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IAS 12

Income Taxes

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Agenda

Sessions

1.	Basic principles of IAS 12
2.	Initial recognition exception
3.	Determine deferred taxes in business combinations
4.	Deferred taxes arising on investments
5.	How to assess recoverability of deferred tax assets
6.	Recognition of deferred tax assets or liabilities outside profit or loss and the application of backward tracing principle
7.	Deferred taxes on share-based payment transactions

IAS 12 Income Taxes

1	Basic principles of IAS 12

Conceptual background

Current tax	Amount payable to or refundable by the tax authorities in respect of the **current and previous periods**
Deferred tax	The **future tax consequences** of recovering or settling the carrying amount of an asset or liability

Conceptual background

Example: plant and equipment used in a manufacturing process

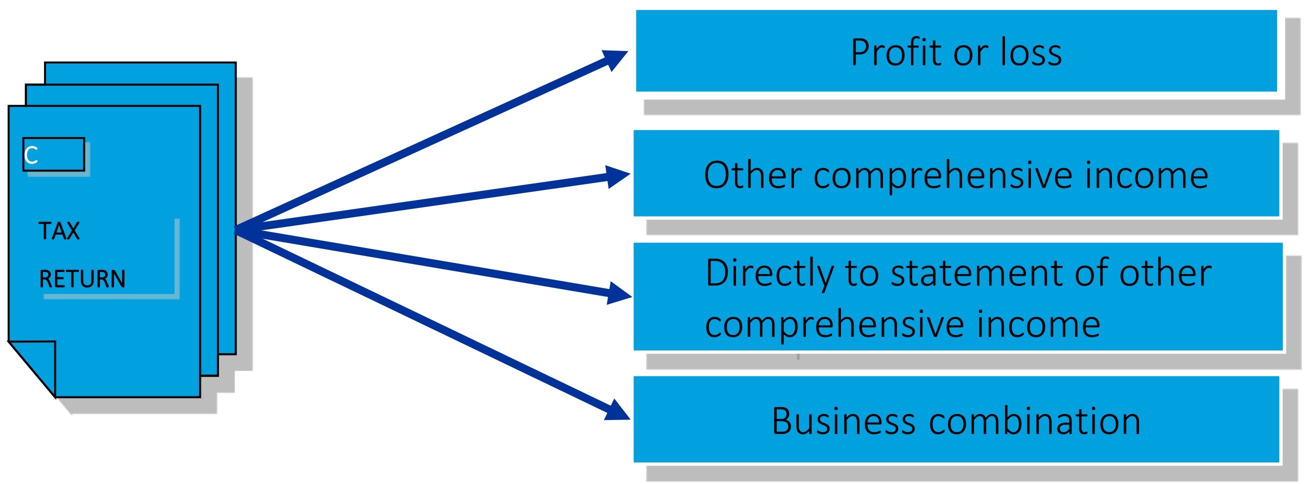
Using the asset will generate economic benefits that are subject to tax → Future tax deductions from the asset reduce the taxable amount → Net future tax consequences on which deferred tax is recognized

$2,000	$1,500	$500
(carrying amount)	*(tax depreciation)*	*(net taxable profits in the future)*

Current taxes

Recognition and measurement of current taxes

Current tax — Amount payable to or refundable by the tax authorities in respect of the **current and previous periods**



Step 1

Calculate current tax liability owing to tax authorities

Step 2

Recognize in the same manner as the underlying item giving rise to the tax

Deferred taxes

Recognition and measurement of deferred taxes

Deferred tax: The **future tax consequences** of recovering or settling the carrying amount of an asset or liability

Calculation steps

Step 1	Calculate the **tax base** of each asset and liability
Step 2	Calculate the **temporary difference** between the carrying amount and tax base
Step 3	Identify which temporary differences will give rise to deferred taxes using the **recognition criteria and exceptions** in IAS 12
Step 4	Calculate the deferred tax asset or liability using the **appropriate tax rate**
Step 5	**Assess the recoverability of deferred tax** assets arising from deductible temporary differences, carried forward unused tax losses and unused tax credits.
Step 6	**Recognize net movement** for the period in profit or loss, outside profit or loss, or as part of accounting for a business combination

