfer from investment property to inventories;
- end of owner-occupation, for a transfer from owner-occupied property to investment property;
- commencement of an operating lease to another party, for a transfer from inventories to investment property; or
- end of construction or development, for a transfer from property in the course of construction or development (covered by IAS 16) to investment property.

**IAS 40****Transfers - cost model**

<b>From</b>	<b>To</b>	<b>Treatment</b>
PPE	IP	No change in cost
Inventory	IP	No change in cost
IP	PPE	No change in cost
IP	Inventory	No change in cost

**IAS 40****Transfers - IP at fair value**

<b>From</b>	<b>To</b>	<b>Treatment</b>
PPE at cost	IP	Value IP at date of transfer in accordance in IAS 16 (revaluation)
Inventory	IP	Change to P&L
IP	PPE	No change in value
IP	Inventory	No change in value

## IAS 40

### Transfers - Example

Kapital Co owns a building which it has been using as a head office. In order to reduce costs, on 30 June 20X9 it moved its head office functions to one of its production centres and is now letting out its head office. Company policy is to use the fair value model for investment property.

The building had an original cost on 1 January 20X0 of \$250,000 and was being depreciated over 50 years. At 31 December 20X9 its fair value was judged to be \$350,000.

**Explain how the building will be accounted for in the financial statements of Kapital Co at 31 December 20X9?**

## IAS 40

### Disclosure requirements

These relate to:

Choice of fair value model or cost model

Criteria for classification as investment property

Assumptions in determining fair value

Use of independent professional valuer (encouraged but not required)

Rental income and expenses

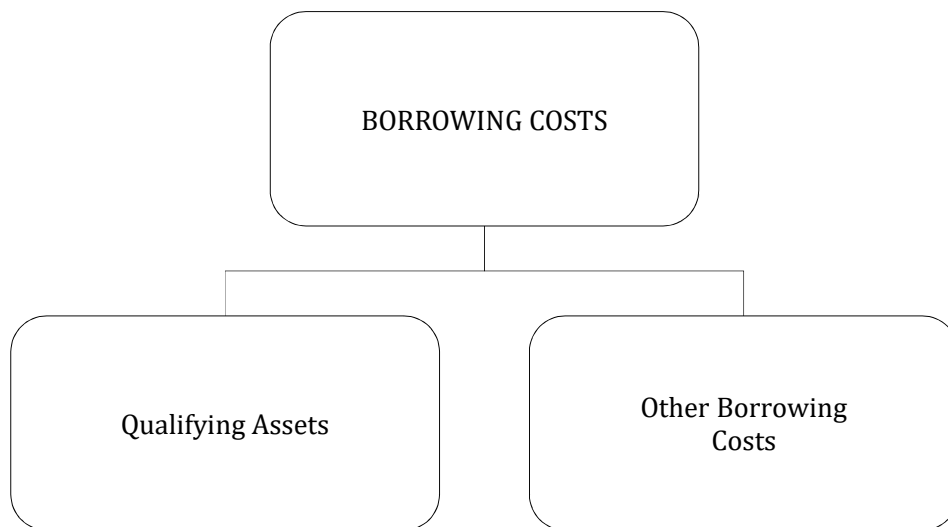
Any restrictions or obligations (IAS 40: paras. 74-79)

# IAS 23 BORROWING COSTS

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IAS 23

Definition





## IAS 23

### Definition

Borrowing Costs

- Interest and other cost incurred for the borrowing of funds.

Qualifying Assets

- The asset which take substantial period of time to get ready for its intended use or sale.

