Philippine Institute of Certified Public Accountants

AGENDA

- Transition to IAS in 2000 – 2004
- PFRS/PAS in 2005
- Business Issues
- Highlights of:

  PAS 19, 32, 39, PFRS 1, 2 & 3

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Transition to IAS in 2000-2004

Prior to 2001	
IAS 11/SFAS 26	Construction Contracts
IAS 18/SFAS 28	Revenue
IAS 23/SFAS 25	Borrowing Costs
IAS 33/SFAS 29	Earnings per Share

Effective 2001	
IAS 1/SFAS 1	Presentation of FS
IAS 2/SFAS 4	Inventories
IAS 7/SFAS 22	Cash Flow Statements
IAS 8/SFAS 13	Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies
IAS 14/SFAS 31	Segment Reporting
IAS 34/SFAS 30	Interim Financial Reporting

Effective 2004	
IAS 12/SFAS 12	Income Taxes
IAS 17/SFAS 17	Leases
IAS 26/SFAS 26	Accounting & Reporting by Retirement Benefit Plans

Effective 2002	
IAS 16/SFAS 16	Property, Plant & Equipment
IAS 24/SFAS 24	Related Party Disclosures
IAS 27/SFAS 27	Consolidated FS & Accounting for Investments in Subsidiaries
IAS 28/SFAS 28	Accounting for Investments in Associates
IAS 31/SFAS 31	Financial Reporting of Interests in Joint Ventures
IAS 36/SFAS 36	Impairment of Assets

Effective 2003	
IAS 10/SFAS 10	Events after the Balance Sheet Date
IAS 20/SFAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 22/SFAS 22	Business Combinations
IAS 37/SFAS 37	Provisions, Contingent Assets & Contingent Liabilities
IAS 38/SFAS 38	Intangible Assets

PAS/PFRS in 2005

New Accounting Standards	
PAS 19	Employee Benefits
PAS 21	The Effects of Changes in Foreign Exchange Rates
PAS 29	Financial Reporting in Hyperinflationary Economies
PAS 30	Disclosures in the Financial Statements of Banks and Similar Financial Institutions
PAS 32	Financial Instruments: Disclosure and Presentation
PAS 39	Financial Instruments: Recognition and Measurement
PAS 40	Investment Property
PAS 41	Agriculture

New IFRS Statements	
PFRS 1	First-time Adoption of International Financial Reporting Standards
PFRS 2	Share-based Payments
PFRS 3	Business Combinations
PFRS 4	Insurance Contracts
PFRS 5	Noncurrent Assets Held for Sale and Discontinued Operations

Revised Accounting Standards	
PAS 1	Presentation of FS
PAS 2	Inventories
PAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
PAS 10	Events after the Balance Sheet Date
PAS 16	Property, Plant & Equipment
PAS 17	Leases
PAS 24	Related Party Disclosures
PAS 27	Consolidated & Separate FS
PAS 28	Investments in Associates
PAS 31	Interests in Joint Ventures
PAS 33	Earnings per Share

Highlights of PAS 39, Financial Instruments: Measurement and Valuation

Highlights of PAS 39

Scope

- IAS 39 applies to financial instruments (whether recognized or unrecognized) other than:
  - Interests in subsidiaries, associates and joint-ventures (IAS 27,28,31)
  - Rights and obligations under leases (IAS 17)
  - Rights and obligations under insurance contracts (Insurance project)
  - Employers' assets and liabilities under employee benefit plans (IAS 19)
  - Equity instruments issued by the reporting enterprise
  - Financial guarantee contracts, including letters of credit, that provide for payments in case of debtor's failure (IAS 37)
  - Contracts for Contingent Consideration in a Business Combination (IAS 22, par. 65-76)
  - Weather derivatives – contracts requiring payment based on a climactic, geological, or other physical variables (basically a form of insurance contract)

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Highlights of PAS 39

Financial Asset

- A financial asset is any asset that is:
- cash;
  - a contractual right to receive cash or another financial asset from another enterprise;
  - a contractual right to exchange financial instruments with another enterprise under potentially favorable conditions; or
  - an equity instrument of another enterprise.

Highlights of PAS 39

IAS 39 identifies four categories of financial assets:

1) **Held for Trading**
   - A financial asset "held for trading" is held for the purpose of generating profit from short-term fluctuations in price or from a dealer's margin.
   - Derivative financial assets are always deemed held for trading unless they are designated as effective hedging instruments.
2) **Held-to-Maturity Investments**
   - A financial asset must be classified as a held-to-maturity investment when it provides for:
     - fixed or determinable payments and
     - a fixed maturity, and
     - he entity has a positive intent and ability to hold the financial asset to maturity.
   - Financial assets falling into category 3 below are prohibited from being classified as held-to-maturity investments.

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Highlights of PAS 39

IAS 39 identifies four categories of financial assets:

3) **Loans and Receivables Originated by the Enterprise**
   - Loans and receivables originated by the enterprise are financial assets that are created by providing money, goods or services directly to a debtor.
   - Loans and receivables originated by the enterprise are not included in held-to-maturity investments, but are classified separately.

4) **Available-for-Sale Financial Assets**
   - Available-for-sale financial assets are those financial assets that are not
     - loans and receivables originated by the enterprise,
     - held-to-maturity investments, or
     - financial assets held for trading.

Highlights of PAS 39

Derivative

- **Derivative –** A financial instrument:
  - Whose value changes in response to changes in a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index, or similar variable (which is known as the "underlying"),
  - That requires no initial net investment or little initial net investment relative to other types of contracts that have a similar response to changes in market conditions, and
  - That is settled at a future date.

Basic types of derivatives

- Forwards/ Futures - A (standardized) contract which forms an obligation for one party to buy, and the other to sell, a specific asset, currency or interest rate for a fixed price at a future date.
- Options - A contract between two parties, which gives the buying party the right but not the obligation to buy or sell an asset, currency or interest rate for a specified price.
- Swaps - An agreement made by two parties to exchange a series of cash flows (for example, fixed interest rate payments for floating-rate payments) in the future.

Highlights of PAS 39

Embedded Derivative

- An embedded derivative is the derivative component of a financial instrument that includes both a derivative and a host contract.
  - If an enterprise is required by IAS 39 to separate an embedded derivative from its host contract but is unable to separately measure the embedded derivative, it should treat the entire combined contract as a financial instrument held for trading (IAS 39.26).

Highlights of PAS 39

Initial Recognition

- **General Rule**
- An enterprise must recognize a financial asset or a financial liability (including a derivative) when it becomes a party to the instrument's contractual provisions.

"Regular Way" Contracts

- **A regular way contract** is a contract for the purchase or sale of financial assets that requires delivery of the assets within the time frame generally established by regulation or convention in the market place concerned. (IAS 39.31)
  - A "regular way" **purchase of financial assets** should be recognized using trade date accounting or settlement date accounting.
  - A "regular way" **sale of financial assets** should be recognized using settlement date accounting. (IAS 39.30)

Highlights of PAS 39

Trade Date Accounting

- Under trade date accounting, the financial asset and liability are recognized on the date the enterprise commits to the purchase.