Deferred taxes

Recognition and measurement of deferred taxes

Deferred tax: The **future tax consequences** of recovering or settling the carrying amount of an asset or liability

Deferred taxes arising from temporary differences

Carrying amount – Tax base = Temporary difference

Temporary difference X Tax rate = Deferred tax asset / liability

Deferred taxes arising from carryforward tax losses/tax credits

Unused tax losses/credits X Tax rate = Deferred tax asset

IAS 12 basic principles—tax rate

Tax rate

- Tax rate expected to apply to the period when the asset is realized or the liability is settled
- Tax rates (and tax laws) that have been enacted or substantively enacted at the end of the reporting period
- Changes in tax rates after the reporting period → no impact, but disclosure required if significant impact
- Dual use assets (use and sale): different tax rates may apply

IAS 12 basic principles—taxes in interim financial statements

Tax rate	= estimated weighted average annual income tax rate expected for the full financial year

Changes in tax rate

- Immediately recognize the year-to-date impact in the interim period the change arises

OR

- Spread the impact over the remaining of the period(s) by including the impact of the change in the estimated annual average income tax rate

IAS 12 basic principles— government grants and investsment tax credits

IAS 12 does not deal with methods of accounting for government grants or investment tax credits.

A tax credit (outside the scope of IAS 12) provides a reduction to taxes payable and can be distinguished from a tax deduction (within the scope of IAS 12) which is factored into the determination of taxable income.

When a tax credit is determined to be an investment tax credit (and, consequently, outside the scope of IAS 12 and IAS 20), it is a matter of judgment under IAS 8.

IAS 12 basic principles —Levies (IFRIC 21)

Levies is excluded from the scope of IAS 12

- Obligating event for the recognition of a liability Is the activity that triggers the payment of the levy in accordance with the relevant legislation
- The Interpretation clarifies that 'economic compulsion' and the going concern principle do not create or imply that an obligating event has occurred.

Recognition

- The liability is recognized progressively if the obligating event occurs over a period of time
- If an obligation is triggered on reaching a minimum threshold, the liability is recognized when that minimum threshold is reached.

IAS 12 basic principles — IFRIC 23

Interpretation covers the following:

- Whether tax treatments should be considered collectively or independently;
- Assumptions for taxation authorities’ examinations;
- The treatment when an entity concludes that it probable (or not) that the relevant authority will accept the tax treament
- The effect of changes in facts and circumstances

Knowledge check - quiz

Question 1

Can deferred tax assets and liabilities be discounted?

Answer

No.

IAS 12.53 strictly prohibits the discounting of deferred tax assets and liabilities.

Knowledge check - quiz

Question 2

When should an entity assess the carrying amount of a deferred tax asset?

A–only on initial recognition

B–on a continuous basis

C–at the end of each reporting period

D–if the net deferred tax position is a liability

Answer

C – IAS 12.56 requires an entity to review the carrying amount of a deferred tax asset at the end of each reporting period and adjust it by reference to the probability of sufficient taxable profits being available against which the deferred tax asset may be utilized.

Knowledge check - quiz

Question 3

Company A has a taxable temporary difference of 100,000 in relation to its plant and equipment at the end of 20X1. The tax rate is 30% for 20X1 and 25% from 20X2 onwards (these rates were substantive enacted prior to 20X1). After the end of the year, the government announces a change in rate to 20% from 20X3 onwards, which is substantively enacted during 20X2. At what amount is the deferred tax liability measured at the end of 20X1?

A–30,000 (100,000 x 30%)

B–25,000 (100,000 x 25%)

C–20,000 (100,000 x 20%)

D–need to schedule the reversal of the temporary difference into that amount reversing in 20X2 and in 20X3 or later

Answer

B– IAS 12.46 and IAS 12.47 (20% rate substantively enacted after reporting period).

