International Financial Reporting Standards (IFRS)

Accounting rules and principles

1. Introduction

National GAAP is being replaced or supplemented by the use of IFRS.
In most EU countries, listed companies have to use the EU-endorsed IFRS. Other companies are allowed to use IFRS but may use national GAAP.
The US is working with IASB to converge IFRS and US GAAP. This process influences the way which IFRS is being developed for the rest of the world.

2. Accounting principles and applicability of IFRS

The IASB sets the IFRS and approves interpretations of these standards.
They apply to the financial statements of profit-oriented entities.
A complete set of financial statements includes:

- Balance sheet
- Income statement
- Statement of changes in equity
- Cash flow statement
- List of accounting policies
- Notes to the financial statements

3. First time adoption

An entity that adopts IFRS for the first time has to apply all IFRS in full and retrospectively. Comparative figures must be restated and any adjustments that arise from the first time application of IFRS are mostly done through the opening retained earnings.

4. Presentation of financial statements

The objective is to facilitate comparison between previous periods and different entities.
The financial statements are prepared on a going concern basis and accruals concept and disclose corresponding information for the preceding period.

- Balance sheet – presents the financial position at a specific point in time
- Income statement – presents the financial performance for a period of time
- Statement of changes in equity – shows the transactions with shareholders
- Cash flow statement – presents cash generation and use

- Notes to the financial statements – These include accounting policies and provide additional information on the items shown on the face of the 'primary' statements

5. Accounting policies, accounting estimates and errors

Management should use its judgement to select the accounting policies that fairly apply to the entity's circumstances. Often these are required by IFRS but in some cases they have nothing to say in this regard or a choice is offered.
They should be applied consistently and in line with fundamental accounting concepts.
Changes in accounting policies (voluntary or required) are accounted for retrospectively by restating the comparative figures.
Material changes in accounting estimates and errors are normally adjusted in the period during which they are affected.

6. Financial instruments

Financial instruments represent contractual rights or obligations to receive or pay cash or other financial assets.
These are addressed in three standards: IAS 32 which deals with distinguishing debt from equity, IFRS 7 which deals with recognition and measurement and IAS 39 which deals with disclosure.

7. Foreign currencies

IAS 21 and IAS 29 deal with transactions and balances denominated in foreign currencies. These are reported in the entity's own currency (functional currency). Foreign operations (such as foreign subsidiaries) maintain their accounts in their local currency. For consolidation purposes in the group's financial statements these are translated into the group's presentation currency.

8. Insurance contracts

IFRS 4 deals with contracts whereby the insurer accepts significant insurance risk from another party to compensate him/her if the insured event adversely affects him/her. This applies to all entities and not insurance companies only.

Income statement and related notes

9. Revenue

IAS 18 deals with recognition and measurement of revenue. Revenue is measured at fair value of the consideration received or receivable and is recognised when the entity transfers the risks and rewards of ownership. With regard to services,

revenue is measured by reference to the stage of completion at the balance sheet date.
IAS 20 deals with government grants which are recognised when there is reasonable assurance that the related conditions will be met. Grants related to income are recognised in the income statement with the accruals concept. Grants related to assets can be either offset against the cost of the asset or shown as deferred income.
IAS 11 deals with construction contracts. Revenue and expenses are recognised using the percentage of completion method.

10. Segment reporting

IAS 14 and IFRS 8 deal with segment reporting. It applies to entities with listed equities or debts. Entities must report their revenue, result, assets, liabilities, capital expenditure and depreciation - by business or geographic segment.

11. Employee benefits

IAS 19 deals with employee benefits and in particular, with pensions of defined contributions plans and defined benefits plans. With the former, the cost is the contributions made by the employer during the period. The latter, however, is more complicated and requires actuarial valuation.

12. Share-based payment

IFRS 2 deals with share-based transactions whereby the entity receives goods or services as consideration for equity consideration. The most common application is to an employee share option scheme. These are measured at the grant date and recognised at fair value as an expense or asset.

13. Taxation

IAS 12 deals with tax in financial statements which comprises both current tax and deferred tax. Taxable profits are rarely equal to accounting profits and deferred tax seeks to deal with this mismatch.

14. Earnings per share

IAS 33 applies to listed companies and deals with earnings per share (EPS), a very important ratio that measures the company’s profitability.
Basic EPS is calculated by dividing the profit for the period attributable to the equity shareholders by the weighted average number of shares in issue.
Diluted EPS is calculated by dividing the adjusted profit for the period attributable to the equity shareholders by the weighted average number of potential shares in issue.