Settlement Date Accounting

- Under settlement date accounting, the financial asset is recognized on the date it is delivered

Highlights of PAS 39

Derecognition of Financial Assets

- **Derecognize** means remove a financial asset or liability, or a portion of a financial asset or liability, from an enterprise's balance sheet.
- **Control** of an asset is the power to obtain the future economic benefits that flow from the asset.
- Under IAS 39, a financial asset is derecognized only when the enterprise loses control of the contractual rights that comprise the financial asset.
- An enterprise loses control if it realizes the rights to benefits specified in the contract, the rights expire, or the enterprise surrenders those rights. (IAS 39.35)
- On derecognition, the difference between the carrying amount of the an asset or a portion of an asset transferred to another party and the sum of the proceeds received or receivable and any prior adjustment to fair value of that asset that had been reported in equity should be included in net profit or loss for the period. (IAS 39.43)

Highlights of PAS 39

Derecognition of Part of a Financial Asset

- If an enterprise transfers a part of a financial asset to others while retaining a part, the carrying amount of the financial asset should be allocated between the part retained and the part sold based on their relative fair values on the date of sale.
- A gain or loss should be recognized based on the proceeds for the portion sold.
- **Fair value –** is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
- **Market value –** is the amount obtainable from the sale, or payable on the acquisition of a financial instrument in an active market

Highlights of PAS 39

Financial Asset Derecognition Coupled with a New Financial Asset or Financial Liability

- If the transfer of a financial asset results in the creation of a new financial asset or the assumption of a new financial liability, the new asset or liability is recognized at its fair value. The gain or loss should be recognized on the transaction based on the difference between:
  - the proceeds; and
  - the carrying amount of the financial asset sold plus the fair value of any new financial liability assumed, minus the fair value of any new financial asset acquired, and plus or minus any adjustment that had previously been reported in equity to reflect the fair value of that asset. (IAS 39.51)
- **Examples:**
  - selling a portfolio of receivables while assuming an obligation to compensate the purchaser of the receivables if collections are below a specified level; and
  - selling a portfolio of receivables while retaining the right to service the receivables for a fee, and the fee to be received is less than the costs of servicing, thereby resulting in a liability for the servicing obligation. (IAS 39.52)

Highlights of PAS 39

Derecognition of Financial Liabilities

- A financial liability is derecognised only when **it is extinguished** (that is, the obligation is discharged, cancelled or expires).
- A financial liability is extinguished when the enterprise either pays the creditor or is legally released from the primary responsibility.
- The condition is met when either:
  - the debtor discharges the liability by paying the creditor, normally with cash, other financial assets, goods or services; or
  - the debtor is legally released from primary responsibility for the liability either by process of law or by the creditor. (IAS 39.58)

Highlights of PAS 39

Derecognition of Part of a Financial Liability

- Derecognition Coupled with the Creation of a New Financial Asset or the Assumption of a New Financial Liability
- These transactions should be accounted for using the general requirements for accounting for asset derecognition coupled with a new financial asset or liability as shown above.

Highlights of PAS 39

Measurement

- **Initial Recognition**
  - All financial assets and liabilities must be initially measured at cost, which is the fair value of the consideration given or received for it. Transaction costs are included in the initial measurement of all financial assets and liabilities. (IAS 39.66)
- **Transaction costs**
  - are incremental costs that are directly attributable to the acquisition or disposal of a financial asset or liability.

Highlights of PAS 39

Measurement

- **Subsequent Measurement – Financial Assets not Designated as Hedges**
  - **After initial recognition, an enterprise should measure financial assets, including derivatives that are assets, at their fair values, without any deduction for transaction costs that it may incur on sale or other disposal, except for the following categories of financial assets, which should be measured under the provisions of the following paragraph:**
    - loans and receivables originated by the enterprise and not held for trading;
    - held-to-maturity investments; and
    - any financial asset that does not have a quoted market price in an active market and whose fair value cannot be reliably measured.

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Highlights of PAS 39

Measurement

- **Amortized cost of a financial asset or financial liability** is:
  - Amount at initial recognition
  - minus principal repayments,
  - plus or minus the cumulative amortization of any difference between that initial amount and the maturity amount, and
  - minus any write-down for impairment or uncollectibility.

Highlights of PAS 39

Measurement

- **The effective interest method**
  - is a method of calculating amortization using the effective interest rate of a financial asset or financial liability.
- **The effective interest rate**
  - is the rate that exactly discounts the expected stream of future cash payments through maturity or the next market-based repricing date to the current net carrying amount of the financial asset or financial liability.

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Highlights of PAS 39

Measurement

- **Loans and Receivables Originated by the Enterprise and Held-to-Maturity Investments**
  - "Loans and receivables originated by the enterprise" and "held-to-maturity investments" must be subsequently measured at amortized cost using the effective interest rate method if they have a fixed maturity.
- **Held for Trading and Available-for-Sale**
  - If the fair value of a "held for trading" or "available-for-sale" financial asset can be **reliably measured**, it must be subsequently measured at **fair value** (without deduction of disposal costs).

Highlights of PAS 39

Measurement

- If a "held for trading" or "available for sale" financial asset does not have a quoted market price in an active market and its fair value **cannot be reliably measured**, it must be subsequently measured as follows:
  - if it has a **fixed maturity**, measure the financial asset at **amortized cost** using the effective interest rate method and review for impairment at each balance date;
  - if it has **no fixed maturity,** measure the financial asset at **cost** and review for impairment at each balance date.

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Highlights of PAS 39

Subsequent Measurement – Financial Liabilities not Designated as Hedges

- Financial liabilities other than those that are "held for trading" and derivatives that are liabilities must be subsequently measured at **amortized cost**.
- After initial recognition, an enterprise should measure liabilities held for trading and derivatives that are liabilities at **fair value**, except for a derivative liability that is linked to and that must be settled by delivery of an unquoted equity instrument whose fair value cannot be measurably measured, which should be measured at **cost**.

Highlights of PAS 39

Gains and Losses on Remeasuring Financial Instruments to Fair Value

- Gains and losses on remeasuring "held for trading" financial assets and liabilities must be recognized in **net profit/loss** in the period in which they arise.

Highlights of PAS 39

Testing for Impairment

- At each reporting date, an enterprise must test for impairment of financial assets.
- If evidence of impairment exists, the enterprise must estimate the recoverable amount of that asset and recognize any impairment loss.
- An **impairment loss** is measured as the excess of carrying amount over recoverable amount, and must be recognized immediately in net profit/loss.

Highlights of PAS 39

Continued-Testing for Impairment

- For "loans and receivables" and "held-to-maturity investments" carried at amortized cost, **recoverable amount** is measured as the present value of the expected future cash flows, discounted at the instruments' original effective interest rate.
- For financial assets carried at cost or amortized cost because fair value cannot be reliably measured, **recoverable amount** is measured as the present value of the expected future cash flows, discounted at the current market rate for similar financial assets.

Highlights of PAS 39

Hedging

- **Hedging** involves designating a financial instrument as an offset, in whole or in part, to changes in the fair value of, or cash flows from, a hedged item. Financial instruments can, provided certain criteria are met, be designated as hedges of:
  - recognized assets or liabilities;
  - firm commitments; or
  - forecasted transactions.
- A **hedged item** is an asset, liability, firm commitment, or forecasted future transaction that
  a) exposes the enterprise to risk of changes in fair value or changes in future cash flows and that
  b) for hedge accounting purposes, is designated as being hedged.

Highlights of PAS 39

Hedging

- A **hedging instrument** is a designated derivative or another financial asset or liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item.
- **Hedge effectiveness** is the degree to which offsetting changes in fair value or cash flows attributable to a hedged risk are achieved by the hedging instrument.