## IAS 23

### Qualifying asset

Constructions to be used for operations;

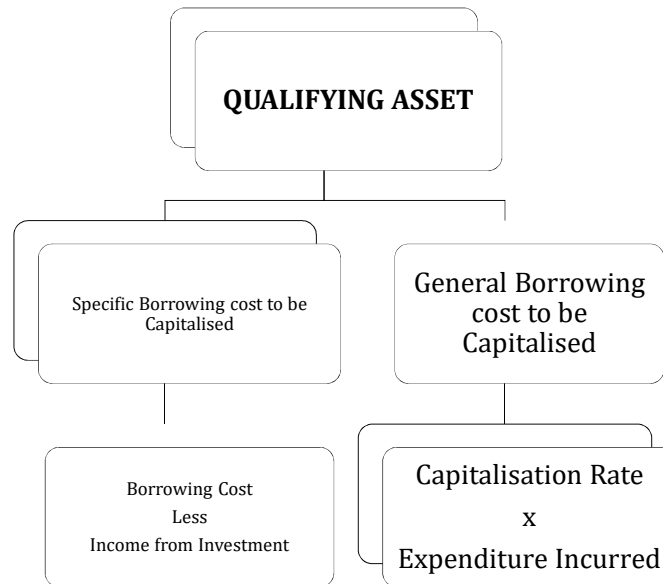
Inventories that need substantial time to bring them to their saleable condition;

Manufacturing Plants;

Power generation facilities

## IAS 23

### Qualifying asset



## IAS 23

### Borrowing costs - example

On 1 January 20X6 Stremans Co borrows \$1.5m to finance the production of two assets, both of which were expected to take a year to build. Work started during 20X6. The loan facility was drawn down and incurred on 1 January 20X6, and was utilized as follows, with the remaining funds invested temporarily.

	Asset Alpha	Asset Bravo
	\$'000	\$'000
1 January 20X6	250	500
1 July 20X6	250	500


The loan rate was 9% and Stremans Co can invest surplus at 7%.

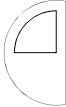
#### **Required**


**Ignoring compound interest, calculate the borrowing cost which may be capitalized for each of the assets and consequently the cost of each asset as at December 20X6**


## IAS 23

### The capitalization process shall begin when

 Expenditure for asset are being incurred;

 Borrowing costs are being incurred;

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

 Capitalisation should be suspended during periods in which active development is interrupted

## IAS 23

### The rate of interest to be taken

- Borrowing costs which may be capitalised are those actually incurred, less any investment income on the temporary investment of the borrowings.
- Where funds for the project are taken from general borrowings: The weighted average cost of general borrowings is taken.

## IAS 23

### Activity: Capitalisation of borrowing costs

Acruni Co had the following loans in place at the beginning and end of 20X6.

	1 January 20X6	31 December 20X6
	\$m	\$m
10% Bank loan repayable 20X8	120	120
9.5% Bank loan repayable	80	80

On 1 January 20X6, Acruni Co began construction of a qualifying asset, a piece of machinery for a hydro-electric plant, using existing borrowings. Expenditure drawn down for the construction was: \$30 million on 1 January 20X6, \$20 million on 1 October 20X6.

Required

Calculate the borrowing costs that can be capitalised for the hydro-electric plant machinery.

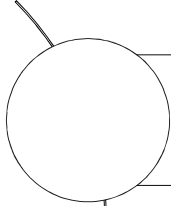
## IAS 23

### Cessation of capitalization

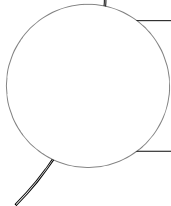
- Capitalization of borrowing costs shall cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.
- When the construction of a qualifying asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalization of borrowing costs shall cease when substantially all the activities necessary to prepare that part for its intended use or sale are completed.

## IAS 23

### Disclosure



The amount of borrowing cost capitalized during the period;



The capitalization rate used to determine the amount of borrowing cost eligible for capitalization.

# IAS 20 GOVERNMENT GRANT

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## IAS 20

### Definition

Are assistance by government in the form of transfers of resources to an enterprise in return for past or future compliance with certain conditions relating to the operating activities of the enterprise.