Balance sheet and related notes

15. Intangible fixed assets

IAS 38 deals with assets which have no physical substance but can be identified: eg, software, patents, brands, etc.
Separately acquired intangible assets are recognised at cost.
Internally generated intangible assets are recognised subject to conditions at developments costs (research costs are excluded).
These are amortised over their useful life span unless this is indefinite.

16. Property, plants and equipment

IAS 16 deals with property, plants and equipment whose cost is expected to deliver future economic benefits to the entity.
These are measured at cost which include all kinds of costs necessary to get the asset into its intended working condition.
They are depreciated over their useful life spans.
Borrowing costs may have been capitalised (and must be capitalised as of 1/1/2009 according to the revised IAS 23).

17. Investment property

IAS 40 deals with land or buildings which are held to earn rentals and/or for capital appreciation. It does not include property which is held for the entity's own use (accounted under IAS 36 PPE) or held as inventory (IAS 2) when held for sale in the ordinary course of business.
Initial measurement is at fair value of its purchase consideration plus directly attributable costs. Subsequently the entity may choose to carry these consistently at fair value or cost.
Fair value is the open market value. Any changes in the fair value are taken in the income statement of the period that it arises.
The cost model requires investment properties to be carried at cost less depreciation – as is the case with PPE. This means that the fair values of these properties are disclosed in the notes.

18. Impairment of assets

IAS 36 deals with impairment of current and non-current assets. On the balance sheet date the assets are tested (where there are indications that an asset may be impaired) to ensure that they are not overstated. In principle, an asset may not be carried on the balance sheet above its recoverable amount. Goodwill, indefinite lived intangibles and intangibles that are not in use must be tested annually.

19. Lease accounting

IAS 17 deals with finance and operating leases.
A finance lease is a lease whereby the lessee bears substantially all the risks and rewards of ownership. The lessee recognises and depreciates the asset in the balance sheet and also a corresponding liability. The lessor recognises the leased asset as a receivable.
Any other lease is an operating lease where the lessee does not recognise the asset and charges the lease payments to the income statement. The lessor recognises the leased asset and depreciates it.

20. Inventories and construction contracts

IAS 2 deals with inventories.
These are values at the lower of cost (which include import duties, transport and handling costs, etc.) and net realisable value (NRV) which is the estimated selling price minus estimated completion and selling expenses.
FIFO or weighted average is allowed but LIFO is not permitted.

21. Provisions and contingencies

IAS 37 deals with provisions and contingencies.
Provisions are future liabilities whose amount or timing is uncertain. In these cases, we recognise it in the financial statements if it is probable that the liability will occur in the future and a reliable estimate of the obligation is made.
Contingent liabilities are possible obligations whose existence will be confirmed by an uncertain future event. If it is possible that they will crystallise in the future these are described in the notes – unless the possibility is remote.
Contingent assets are only recognised unless the outcome is certain. They are, however, described in the notes if their outcome is probable.

22. Post balance sheet events and financial commitments

IAS 10 deals with events that occur from the balance sheet date until the date the financial statements are authorised for issue.
Adjusting events are those events that provide further evidence of conditions that existed on the balance sheet date.
Non-adjusting events relate to conditions that arose after the balance sheet date.
The carrying amounts of assets and liabilities at the balance sheet date are only adjusted for adjusting events. Significant non-adjusting post-balance-sheet events are disclosed as a note.

23. Share capital and reserves

Equity is defined as the total assets of the entity less its total liabilities.

Different classes of share capital may be treated either as debt or equity.
Equity instruments are not re-measured after initial recognition.
Reserves include retained earnings, asset revaluation reserves, foreign currency translation reserve and other statutory reserves, etc.
Minority interests in consolidated financial statements are presented as part of equity separate from the shareholders' equity.
IAS 1 requires disclosure on issued share capital and reserves, presentation of statement of changes in equity and dividend information.

Consolidated and separate financial statements

24. Consolidated and separate financial statements

IAS 27 deals with consolidated and separate financial statements.
A group is required to produce consolidated financial statements. A subsidiary is an entity that is controlled by the parent company. Control is the power to govern the financial and operating policies of an entity. Control is presumed if an investor holds more than 50 per cent of an investee.
A consolidation is prepared to show the effect of the parent company and its subsidiaries as if they were a single entity. Therefore intergroup transactions and balances are eliminated.
From the date of acquisition of a subsidiary company, its results are consolidated and on acquisition date the acquired assets and liabilities are recognised at fair values including any goodwill that arises on consolidation.