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Highlights of PAS 39

Hedge Accounting

- There are three types of hedging relationships:
  - **a fair value hedge, which is a hedge of exposure to changes in the fair value of a recognized asset or liability; or an identified portion of such an asset or liability that is attributable to a particular risk and that will affect reported net income.**
  - **a cash flow hedge, which is a hedge of exposure to cash flow variability of a recognized asset or liability or a forecasted transaction; and**
  - **a hedge of a net investment in a foreign entity as defined in IAS 21, The Effects of Changes in Foreign Exchange Rates.**

Highlights of PAS 39

Hedge Accounting

- A hedge relationship qualifies for hedge accounting only when:
  - certain formal documentation is in place at inception;
  - the hedge is expected to be highly effective in offsetting changes in the fair value or cash flows of the hedged item, and the hedge effectiveness can be reliably measured;
  - the hedge is assessed on an ongoing basis and determined actually to have been highly effective during the reporting period; and
  - for a cash flow hedge of a forecasted transaction, the forecasted transaction is highly probable and represents exposure to variations in cash flows that could ultimately affect net profit/loss;
  - the effectiveness of the hedge can be reliably measured.

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Highlights of PAS 39

Hedge Accounting - Fair Value Hedge

- Hedge accounting for a fair value hedge involves remeasuring the hedging instrument to fair value, with any gain or loss recognized immediately in net profit/loss.

Highlights of PAS 39

Hedge Accounting – Cash Flow Hedge

- Hedge accounting for a cash flow hedge involves recognizing that portion of the gain or loss on the hedging instrument determined to be an effective hedge directly in equity.
- The ineffective portion is recognized:
  - immediately in net profit/loss if the hedging instrument is a derivative; or
  - if the hedging instrument is not a derivative, either in net profit or loss or directly in equity

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Highlights of PAS 39

Hedge Accounting – Net Investment in Foreign Entity

- Hedges of net investments in foreign entities are treated in the same way as cash flow hedges.
- Therefore, that portion of any gain or loss on the hedging instrument determined to be an effective hedge is recognized directly in equity.
- The ineffective portion is recognized:
  - immediately in net profit/loss if the hedging instrument is a derivative; or
  - directly in equity until disposal of the net investment if the hedging instrument is not a derivative.
- The gain or loss on the hedging instrument relating to the effective portion of the hedge should be classified in the same manner as the foreign currency translation gain or loss.

Highlights of PAS 39

IAS 39 Financial Instruments: Recognition and Measurement

- **Examples: Derecognition of Part of a Financial Asset**
  - separating the principal and interest cash flows of a bond and selling some of them to another party while retaining the rest;
  - selling a portfolio of receivables while retaining the right to service the receivables profitably for a fee, resulting in an asset for the servicing right. (IAS 39.38)
  - Assume receivables with a carrying amount of P100 million are sold for P90 million. The selling enterprise retains the right to service those receivables for a fee that is expected to exceed the cost of servicing, but the fair value of the servicing right cannot be measured reliably. In that case, a loss of P10 million would be recognized and the servicing right would be recorded at zero.

Highlights of PAS 32, Financial Instruments: Disclosure and Presentation

Highlights of PAS 32

Scope

- IAS 32 applies to financial instruments (whether recognized or unrecognized) other than:
  - Interests in subsidiaries, associates and joint-ventures (IAS 27,28,31)
  - Rights and obligations under leases (IAS 17)
  - Rights and obligations under insurance contracts (Insurance project)
  - Employers' assets and liabilities under employee benefit plans (IAS 19)
  - Equity instruments issued by the reporting enterprise
  - Financial guarantee contracts, including letters of credit, that provide for payments in case of debtor's failure (IAS 37)
  - Contracts for Contingent Consideration in a Business Combination (IAS 22, par. 65-76)
  - Weather derivatives – contracts requiring payment based on a climactic, geological, or other physical variables (basically a form of insurance contract)

Highlights of PAS 32

Requirements

- IAS 32 prescribes:
  - requirements for the presentation of "on-balance-sheet" (recognized) financial instruments.
  - disclosures about both recognized and unrecognized financial instruments

Highlights of PAS 32

Financial Asset

- A financial asset is any asset that is:
- cash;
  - a contractual right to receive cash or another financial asset from another enterprise;
  - a contractual right to exchange financial instruments with another enterprise under potentially favorable conditions; or
  - an equity instrument of another enterprise.

Financial Liability

- A financial liability is any liability that is a contractual obligation:
  - to deliver cash or another financial asset to another enterprise; or
  - to exchange financial instruments with another enterprise under potentially unfavorable conditions.

Equity instrument

- is any contract that evidences a residual interest in the assts of an enterprise after deducting all of its liabilities.

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Highlights of PAS 32

Types of Financial Risks

- **Price risk – the risk of changes in value through changes in currency exchange rates, interest rates and market prices.**
- **Credit risk – the risk one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.**
- **Liquidity risk or funding risk – the risk that an enterprise will encounter difficulty raising funds to meet commitments.**
- **Cash flow risk – the risk that the future cash flows associated with a monetary financial instrument will fluctuate in amount. For example, when a debt instrument carries a floating interest rate.**

Highlights of PAS 32

Classification of an Instrument as a Financial Liability or Equity

An instrument must be classified in accordance with the substance of the contractual arrangements giving rise to the instrument and the definitions of "**financial liability**" and "**equity instrument**".

- **Example:**
  - A preferred share that provides for mandatory redemption for a fixed or determinable amount at fixed or determinable dates meets the definition of "financial liability".
- The **critical feature** in differentiating a financial liability from an equity instrument:
  - is the existence of a contractual obligation of one party either to deliver cash or another financial asset to the other party (the holder) or
  - to exchange another financial instrument with the holder under conditions that are **potentially unfavorable** to the issuer.

Highlights of PAS 32

Classification of Compound Instruments

- For a compound financial instrument, the component parts must be **classified separately**.
  - For example, a debt instrument that provides the holder with an option to convert the instrument into shares of the issuer (e.g., a bond which can be converted into common shares) comprises the following components:
    - an obligation to repay interest and principal, which would be classified as a financial liability; and
    - an embedded call option granting the holder the right to convert to shares, which would be classified as equity.

Highlights of PAS 32

Classification of Compound Instruments

- PAS 32 requires the issuer of such a financial instrument to present the liability component and the equity component separately on the balance sheet from their initial recognition.
  - The fair value of the **liability component** is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied by the market.
  - The **equity instrument is an embedded option** to convert the liability into equity of the issuer.
  - The fair value of the option comprises **its time value and its intrinsic value**, if any.
  - The **intrinsic value** is the excess, if any, of **the fair value** of the underlying financial instrument **over the contractual price** at which the underlying instrument is to be acquired, issued, sold or exchanged.
  - The **time value** is fair value less intrinsic value.
  - It is uncommon for the embedded option in a convertible bond or similar instrument to have any intrinsic value on issuance.

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Highlights of PAS 32

Interest, Dividends, Losses and Gains

- The classification of interest, dividends, losses or gains depends on the classification of the financial instrument that the interest, dividends, losses or gains relate to.
- If they relate to a financial instrument or component part classified as a **financial liability**, then the interest, dividends, losses or gains are reported in the **income statement.**

Offsetting Financial Assets and Financial Liabilities

- Financial assets and financial liabilities should be offset and the net amount reported in the balance sheet when the enterprise:
  - has a legally enforceable right to set off the recognized amounts; and
  - intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

Highlights of PAS 32

General Disclosure Requirements

- An enterprise must disclose:
  - a description of the financial risk management objectives and policies it adopts,
  - including its hedging policies for each major type of forecasted transaction for which hedge accounting is used.
- Enterprises are also encouraged to disclose information about:
  - the extent to which financial instruments are used, and
  - the associated risks and business purposes served.
- For each class of financial asset, financial liability and equity instrument, (both recognized and unrecognized), the enterprise must disclose:
  - information about their extent and nature, including significant terms and conditions that may affect future cash flows; and
  - the accounting policies and methods adopted, including the criteria for recognition and the basis of measurement applied.