## IAS 20

### Recognition

the enterprise will comply with the conditions attaching to them; and

the grants will be received

## IAS 20

### Recognition

Write off the grant against the cost of the non-current asset and depreciate the reduced cost.

Treat the grant as a deferred credit and transfer a portion to revenue each year, so offsetting the higher depreciation charge on the original cost.

## IAS 20

### Grants related to ASSETS

As deferred income:  
DR Cash  
CR Deferred Income  
And amortised by  
DR Deferred Income

CR PL  
PL extract  
Income: amortization of govt grant  
Expense: depreciation

SOFP extract  
NCA:  
Cost  
Less: Accumulated Dep  
NCL: Deferred Income  
CL: Deferred Income

By deducting the grant from the asset's carrying amount  
DR Cash  
CR Asset

Results in reduced depreciation charge

PL extract  
Expense: depreciation (reduced amt)

SOFP extract  
NCA:  
Cost  
Less: Accumulated Dep

Grants relating to INCOME

Based on accruals concept

As deferred income:  
other income

Deduct from related  
expenses

**Grant becomes repayable**

Repayment should be applied first against any related unamortized deferred credit.

Any excess should be dealt with as an expense.



## IAS 20

### Grant becomes repayable

#### Treated as a change in estimate

- The repayment should be treated as increasing the carrying amount of the asset

DR Asset  
CR Cash

- Cumulative dep which would have been charged had the grant not been received should be charged as an expenses

DR Asset  
CR P/L

## IAS 20

### Recognition of the grant

Maddoc purchased a new item of plant for \$800,000 on 1 January 20X2, and expected to use it for five years with a zero residual value. The Government awarded Maddoc a grant of \$300,000 towards the cost of the plant on the same date.

Maddoc treated the grant as deferred income and has a 30 June year end.

Required

How much is recognised in non-current liabilities in respect of the grant as at 30 June 20X2?

- \$60,000
- \$30,000
- \$210,000
- \$270,000

## IAS 20

### Depreciation after Revaluation

1. After a revaluation, depreciation continues over the remaining useful life.
2. An annual transfer can be made from the revaluation reserve to retained earnings equal to the additional depreciation expense relating to the revaluation. This is not mandatory.

Dr Revaluation reserve  
Cr Retained earnings

Reserves  
transfer

**SOCIE**

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# **Chapter 4**

## **INTANGIBLE ASSETS**

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## **IAS 38 INTANGIBLE ASSETS**

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## IAS 38

### Definition

An intangible asset is an “**identifiable**” **non-monetary asset without physical substance**

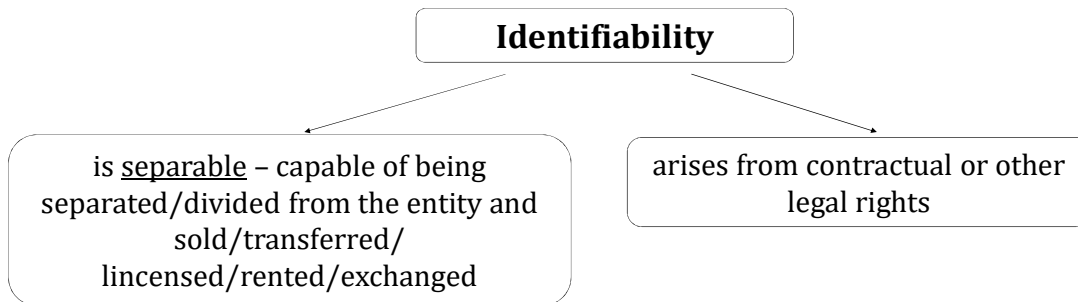
The **three critical attributes** of an intangible asset are:

- **identifiability**
- **control** (power to obtain benefits from the asset)
- **future economic benefits** (such as revenues or reduced future costs)



## IAS 38

### Definition



## IAS 38

### Definition

### Control

- If the entity has the **power to obtain** the **future economic benefits** flowing from the asset **and to restrict the access** of others to those benefits.
- This can stem from legal rights. In the absence of legal rights, it is more difficult to demonstrate control.
- Legal enforceability is not a necessary condition for control because an entity may be able to control the future economic benefits in some other way.