25. Business combinations

IFRS 3 deals with business combinations which brings together separate entities or businesses into one reporting entity.
The cost of the acquired entity is measured at the acquisition date (date control is obtained) and is measured as cash and cash equivalents plus fair value of the non-cash consideration given.
The cost of the consideration given is compared to the fair value of the acquiree's assets (including intangibles not previously recognised) and liabilities (including contingent liabilities) and minority interest (if the acquisition is for less than 100 percent) and the difference represents goodwill. Goodwill is recognised as an intangible asset and tested annually for impairment. In rare circumstances where goodwill is negative, this is taken into consideration on the income statement.

26. Disposals of subsidiaries, businesses and non-current assets

IFRS 5 deals with non-current assets held for sale and discontinued operations.
These assets should be classified as 'held for sale' if they are immediately available for sale in their current condition.

These ‘held for sale’ assets are carried at lower of cost and fair value less selling costs. They are not depreciated and they are presented separately on the balance sheet.
The disposal date of a subsidiary is the date control passes. The results of that subsidiary are consolidated up to the disposal date. Any gain or loss on disposal is also included in the consolidated income statement.

27. Associates

IAS 28 deals with investments in associated companies whereby the investor has significant influence but not control of the entity. Significant influence is presumed if the investor holds at least 20 percent of the voting powers of the investee.
Associates are accounted with the equity method of accounting where it is initially recognised at cost and increased or decreased in accordance with the investor’s share of post-acquisition profits or losses.
Investments in associates are classified as non-current assets as one line in the balance sheet and include goodwill arising on acquisition.

28. Joint ventures

IAS 31 deals with joint ventures whereby two or more venturers undertake an economic activity that is subject to joint control
A jointly controlled entity involves the establishment of a separate entity. Entities are accounted for using the equity method of accounting or proportionate accounting (which is not permitted under US GAAP and therefore IAS 31 will probably be revised to remove this method).
Jointly controlled operations and jointly controlled assets do not involve the establishment of an entity and each venture carries out its own part separately or jointly own one or more assets. In these cases the entity is accounted for its share of the assets, liabilities and cash flows under management.

Other subjects

29. Related party disclosures

IAS 24 deals with disclosure of an entity’s transactions and balances with related-parties.
Related parties include:

- Subsidiaries
- Fellow subsidiaries
- Associates
- Joint ventures
- Key management personnel of entity and parent company (including close family members)

- Parties with control/joint control/significant influence over the entity (including close family members)
- Post-employment benefit plans

The financial statements must disclose the ultimate parent entity and the names of the immediate and ultimate controlling parties.
The nature and amounts of transactions and balances must be disclosed as well as that these were made at arm’s length – if such is the case.

30. Cash flow statements

IAS 7 deals with the cash flow statement which is one of the primary statements. It presents the generation and use of cash and cash equivalents by category (operating, investing and finance) over a period of time.
Operating activities are the entity’s revenue-producing activities.
Investing activities are the acquisition of non-current assets.
Financing activities are changes in equity and borrowings.

31. Interim reports

IAS 34 applies where an entity publishes interim financial reports in accordance with IFRS. It allows entities to prepare full IFRS financial statements or condensed financial statements which include, in condensed form, the four primary statements and selected note disclosure.
Current period and comparative figures are disclosed as follows:

- Balance sheet - as at current period end and the immediately preceding year end
- Income statement - current interim period, financial year to date and the corresponding figures of the preceding periods
- Cash flow statement and statement of changes in equity – financial year to date with the corresponding figures for the same year to date period of the preceding year

Industry-specific topics

32. Agriculture

IAS 41 deals with agricultural activities defined as the managed biological transformation of biological assets (living animals and plants) for sale into agricultural produce (harvested products or biological assets) or into additional biological assets.
Biological assets and agricultural produce are measured fair value less estimated point of sale costs.

33. Retirement benefit plans

IAS 26 must be followed by all retirement benefit plans that prepare financial statements in accordance with IFRS.
There are different disclosure requirements depending on whether the plan is a defined contribution plan or a defined benefit plan.
All investments held by all plans are carried at fair value.

34. Extractive industries

IFRS 6 addresses financial reporting regarding the exploration for and evaluation of mineral resources.
Exploration and evaluation assets are initially measured at cost and classified as tangible or intangible assets according to the nature of the assets. This classification should be applied consistently.