Highlights of PAS 32

Interest Rate Risk

- For each class of financial asset and financial liability, an enterprise must disclose information about its exposure to interest rate risk, including:
  - contractual repricing or maturity dates (whichever dates are earlier); and
  - where applicable, the effective interest rates/yields.
- An enterprise indicates which of its financial assets and financial liabilities are:
  - exposed to interest rate price risk, such as monetary financial assets and financial liabilities with a fixed interest rate;
  - exposed to interest rate cash flow risk, such as monetary financial assets and financial liabilities with a floating interest rate that is reset as market rates change; and
  - not exposed to interest rate risk, such as some investments in equity securities.

Highlights of PAS 32

Credit Risk

- For each class of financial asset, an enterprise should disclose information about its exposure to credit risk, including:
  - the amount that best represents its maximum credit risk exposure at the balance sheet date, without taking account of the fair value of any collateral, in the event other parties fail to perform their obligations under financial instruments; and
  - significant concentrations of credit risk. (IAS 32.66)
- It is also desirable for an enterprise to disclose the terms of the master netting arrangements that determine the extent of the reduction in its credit risk.

Highlights of PAS 32

Fair Value

- For each class of financial asset and financial liability, an enterprise must disclose information about fair value.
- Where it is not practicable to determine fair value with sufficient reliability, that fact must be disclosed.

Financial Assets Carried at an Amount in Excess of Fair Value

- Where a financial asset is carried at amount that exceeds its fair value, an enterprise must disclose;
  - the carrying amount and the fair value of either the individual assets or appropriate groupings of those individual assets; and
  - the reasons for not reducing the carrying amount to fair value.

Highlights of PAS 32

Hedges of Anticipated -Future Transactions

- When an enterprise has accounted for a financial instrument as a hedge of risks associated with anticipated future transactions, it should disclose:
  1. a description of the anticipated transactions, including the period of time until they are expected to occur;
  2. a description of the hedging instruments; and
  3. the amount of any deferred or unrecognized gain or loss and the expected timing of recognition as income or expense (IAS 32.91).
  4. describe the enterprise's financial risk management objectives and policies.

Highlights of PAS 19, Employee Benefits

Highlights of PAS 19

Employee Benefits

- are all forms of consideration given by an enterprise in exchange for service rendered by employees. Includes compensation in the form of financial assets, goods and services and equity instruments of the employer

Structure of the Standard

PAS 19 deals separately with:

- short-term employee benefits
- post-employment benefits
- other long-term employee benefits
- termination benefits
- equity compensation benefits

Highlights of PAS 19

Short-term Employee Benefits

- are employee benefits (other than termination benefits and equity compensation benefits) which fall due wholly within 12 months after the end of the period in which the employees render the related service. Eg Accrued wages and salaries, vacation benefits, sick pay
- Must be recognised as a liability and an expense (unless another IAS permits the costs to be capitalised as part of the cost of an asset)
- Must be measured at the undiscounted amount expected to be paid

Highlights of PAS 19

Short-term Compensated Absences

- Include, sick leave, paternity leave, jury service, etc.
- Are recognised when:
  - if the benefit accumulates, employees render service that increases their entitlement
  - If the benefit is non-accumulating, the absences occur

Accumulating Compensated Absences

- Are measured as the additional amount the enterprise expects to pay as a result of the unused entitlement that has accumulated at balance date
- Generally would not be of material amount unless unpaid sick leave can be taken as paid vacation or on termination

Highlights of PAS 19

Profit Sharing and Bonus Plans

Expected costs of profit sharing and bonus payments are only recognised if:

- the enterprise has a legal or constructive obligation to make the payments; and
- a reliable estimate of the obligation can be made

Post-employment Benefits

- Post-employment include retirement benefits, such as pensions, and other post-employment benefits, such as post-employment medical care
- are provided by way of arrangements known as post-employment benefit plans

Highlights of PAS 19

Post-employment Benefit Plans

- Must be classified by the enterprise as defined contribution plans or defined benefit plans
- For multi-employer plans and State plans, the nature of the plan from the enterprise's perspective must be determined and accounted for accordingly

Insured Benefits

- Where an enterprise pays insurance premiums to fund a post-employment benefit plan, it will normally be classified as a defined contribution plan
- However, the plan must be classified as a defined benefit plan if the enterprise has a legal or constructive obligation to pay the employee benefits directly or any shortfall

Highlights of PAS 19

Defined contribution plans

- Plans under which an enterprise pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior p eriods

Accounting for defined contribution plans

- Contributions payable in respect of employee service for the period are recognised as a liability and an expense (unless another IAS permits the costs to be capitalised as part of the cost of an asset)

Highlights of PAS 19

Defined benefit plans

- Are defined as post-employment plans other than defined contribution plans
- Are sometimes known as promised benefit plans in that the employer effectively agrees to a promised level of benefits - this exposes the enterprise to actuarial and investment risks

Accounting for Defined Benefit Plans

- The recognition and measurement of employee benefits involves the following steps:
  - estimating the amount of benefit employees have earned in the current and prior periods
  - discounting the benefit to determine the present value of the obligation and the current service cost (expense)
  - determining the fair value of any plan assets
  - determining the total amount of actuarial gains and losses and the amount of those actuarial gains and losses that should be recognised
  - where a plan has been introduced or changed, determining the resulting past service cost
  - where a plan has been curtailed or settled, determining the resulting gain or loss

Highlights of PAS 19

Defined Benefit Plans

- Defined Benefit Plans – Measuring Benefits Earned and Attributing them to Service Periods
  - An actuarial valuation method known as the Projected Unit Credit Method must be used to measure defined benefit obligations and the current and past service costs – an example of the method is given in paragraph 66 of IAS 19
  - Benefit is normally attributed to periods of service in accordance with the plan's benefit formula

Example of Benefit Attribution

- A plan pays a benefit of 100 for each year of service, excluding service before the age of 25. The benefits vest immediately
  - ✓ *No benefit is attributed to service before the age of 25 because service before that date does not lead to benefits. A benefit of 100 is attributed to each subsequent year*

Highlights of PAS 19

Actuarial Valuations

- In applying actuarial valuation methodology, the enterprise will be required to make estimates of the variables that will determine the ultimate cost of providing post-employment benefits.
- These **assumptions,** which include both demographic and financial assumptions, must be both unbiased and mutually compatible

Actuarial Assumptions

- **Discount rate** – is to be based on the market yield on high quality corporate bonds. The currency and term of the bonds is to be consistent with the currency and term of the post-employment benefit obligations
- **Salaries** – are to include estimated future salary increases
- **Benefits** – are to reflect the benefits set out in the terms of the plan and are to include any changes to the terms that have occurred before the balance sheet date
- **Medical costs –** are to include estimated future changes in the cost of medical services

Highlights of PAS 19

Actuarial Gains and Losses

- Can result from increases or decreases in either the present value of a defined benefit obligation or the fair value of any related plan assets
- Causes include: (i) unexpectedly high or low rates of employee turnover, early retirement or mortality or of salary increases and the effect of changes in estimates thereof; (ii) effects of changes in the discount rate; and, (iii) differences between the actual return on plan assets and the expected return thereon
- To avoid volatility in reported income, IAS 19 permits the use of a "corridor" approach in recognising in the income statement the effect on the defined benefit liability of actuarial gains and losses

Highlights of PAS 19

Actuarial Gains and Losses - The Corridor

- IAS 19 permits an enterprise to recognise, as expense or revenue, a portion of the actuarial gains and losses if the net cumulative unrecognised actuarial gains and losses at the end of the previous reporting period exceeded the greater of:
  - 10% of the PV of the of the defined benefit obligation at that date (before deducting plan assets): and
  - 10% of the fair value of plan assets at that date
- The minimum amount that the enterprise must recognise is the excess, i.e. the actuarial gains and losses that fall outside the corridor of plus or minus 10%, divided by the expected remaining working lives of the employees participating in the plan