## IAS 38

### Activity: Intangible Assets

Indicate whether the following meet the definition of an intangible asset:

- Staff knowledge and skill
- Technology purchased to save production costs
- Internally generated goodwill
- A customer list
- A brand name developed by a company

## IAS 38

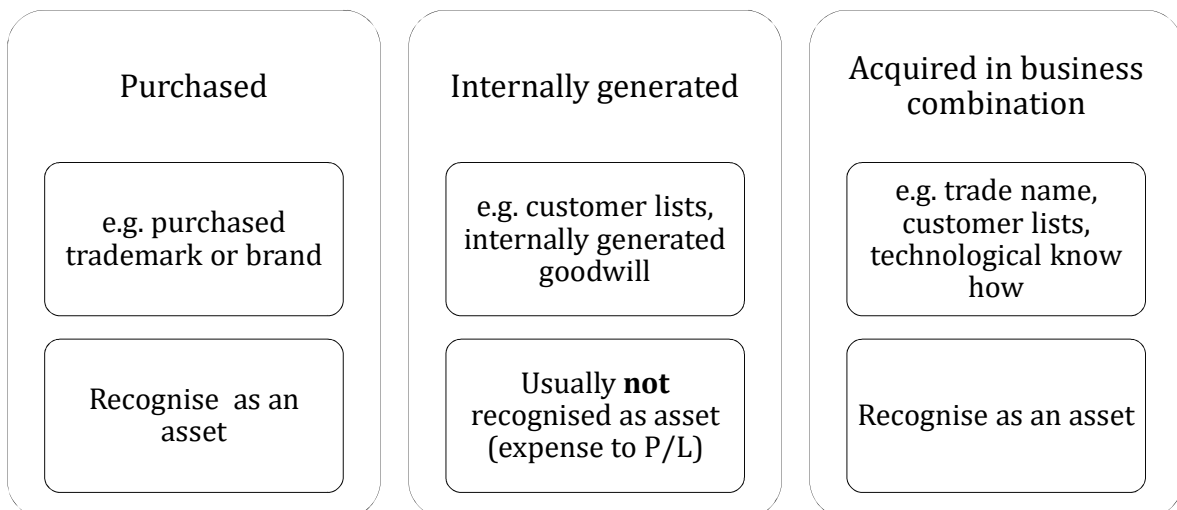
### Recognition

- Meet the definition of an intangible asset, and
- Meet the recognition criteria of the framework:
  - It is probable that future economic benefits attributable to the asset will flow to the entity
  - The cost of the asset can be measured reliably.

**An intangible asset should be measured initially at cost**

## IAS 38

### Application of Recognition Criteria



## IAS 38

### Separate Acquisition

Cost of a separately acquired intangible asset comprises:

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

## IAS 38

### Directly attributable costs are

Employment costs arising directly from bringing the asset to its working condition;

Professional fees arising directly from bringing the asset to its working condition; and

Costs of testing whether the asset is functioning properly

## IAS 38

### Separate Acquisition

**Expenditures that are NOT part of the cost → expense immediately**

- costs of introducing a new product or service
- costs of conducting business in a new location or with a new class of customer (including costs of staff training); and
- administration and other general overhead costs.

## IAS 38

### **Activity: Initial measurement of a separately acquired intangible asset**

Apricot Co purchases an operating licence from an overseas supplier for \$180,000 plus non-refundable purchase taxes of \$18,000. The supplier's normal list price is \$200,000 but it has awarded Apricot Co a 10% trade discount. Apricot Co has to pay import duties on the purchase of this licence of \$20,000. As part of the purchase process, Apricot Co seeks advice from a lawyer and incurs legal fees of \$15,000.