Knowledge check - quiz

Question 4

Company B undertakes a business combination during the year. The provisional accounting for the business combination indicates a goodwill balance of 80,000. The tax authority does not allow goodwill to be amortized or deducted on sale. What deferred tax amount should be recognized in respect of the goodwill if the tax rate is 30%?

A–deferred tax liability of 24,000 (80,000 x 30%)

B–nil

C–depends on management's intention as to how the goodwill will be recovered

Answer

B– IAS 12.15(a) prohibits the recognition of a deferred tax liability in respect of the initial recognition of goodwill.

Question 5

Which of the following are **required** to be disclosed on the face of the statement of comprehensive income?

A–income tax expense related to profit or loss from ordinary activities

B–income tax expense related to discontinued operations

C–total income tax expense

D–major components of income tax expense

Answer

A – This is required by IAS 12.77. B is optional (IFRS 5.33), accordingly C is not shown or the components are shown separately and D is only required by way of note (IAS 12.79).

2 Initial recognition exception

Initial recognition exceptions

Under IAS 12, all DTAs and DTLs are recognized, except in certain circumstances

	Deferred tax asset
Initial recognition of an asset	Exception
Initial recognition of goodwill	No exception
Investment in subsidiary, branch, associate, or interest in joint arrangement	Exception
Probability of recovery not met	Exception

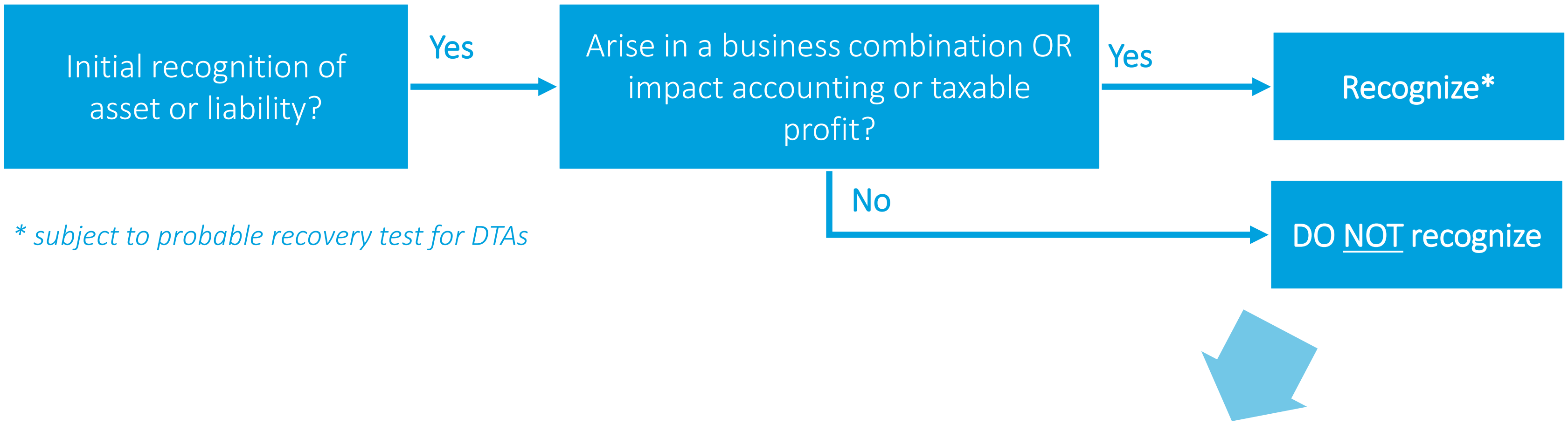
Initial recognition exceptions

Under IAS 12, all DTAs and DTLs are recognized, except in certain circumstances

	Deferred tax liability
Initial recognition of an liability	Exception
Initial recognition of goodwill	Exception
Investment in subsidiary, branch, associate, or interest in joint arrangement	Exception
Probability of recovery not met	Not applicable