Highlights of PAS 19

Actuarial Gains and Losses – Alternative Recognition Scenarios

- IAS 19 permits enterprises to adopt any systematic method that results in faster recognition of actuarial gains and losses, but the method must be consistently applied
- One such alternative is immediate recognition

Highlights of PAS 19

Past Service Cost

- Is the change in the defined benefit liability for employee service in prior periods resulting from the introduction of, or changes to, a defined benefit plan
- Is to be recognised as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits vest immediately, the past service cost is recognised immediately

Plan Assets – Recognition & Measurement

- Plan assets are to be measured at fair value for the purpose of determining the amount to be recognised as the defined benefit liability.
- In the absence of observable market prices for plan assets, the enterprise is to use estimation techniques, such as discounted cash flows, to determine fair vale

Highlights of PAS 19

Curtailments and Settlements

- Gains and losses on the curtailment or settlement of a defined benefit plan are to be recognised immediately. They comprise:
  - (a) any resulting change in the PV of the defined benefit obligation
  - (b) any resulting change in the fair value of the plan assets
  - (c) any related actuarial gains and losses that had not previously been recognised

Highlights of PAS 19

Balance Sheet Recognition

The amount recognised as a **defined benefit liability** is the **net** total of:

- (a) The PV of the defined benefit liability at balance date
- (b) plus any actuarial gains (less any actuarial losses) not recognised
- (c) minus any past service cost not yet recognised
- (d) minus the fair value at balance date of plan assets

The amount recognised may be **negative** (ie an asset). The asset is to be measured as:

- (a) the net total amount determined as per the previous slide and
- (b) the net total of any unrecognised actuarial losses and past service cost and the present value of any refunds or reductions in future contributions available from the plan

Highlights of PAS 19

Income Statement

The net total of the following amounts is to be recognised as income or expense (unless another IAS permits their inclusion in the cost of an asset):

(a) current service cost
(b) interest cost
(c) the expected return on plan assets
(d) recognised actuarial gains and losses
(e) recognised past service cost
(f) the effect of any curtailments or settlements

Highlights of PAS 19

Defined Benefit Plans: Presentation – Offset

- An asset relating to one plan can be setoff against a liability relating to another plan only when the enterprise:
  (a) has a legally enforceable right to use a surplus in one plan to settle obligations under the other plan
  (b) intends either to settle the obligations on a net basis, or to realise the surplus in one plan and settle its obligation under the other plan simultaneously

Defined Benefit Plans – Disclosure

- IAS 19 paragraph 120 specifies extensive disclosures about defined benefit plans, including the accounting policies applied, the components of the amounts reported in the income statement and balance sheet, and the principal actuarial assumptions

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Highlights of PFRS 2, Share-based Payments

Highlights of PFRS 2

Scope

- Applies to all share-based payment transactions, including:
  - Equity-settled transactions, in which the entity issues its own equity instruments (including shares or share options) to the other party
  - Cash-settled transactions, in which the entity pays a price to the other party based on the value of its own equity instrument
  - Transactions that are settled in cash or by issuing equity instruments, at the option of either the entity or the other party
- Does not apply to share based transactions:
  - Not involving acquisition of goods and services (e.g., dividend, purchase of treasure shares, issuance of additional shares)
  - With employees in their capacity as holders of the entity's equity instruments (e.g., general dividends received by holders of equity instruments)
  - Covered by IFRS 3 (Business Combinations)
  - Covered by IAS 32 and 39 (Financial Instruments)

Highlights of PFRS 2

Recognition of a share-based payment transaction

- Goods are recognised when they are received, and services are recognised as they are obtained.
- The goods or services are treated as an expense, unless they qualify to be recognised as an asset.
- The other side of the double entry is either:
  - An increase in equity (for an equity-settled transaction), or
  - A liability (for a cash-settled transaction)

Dr Share option expense	xxx	
Cr Equity or liability		xxx

Highlights of PFRS 2

Equity-settled transactions

- The transaction is recorded at the fair value of the goods/services received, provided the fair value can be estimated reliably.
- Otherwise, it is recorded by reference to the fair value of the equity instruments granted.
  - This latter approach is required for employee services.
  - For other transactions, there is a rebuttable presumption that the fair value of goods and services *can* be reliably estimated, and thus that the former approach can be used.

Highlights of PFRS 2

Measurement date

- For transactions involving employee services, the measurement date is **grant date.**
  - This is the date at which the parties reach a shared understanding of the terms of the arrangement.
- For other transactions, the fair value is measured at the date the goods or services are obtained.
  - This date applies regardless of whether the goods/ services or the equity instruments are being valued.

Highlights of PFRS 2

When to recognise transactions for employee services

- If the equity instruments granted vest immediately, recognise the services in full at grant date.
- If they vest over a fixed period, recognise the services over that period.
- If the length of the vesting period depends on fulfilling other conditions as well, recognise the services over the most likely estimate of the period.
  - If it is a *market condition*, that estimated period is fixed.
  - For other conditions, update the estimate in future years.

Highlights of PFRS 2

Fair value of equity instruments

- Refer to market prices, if available.
- Otherwise, use valuation techniques to simulate a price acceptable to knowledgeable, willing parties.
- Effect of vesting conditions:
  - If it is a *market condition*, take it into account in assessing the fair value of the equity instrument.
  - For other conditions, don't adjust the fair value of the instrument: adjust the number of instruments that is ultimately expected to be vested (and therefore be issued).

Highlights of PFRS 2

Subsequent accounting

- During the vesting period, cumulative amount recognised is 'trued up' for changed estimates of the outcome of non-market vesting conditions.
  - This includes restating to zero if such conditions are not met by the end of the period
- No change is made for the outcome of market conditions.
- After vesting date, no changes are made to equity, other than possible reclassifications.

Highlights of PFRS 3, Business Combinations

Highlights of PFRS 3

Method of Accounting

- **General statement:** All business combinations shall be accounted for by applying the purchase method.
- Application of the purchase method:
  - Identifying an acquirer.
  - Measurement of the cost of a business combination.
  - Allocation of the cost of business combination at acquisition date, to the assets acquired, liabilities and contingent liabilities assumed.
- The acquirer is the combining entity that obtains **CONTROL** of the other combining entities or businesses.

Highlights of PFRS 3

Allocation of the Cost of Business Combination

GOODWILL

- The acquirer shall, at the acquisition date:

  - recognize goodwill acquired in a business combination as an asset; and

  - initially measure goodwill at cost, being the excess of the cost of business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognized.

After initial recognition, the acquirer shall measure goodwill at cost less any accumulated impairment losses.

The acquirer shall test goodwill for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired, in accordance with IAS 36, Impairment of Assets.

Highlights of PFRS 3

Allocation of the Cost of Business Combination

EXCESS OF ACQUIRER'S INTEREST IN THE NET FAIR VALUE OF ACQUIREE'S IDENTIFIABLE ASSETS, LIABILITIES AND CONTINGENT LIABILITIES OVER COST (previously referred to as "Negative Goodwill")

The acquirer shall reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the business combination and recognize immediately in profit or loss any excess remaining after that reassessment.