### **Required**

Calculate the initial cost of the intangible asset that Apricot Co should recognise in relation to this licence



## IAS 38

### Exchange of assets

If one intangible asset is exchanged for another the cost of the intangible asset at fair value unless:

- a) The exchange transaction lacks commercial substance, or
- b) The fair value of neither the asset received nor the asset given up can be reliably measured.

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

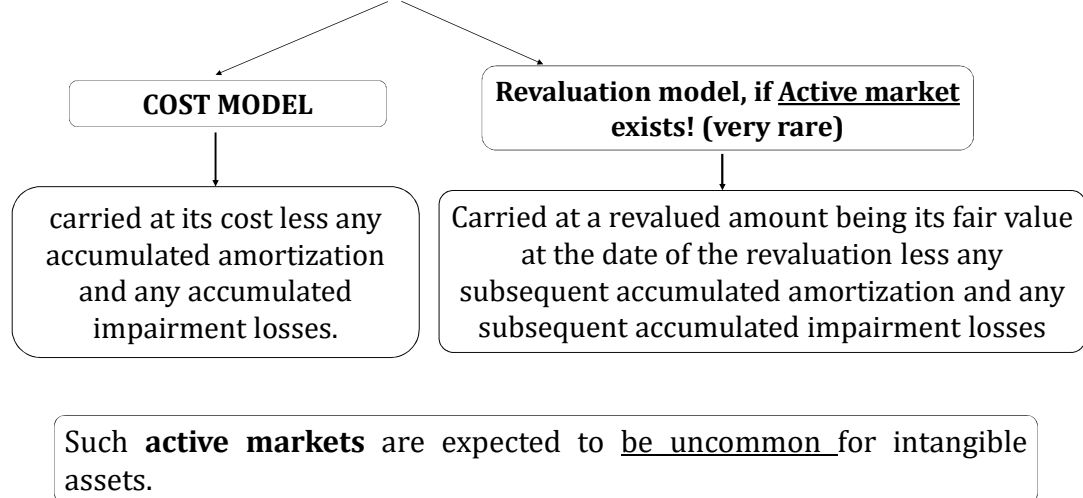
## IAS 38

### Initial Measurement

Separately purchased	Cost
Internally generated (development costs)	Costs from date criteria met
Business combination	Fair value
Acquired by way of government grant	Fair value or cost
Acquired by exchange of assets	Usually fair value

## IAS 38

### MEASUREMENT



## IAS 38

### Active market

Active market has the following characteristics

- Product is homogenous
- There are willing buyers and suppliers

Generally, intangible assets are **UNIQUE** in nature and therefore active market does not exist....

So, revaluation model is **NOT** applicable.

## IAS 38

### Revaluation model

Fair value should be determined by **reference to an active market**

- Revaluations should be made with sufficient **regularity** such that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date
- If an intangible asset is revalued, all the other assets in its **class** should also be revalued. revaluations are carried out regularly.

## IAS 38

### Accounting for revaluation

Increase in value	Decrease in value
Recognise in other comprehensive income (and accumulate in equity under the heading 'revaluation surplus')	(a) Recognise in other comprehensive income to the extent of any credit balance in the revaluation surplus in respect of that asset (and reduce the revaluation surplus in equity) (b) Recognise any excess in profit or loss
DEBIT Asset (carrying amount) CREDIT Other comprehensive income (and accumulate in 'revaluation surplus')	DEBIT Other comprehensive income (and reduce revaluation surplus) DEBIT Profit or loss CREDIT Asset (carrying amount)

## IAS 38

### Amortisation

Useful life is **FINITE**  
(limited)

- Amortise asset on a systematic basis over its useful life
- Usually recognise amortisation in profit or loss (unless part of the cost of another asset)
- Residual value is normally zero
- Amortisation begins when asset is available for use
- Review useful life and amortisation method at least each year end and adjust where necessary