Initial recognition exception

Initial recognition exception applies for both DTLs and DTAs



For NON-recognition, ALL these requirements must be met:
Must arise on the initial recognition of an asset or liability
Must not arise in a business combination
Must not impact accounting profit at the time of the transaction
Must not impact taxable profit at the time of the transaction

Initial recognition exception

Applying the initial recognition exception in practice

Examples	Carrying amount	Tax base	A	B	C	D	Recognize?
Purchase of plant and equipment	250,000	250,000	n/a	n/a	n/a	n/a	**n/a**
Accrued annual leave, deductible when paid	40,000	nil	☑	☑	☒	☑	YES
Investment property directly acquired	500,000	450,000	☑	☑	☑	☑	NO
Investment property acquired as part of a business combination	500,000	450,000	☑	☒	☑	☑	YES

A - must arise on initial recognition of asset or liability
B - must not arise in a business combination
C - must not impact accounting profit at the time of the transaction
D - must not impact taxable profit at the time of the transaction

Subsequent recognition measurement of deferred taxes

Example: An investment property that is directly acquired, has a carrying amount of USD500,000 and a tax base of USD450,000.

Three different scenarios of subsequent measurement:

FV USD525,000 Tax Base USD450,000	FV USD475,000 Tax Base USD450,000	FV USD425,000 Tax Base USD450,000
Deferred Tax Liability of USD25,000	No Deferred Taxes	Deferred Tax Asset of USD25,000

Key Learning points

- There are a limited number of exceptions to the recognition of deferred tax liabilities and deferred tax assets.
- For the initial recognition exception to apply, all of the following criteria must be met:
  - The temporary difference must arise on initial recognition of asset or liability
  - The temporary difference must not arise in a transaction that represents a business combination
  - Initial recognition of the asset or liability to which the temporary difference relates must not impact accounting profit at the time of the transaction
  - The initial recognition of the asset or liability to which the temporary difference relates must not impact taxable profit at the time of the transaction.