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Highlights of PFRS 3

Business Combination Achieved in Stages

- A business combination may involve more than one exchange transaction. If so, each exchange transaction shall be treated separately by the acquirer, using the cost of the transaction and fair value information at the date of each exchange transaction, to determine the amount of any goodwill associated with that transaction

Highlights of PFRS 3

Method of Accounting

IFRS 3	IAS 22
Requires all business combination within its scope to be accounted for by applying the purchase method	Permits business combinations to be accounted for using one of the two methods: - Purchase method – used for an acquisition (i.e., an acquirer can be identified) - Pooling of interest method – used for a uniting of interest (in exceptional case where an acquirer cannot be identified)
Requires an acquirer to be identified for every business combination	Does not require identification of acquirer but gives indication of the acquirer's existence

Highlights of PFRS 3

Recognition of the Identifiable Assets Acquired, Liabilities and Contingent Liabilities Assumed

IFRS 3	IAS 22
Acquirer to recognize as part of allocating the cost of a business combination -	
Liabilities for terminating or reducing the activities of the acquiree only when the acquiree has, at the acquisition date, an existing liability for restructuring recognized in accordance with IAS 37.	A provision for terminating or reducing the activities of the acquiree that was not a liability of the acquiree at the acquisition date, provided the acquirer satisfied specified criteria.
Acquiree's contingent liabilities (as defined in IAS 37) at the acquisition date provided their fair values can be measured reliably	Contingent liabilities were subsumed within the amount recognized as goodwill or negative goodwill.

Highlights of PFRS 3

Measuring identifiable assets acquired and liabilities and contingent liabilities assumed

IFRS 3	IAS 22
Allows only one treatment: Requires the identifiable assets, liabilities and contingent liabilities recognized as part of allocating the cost of the combination to be measured initially by the acquirer at their fair values at the acquisition date, irrespective of the extent of any minority interest.	Includes a benchmark and allowed alternative treatment for the initial measurement of the identifiable net assets acquired • Benchmark treatment – not to apply fair valuation to the minority's proportion of net assets (minority is carried at pre-acquisition carrying amount) • Allowed alternative – to fair value the whole of the net assets (minority's proportion stated at fair value)

Highlights of PFRS 3

Subsequent accounting for goodwill

IFRS 3	IAS 22
Carry goodwill acquired in a business combination at cost cost less any accumulated impairment losses Goodwill shall not be amortized. Instead, the acquirer shall test it for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired, in accordance with IAS 36	Carry goodwill at cost less accumulated amortization and impairment losses. Requires acquired goodwill to be amortized on a systematic basis over the best estimate of its useful life. Rebuttable presumption that its useful life does not exceed 20 years. Otherwise, goodwill shall be tested for impairment at each financial year-end even if there is no indication that it is impaired.

Highlights of PFRS 3

Excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost

IFRS 3	IAS 22
Does not use the term "negative goodwill" Reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination, and ,	Referred to as "negative goodwill" Does not specify reassessment

Highlights of PFRS 3

Excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost

IFRS 3	IAS 22

(Cont'd)
- Recognize immediately in profit or loss any excess remaining after that assessment.
	- If it relates to expected future losses, recognize as income when the identified future losses and expenses occur
	Otherwise:
	  - Recognize as income over average remaining useful life of assets to the extent of FV of acquired identifiable non-monetary assets
	  - Recognize as income immediately excess over FV of acquired identifiable non-monetary assets

Highlights of PFRS 1, First-time Adoption of International Financial Reporting Standards

Highlights of PFRS 1

Definitions

- IFRSs - IFRS, IAS, and interpretations of IFRIC and the SIC
- The first IFRS financial statements are the first financial statements in which an entity adopts IFRSs by an explicit and unreserved statement of compliance with IFRSs.
- The date of transition to IFRSs is the beginning of the earliest period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements. The opening IFRS balance sheet is the balance sheet (whether or not published) at this date.
- The first IFRS reporting period is the reporting period ending on the reporting date of an entity's first IFRS financial statements.
- Previous GAAP is the basis of accounting used by a first-time adopter immediately before it adopts IFRSs.

Highlights of PFRS 1

Scope

- IFRS 1 does not apply to entities that presented accounts in the previous year that contained an explicit and unreserved statement of compliance with IFRSs.
- If an entity's accounts in previous years contained that statement, any material departures from IFRSs (whether disclosed or undisclosed) are errors and should be corrected under IAS 8.

Accounting policies

- An entity must use the same accounting policies in its opening IFRS balance sheet and for all periods presented in its first IFRS financial statements.
- The accounting policies must comply with each IFRS effective at the reporting date for its first IFRS financial statements (except for limited exemptions given by IFRS 1).
- An entity may apply a new IFRS that is not yet mandatory if it permits early application.

Highlights of PFRS 1

Rules for opening balance sheet

- Except where IFRS 1 gives an exception or an exemption, an entity must:
  - **Recognise** all assets and liabilities whose recognition is required by IFRSs
  - **Not recognise** items as assets and liabilities if IFRSs do not permit such recognition
  - **Reclassify** items that it recognised under previous GAAP as one type of asset, liability, or component of equity, but are a different type under IFRSs
  - Apply IFRSs in **measuring** all recognised assets and liabilities
- The restatement is booked through retained earnings (except for certain adjustments to acquired intangibles)

Highlights of PFRS 1

The optional exemptions from retrospective application

- Fair value or revaluation to be used as deemed cost
- Business combinations
- Employee benefits
- Cumulative translation differences
- Compound financial instruments
- Assets and liabilities of subsidiaries, associates, and joint ventures
- Designation of previously recognised financial instruments
- Share-based payment transactions
- Insurance contracts

Highlights of PFRS 1

Fair value as deemed cost

- An item of property, plant, and equipment may be measured at its fair value at the date of transition to IFRSs, or at a revaluation used under previous GAAP.
  - This value is treated as the item's deemed cost at the date of the valuation.
  - This option may be elected asset by asset.
  - The option is also available for investment property and any intangible assets that meet the criteria for recognition and revaluation under IAS 38
  - The fair value is determined following IAS 22 principles, unless another IFRS contains more specific guidance.

Highlights of PFRS 1

Business combinations

- A first-time adopter has the following options:
  - Restate all past business combinations (apply IFRS 3 retrospectively)
  - Restate business combinations that have occurred since a certain date (determined by the entity)
  - Not restate any business combinations that occurred before the date of transition to IFRSs
- This exemption applies also to past acquisitions of investments in associates and of interests in joint ventures.

Combinations that are restated

- The transitional provisions of IFRS 3 do not apply.
- The entity applies IFRS 3 retrospectively:
  - Classification of business combinations (as acquisitions or reverse acquisitions)
  - Determination of the cost of acquisition
  - Recognition and measurement of identifiable assets and liabilities
  - Recognition of goodwill or negative goodwill

Highlights of PFRS 1

Combinations that are not restated

- Keep the same classification as in the previous GAAP financial statements (acquisition, reverse acquisition, or uniting of interests)
- Recognise all assets and liabilities at the date of transition to IFRSs that were acquired or assumed in a past business combination, except:
  - Certain financial assets and liabilities derecognised under previous GAAP
  - Items that were not recognised under previous GAAP in the consolidated balance sheet and also would not qualify for recognition under IFRSs in the separate balance sheet of the acquiree
- Exclude from the opening IFRS balance sheet any item recognised under previous GAAP that does not qualify for recognition as an asset or liability under IFRSs.
- Adjustments are taken to retained earnings, except any that require an intangible asset to be reclassified as goodwill or vice versa.