Useful life is **INDEFINITE**  
(unpredictable)

- Do not amortise asset
- Conduct impairment reviews:
    - Annually; and
    - Where indication of possible impairment
  - Review useful life at least annually to determine if events and circumstances still support an indefinite useful life assessment

## IAS 38

### Amortisation

Many factors are considered in determining the useful life of an intangible asset, including:

- Expected usage
- Typical product of life cycles
- Technical, technological, commercial or other types of obsolescence
- The stability of the industry; expected actions by competitors
- The level of maintenance expenditure required
- Legal or similar limits on the use of the asset, such as the expiry dates of related leases

## IAS 38

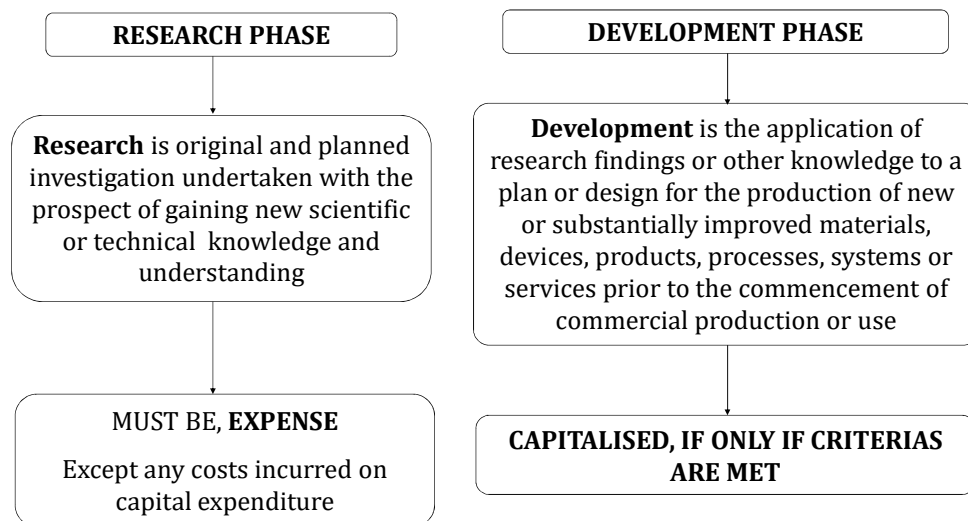
### Amortisation

An intangible asset with a finite useful life should be amortized over its expected useful life.

- a) Amortization should start when the asset is available for use
- b) Amortization should cease at the earlier of the date that the asset is classified as held for sale in accordance with IFRS 5 Non-current Assets held for Sale and Discontinued Operations and the date that the asset is derecognized.
- c) The amortization method used should reflect the pattern in which the asset's future economic benefits are consumed. If such a pattern cannot be predicted reliably, the straight-line method should be used.
- d) The amortization charge for each period should normally be recognized in profit or loss

## IAS 38

### Research and development



## IAS 38

### Research and development

- Probable future economic benefits from the asset, whether through sale or internal cost savings.
- Intention to complete the intangible asset and use or sell it
- Resources available to complete the development and to use or sell the intangible asset
- Ability to use or sell the intangible asset
- Technical feasibility of completing the intangible asset so that it will be available for use or sale
- Expenses attributable to the intangible asset during its development can be measured.

**PIRATE**

## IAS 38

### Activity: Development Costs

In its first year of trading to 31 December, Eco-chem incurred the following expenditure on research and development, none of which related to the purchase of property, plant and equipment.

1. \$12,000 on successfully devising processes to convert the sap extracted from mangroves into chemicals X, Y and Z.
2. \$60,000 on developing an analgesic medication based on chemical Z. No commercial uses have yet been discovered for chemicals X and Y.

Commercial production and sales of the analgesic commenced on 1 September, and are expected to produce steady profitable income during a five-year period before being replaced. Adequate resources exist for the company to achieve this.