3 Determine deferred taxes in business combinations

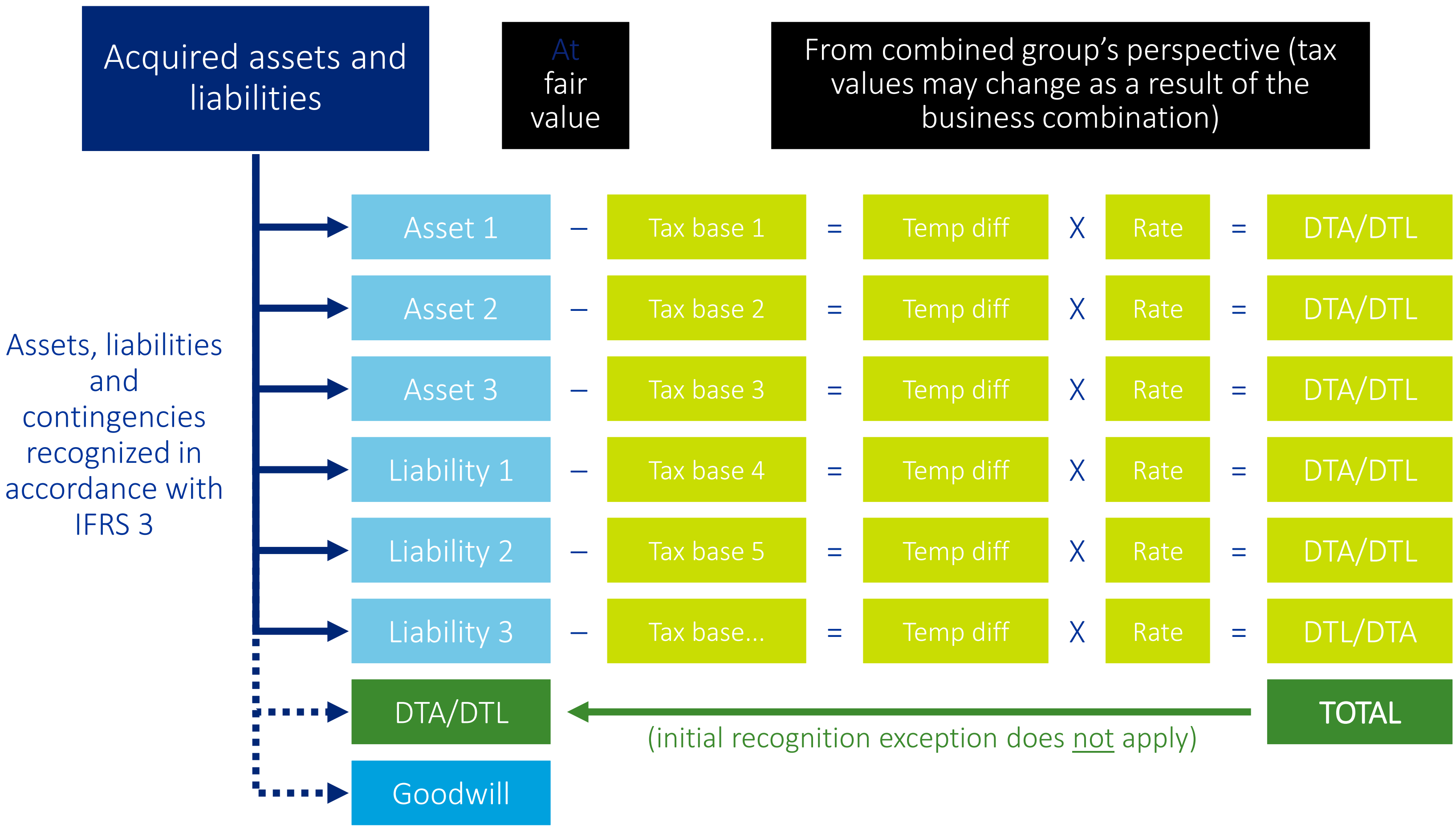
Deferred taxes and business combinations

Carrying amount of investment − Tax base of investment = Temporary difference

Carrying amount of investment	Tax base of investment	Temporary difference
↑	↑	↓
Determined under IFRS 3 / IAS 27	Often the amount paid	May be nil at acquisition date

Deferred taxes and business combinations

Methodology for accounting for taxes arising in business combinations



Deferred taxes and business combinations

Simplified example

- Company A acquires 100% of the common shares of Company B for $2,000
- Fair value of B's net identifiable assets is $1,800 and carrying amounts (in the financial statements of B) and tax base of net assets is $1,000

Net deferred tax implications	Amount ($)
Aggregate fair value of acquired net identifiable assets	1,800
Tax base of acquired net assets	(1,000)
Taxable temporary difference	800
Net deferred tax liability (at 30% Company's B tax rate)	**240**

Accounting for the business combination	Amount ($)
Fair value of acquired net assets (excluding taxes)	1,800
Net deferred tax liability	(240)
Goodwill	440
Total consideration transferred	**2,000**