Highlights of PFRS 1

Combinations that are not restated

- Measure the assets acquired and liabilities assumed …
- … which were recognised under previous GAAP
  - If measured on the basis of cost:
    - The carrying amount under previous GAAP is the deemed cost under IFRSs at that date (i.e. date of the business combination)
  - If measured on another basis (e.G. Fair value):
    - The assets and liabilities are measured on that basis at the date of transition, even if they arose from a past business combination
- … which were not recognised under previous GAAP
  - On the basis that IFRSs would require in the separate balance sheet of the acquiree

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Highlights of PFRS 1

Combinations that are not restated

- The carrying amount of goodwill in the opening IFRS balance sheet is the carrying amount under previous GAAP at the date of transition to IFRSs, except for:
  - Restatements to recognise or derecognise acquired intangibles
  - Restatements of contingent adjustment of the purchase consideration
  - Any impairment of goodwill that has to be recognised
- If an entity recognised goodwill under previous GAAP as a deduction from equity:
  - It does not recognise that goodwill in its opening IFRS balance sheet.
  - It does not transfer that goodwill to the income statement if the subsidiary is disposed of or the investment impaired.
  - Adjustments resulting from the subsequent resolution of a contingency affecting the purchase consideration are recognised in retained earnings.

Highlights of PFRS 1

Combinations that are not restated

- If a subsidiary was not consolidated under previous GAAP, it should be consolidated at the date of transition:
  - Restate its assets and liabilities to comply with IFRSs.
  - Goodwill is the difference, at the date of transition to IFRSs, between the parent's interest in the adjusted carrying amounts of assets and liabilities and the cost of its investment in the subsidiary.
- Any adjustments of the assets and liabilities may also affect minority interests and deferred taxes.

Business combinations and IAS 21

- A first-time adopter may choose not to apply IAS 21 retrospectively to fair value adjustments and goodwill.
- In that case, these items are treated as assets and liabilities of the entity and are either:
  - Expressed in the entity's own functional currency
  - Non-monetary foreign currency items which are translated at the exchange rate applied under previous GAAP

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Highlights of PFRS 1

Employee benefits

- In its opening IFRS balance sheet, a first-time adopter applies IAS 19 to measure assets or liabilities under defined benefit plans:
  - Under IAS 19, it may use a 'corridor' approach that leaves some actuarial gains and losses unrecognised.
- IFRS 1 allows it to elect to recognise all cumulative actuarial gains and losses at the date of transition:
  - If an entity uses this election, it must apply it to all plans.
  - It may still use the corridor approach for later gains and losses even if it uses this election.

Cumulative translation differences

- An entity may deem the cumulative translation differences for all foreign operations to be zero at the date of transition to IFRSs.
  - In this case, the gain or loss on a subsequent disposal of any foreign operation excludes translation differences that arose before the date of transition to IFRSs (but includes later translation differences).
- If this exemption is elected, it must be applied to all cumulative translation differences.

Highlights of PFRS 1

Compound financial instruments

- If the liability component is no longer outstanding at the date of transition, no retrospective separation of the two portions of equity is required.
- Without this exemption it would be necessary to analyse the equity into two components:
  - One representing the original equity component
  - One representing the cumulative interest accreted on the liability component

Highlights of PFRS 1

Assets and liabilities of subsidiaries associates and joint ventures

- If a parent adopts IFRSs later than its subsidiary (or associate or joint venture), it will measure the assets and liabilities of the subsidiary in the consolidated financial statements:
  - At the same carrying amounts as in the separate IFRS financial statements of the subsidiary
  - Ater adjusting for consolidation (or equity accounting) adjustments and the effects of the business combination

- If a subsidiary (or associate or JV) adopts IFRS later than its parent, it measures its assets and liabilities in its individual accounts, at either:
  - The carrying amounts that would be included in the IFRS consolidated financial statements based on parent's date of transition, before consolidation and business combination adjustments
  - The carrying amounts required by the rest of IFRS 1 (based on the subsidiary's date of transition to IFRSs)

Highlights of PFRS 1

Designation of previously recognised financial instruments

- IAS 39 permits a financial instrument to be designated on initial recognition either as:
  - A financial asset or financial liability at fair value through profit or loss
  - Available for sale
- An entity is permitted to make such a designation at the date of transition to IFRSs

Share-based payment transactions

- A first-time adopter is not required to apply IFRS 2:
  - To equity instruments granted on or before 7 November 2002
  - To equity instruments granted after 7 November 2002 that vested before the later of the date of transition and 1 January 2005
    - If the entity elects to apply IFRS 2 to such equity instruments, it may do so only if it has disclosed publicly the fair value of those equity instruments, determined at the measurement date
  - To liabilities arising from share-based payment transactions that were settled before the later of the date of transition and 1 January 2005

Highlights of PFRS 1

Mandatory exceptions to retrospective application

- IFRS 1 prohibits retrospective application in the following cases:
  - Derecognition of financial assets and financial liabilities
  - Hedge accounting
  - Estimates
  - Assets classified as held for sale and discontinued operations

Highlights of PFRS 1

Derecognition of financial assets and financial liabilities

- The derecognition requirements in IAS 39 are to be applied prospectively from 1 January 2004.
  - This means that if the entity derecognised non-derivative financial assets or liabilities under previous GAAP in a transaction before that date, it does not recognise them in the opening IFRS balance sheet unless they qualify for recognition in a later transaction.
- However, the entity may opt to apply the IAS 39 rules from an earlier date of its own choice, so long as the necessary information had been obtained at that time.

Highlights of PFRS 1

Hedge accounting

- At the date of transition to IFRSs, an entity must :
  - Measure all derivatives at fair value
  - Eliminate any deferred losses and gains arising on derivatives that were reported as assets and liabilities under previous GAAP
- It must not reflect in its opening IFRS balance sheet a hedging relationship of a type that does not qualify for hedge accounting under IAS 39.
- However, if it designated a net position as a hedged item under previous GAAP, it may designate an individual item within that net position as a hedged item under IFRSs, provided it does so by the date of transition to IFRSs.

Highlights of PFRS 1

Hedge accounting

- If, before the date of transition, an entity had designated a transaction as a hedge, but the hedge does not meet the conditions for hedge accounting under IAS 39, the entity must apply IAS 39 to discontinue hedge accounting:
  - If the hedging instrument expires or is sold, terminated, or exercised
  - If the hedge no longer meets the criteria for hedge accounting
  - If the entity revokes designation
  - For a cash flow hedge, if the forecast transaction is no longer expected to occur
- Transactions entered into before the date of transition must not be retrospectively designated as hedges.

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Highlights of PFRS 1

Estimates

- Estimates made under IFRSs at the date of transition must be consistent with those made for the same date under previous GAAP, unless:
  - They need to be adjusted to reflect different accounting policies
  - There is objective evidence that those estimates were in error
- Information received after the date of transition about estimates made under previous GAAP are treated in the same way as non-adjusting events after the balance-sheet date, in accordance with IAS 10.
- Any estimates that were not needed under previous GAAP should be based on conditions as at the date of transition.

Assets classified as held for sale and discontinued operations

- If a first-time adopter moves to IFRSs before 1 January 2005, it uses the IFRS 5 transitional provisions and applies the standard prospectively.
- Otherwise, it applies IFRS 5 retrospectively for all periods presented:
  - Under IFRS 1 it must still not use hindsight when making estimates relating to earlier periods.

Highlights of PFRS 1

Explanation of transition to IFRSs

- A first-time adopter must explain how the transition to IFRSs affected its reported financial position, financial performance. and cash flows. This is given
  - In its first IFRS financial statements
  - In the interim financial statements for a part of the period covered by its first financial statements
- If the entity did not present financial statements for previous periods, it must disclose that fact.
- IAS 8's requirements for disclosures about changes in accounting policies do not apply to the first IFRS financial statements, except for IAS 32 and IAS 39.