#### Required:

Assuming no impairment, determine the maximum amount of development expenditure which may be carried forward at 31 December under IAS 38.

## IAS 38

### Answer to Activity: Development Costs

#### Cost

1. This is research expenditure which cannot be capitalised under any circumstances and must therefore be expensed to profit or loss.
2. Initially recognised cost is \$60,000. Residual value is presumed to be zero.

#### Amortisation

Amortise from 1 September for a period of 5 years.

Charge for 4 months is:  $4/60 \times \$60,000 = \$4,000$

#### Carrying amount

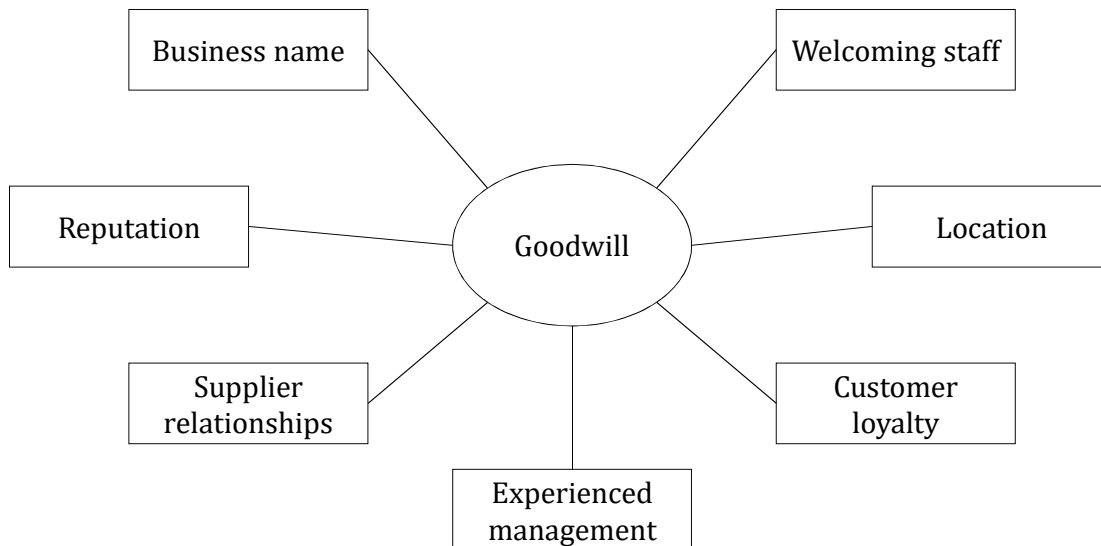
This is the maximum carry forward, assuming no impairment.

$\$60,000 - \$4,000 = \$56,000$

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## IAS 38

**GOODWILL - The difference between the cost of the acquisition and the fair values of the net assets acquired**



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## IAS 38

### Goodwill

#### INTERNALLY GENERATED

NO RECOGNITION

#### PURCHASED GOODWILL

**CAPITALISED AND CHECKED FOR IMPAIRMENT**

- No amortisation

## IAS 38

### Derecognition

- On disposal; or
- When no future economic benefits are expected

#### Revaluation model

On derecognition, if the intangible asset has been held under the revaluation model, any balance on the revaluation surplus may be transferred to retained earnings (IAS 38: para. 87):

DEBIT (↓)

CREDIT (↑)

Revaluation surplus

Retained earnings

#### The gain or loss on derecognition is calculated as:

	\$
Net disposal proceeds (proceeds less selling costs)	X
Less: Carrying amount of intangible asset	(X)
Gain/loss on derecognition (recognise in profit or loss)	X(X)
The accounting entry required on derecognition is:	
DEBIT (↓)	Cash (if any)
CREDIT (↑)	Intangible asset
CREDIT/DEBIT	Profit or loss (balancing figure)





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## Chapter 5

# IMPAIRMENT OF ASSETS

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