Highlights of PFRS 1

Reconciliations required

- Equity reported under previous GAAP to equity reported under IFRSs:
  - At the date of transition to IFRSs
  - At the end of the last period when previous GAAP was used
- Profit or loss reported under previous GAAP to profit or loss reported under IFRSs, for the last period when previous GAAP was used
- If a cash flow statement was given under previous GAAP, an explanation of the material adjustments

Comparative information

- The first IFRS financial statements must give at least one year's comparative information (with an exemption for comparative information relating to IAS 32 and IAS 39).
- If the entity gives any historical summaries for earlier periods, or any comparative information prepared under previous GAAP, it must:
  - Highlight that the previous GAAP information is not prepared under IFRSs
  - Disclose the nature of the main adjustments (without quantification) that would make it comply with IFRSs

Highlights of PFRS 1

IAS 32 and 39 exemptions

- An entity adopting IFRSs for the first time before 1 January 2006 need not restate comparative financial statements to comply with IAS 32 and IAS 39.
- However, it must:
  - Apply its previous GAAP to financial instruments within the scope of IAS 32 and IAS 39 in the comparative information
  - Disclose this fact, and the basis used to prepare the information
  - Disclose the nature (not the amount) of the main adjustments that would make the information comply with IAS 32 and IAS 39
  - Treat any adjustments between the end of the comparative period and the start of the first IFRS reporting period as arising from a change in accounting policy, and make disclosures

Highlights of PAS 19

Other Long-term Benefits

- Examples include: long service leave; sabbatical leave; long-term disability benefits; deferred compensation; and, profit sharing and bonuses payable 12 months or more after the end of the period in which the employees render the related service

Other Long-term Benefits: Recognition and Measurement – Balance Sheet

- IAS 19 adopts a simplified method, whereby actuarial gains and losses and past service costs are recognised immediately
- The liability for other long-term benefits is therefore the present value of the defined benefit obligation less the fair value of plan assets (if any)

Highlights of PAS 19

Other Long-term Benefits: Recognition and Measurement – Income Statement

- An expense or income for other long-term benefits is to be recognised (except where another IAS permits or requires their inclusion in the cost of an asset) as the net total of:
  - (a) current service cost
  - (b) interest cost
  - (c) the expected return on plan assets
  - (d) actuarial gains and losses
  - (e) past service cost
  - (f) the effect of any curtailments or settlements

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Highlights of PAS 19

Termination Benefits

- Are to be recognised as a liability and expense when the enterprise is demonstrably committed to either:
  - (a) terminate the employment of employees before the normal retirement date
  - (b) provide termination benefits as a result of an offer made to encourage voluntary redundancy
- A liability for termination benefits can only be recognised if the enterprise is demonstrably committed to a termination. "Demonstrably committed" has the same meaning as in IAS 37.
- The liability must be measured at PV if the benefits fall due more than 12 months after balance date
- For a voluntary redundancy offer, termination benefits must be measured based on the number of employees expected to accept the offer

Highlights of PAS 19

Equity Compensation Benefits

- Include shares, share options, etc issued to employees at less than their fair value, and cash payments dependent upon the future market price of the enterprise's shares
- IAS 19 paragraph 147 specifies detailed disclosures about an enterprise's equity compensation plans. However, the Standard **does not** contain any accounting requirements

Highlights of PAS 19

Transitional Provisions

- A transitional liability must be calculated for defined benefit plans as:
  - (a) the PV of the obligation
  - (b) minus the fair value of plan assets
  - (c) minus any past service costs that should be recognised in later period
- The transitional liability is compared with the liability that would have been recognised under the enterprise's previous policy
- If it is less, the decrease should be recognised immediately in accordance with IAS 8
- If it is more, the enterprise makes an irrevocable choice to recognise the increase immediately or amortise it on a straight line basis over 5 years from the date of adoption

Highlights of PFRS 2

Modification to the terms and conditions of equity instruments

- Includes repricing of options, or other changes to their conditions.
- Any such modification to the terms and conditions can increase but not reduce the amounts previously recognised.
  - Any increase in fair value is recognised over remainder of the vesting period, or immediately if already vested
  - The minimum to be recognised for the services received remains the fair value of the instruments as measured at the original grant date (apart from the effect of any non-market vesting conditions not being met)

Highlights of PFRS 2

Cancellation or settlement

- Cancellation or settlement is treated as an acceleration of the vesting date:
  - Gives rise to immediate recognition, as if vested
- Any payment made to the employee is treated as the repurchase of an equity interest and expensed to the extent that it exceeds the fair value of the instrument.
- If new instruments are issued as a replacement for those cancelled, this is treated as a modification.

Highlights of PFRS 2

Cash-settled transactions

- Timing of recognition is the same as for equity-settled transactions.
- The transaction is measured at the fair value of the liability incurred.
- This is remeasured at each balance sheet date until the liability is settled.
- Differences on remeasurement are included in profit or loss for the period.

Highlights of PFRS 2

Share-based transactions with cash alternatives

- Where one of the parties can choose whether the transaction is settled in cash or equity
- The entity should account for the transaction:
  - As a cash-settled transaction to the extent that it has incurred a liability, and
  - As an equity-settled transaction to the extent that no such liability has been incurred
- This mainly depends on which of the two parties can choose the form of settlement .

Highlights of PFRS 2

If the other party has the choice

- The instrument is treated as a compound instrument, with debt and equity components.
- The fair value of each of these components has to be established: debt is measured first, with any excess attributed to equity.
- The two components are then accounted for under the respective rules for cash- and equity-settled transactions.

Treatment on settlement

- At the date of settlement, the liability component is remeasured to its fair value at that date.
- If the transaction is settled in cash:
  - This eliminates the liability component.
  - Any equity component remains in equity, although it may require to be reclassified within equity.
- If it is settled by issuing equity instruments:
  - The liability component is transferred to equity as the consideration for the issue.

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Highlights of PFRS 2

If the entity has the choice

- Recognise the instrument as a liability unless:
  - The choice of settling in equity instruments has no commercial substance, or
  - The entity has a past practice or a stated policy of settling in cash, or
  - The entity generally settles in cash whenever the other party asks for cash settlement
- If a liability, treat it as a cash-settled transaction
- Otherwise, treat it as an equity-settled transaction

Treatment on settlement

- If the entity settles the transaction in the way that has been assumed, treatment is straightforward:
  - If it is settled in cash, this eliminates the liability.
  - If it is settled by issuing equity instruments, there is no further accounting except a transfer within equity.
- If the entity settles the transaction in the other way:
  - This is treated as either the issue or repurchase of an equity interest.
  - If this alternative has a higher fair value, the excess fair value is recognised as an additional expense.

Highlights of PFRS 2

Disclosure requirements - principles

- The standard incorporates three general disclosure principles:
  - An understanding of the nature and extent of share-based payment arrangements that existed during the period
  - An understanding how the fair value of goods or services received, or the fair value of the equity instruments granted during the period was determined
  - An understanding of the effect of share-based payment transactions on the profit or loss for the period and the financial position

Highlights of PFRS 2

First-time adoption issues

- For equity-settled transactions:
  - Full application of the standard is required for equity instruments that were granted after 7 November 2002 and had not yet vested at the effective date of IFRS 2.
  - Application is encouraged, but not required, for other equity instruments if the entity has publicly disclosed their fair value, determined at the measurement date. IFRS 2's rules on disclosures, and on any modifications to these instruments, apply in any case.
  - For all grants of equity instruments to which IFRS 2 is applied, restate the comparative information and the opening balance of retained earnings for the earliest period presented.
- IFRS 2 applies retrospectively to liabilities arising from share-based payment transactions that exist at the effective date of the standard:
  - Restate the comparative information and the opening balance of retained earnings for the earliest period presented, except to the extent that it relates to a period or date before 7 November 2002.
  - Retrospective application is encouraged, but not required, for other liabilities (such as those settled before the standard came into force).