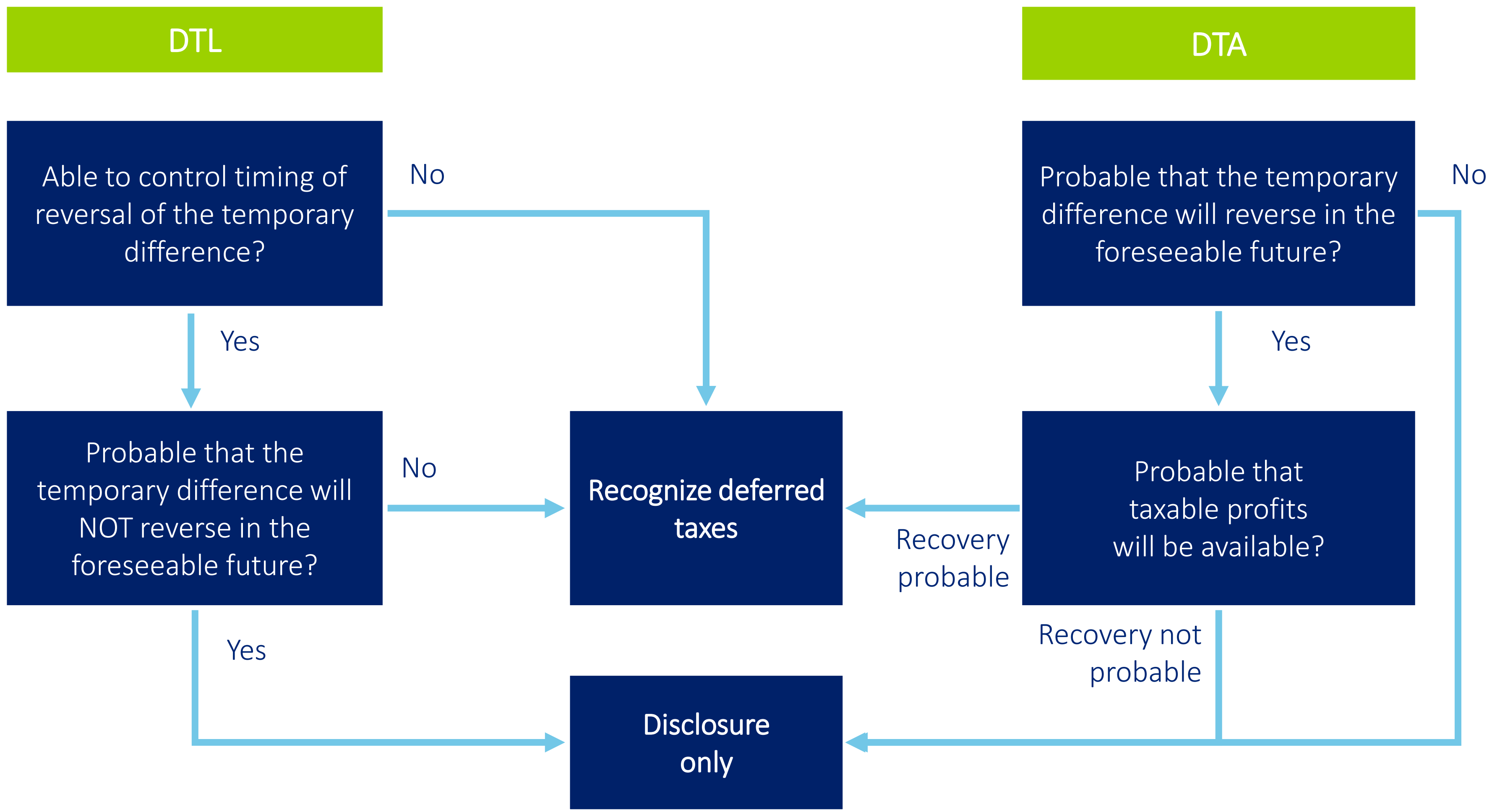
Key learning points

- Deferred taxes need to be taken into account when recording the initial accounting for a business combination.
- In a business combination, deferred tax assets and liabilities arise due to a difference in the fair value of the assets and liabilities recorded on consolidation and their tax bases.
- The recognition of deferred tax assets and liabilities affects the amount of goodwill recognized.
- A deferred tax liability is not recognized on the initial recognition of goodwill.

4 Deferred tax principles arising on investments

Deferred taxes and investments

Recognition exception for investments in subsidiaries, branches, associates and interests in joint arrangements



What impact does equity accounting have on deferred tax accounting?

1) Equity accounted investments?

- Equity accounting adjustments
- Recognition and reversal of impairment losses
- Changes in the tax treatments (capital tax cost base adjustments, roll-overs, etc.)

2) Investments in subsidiaries, branches and associates or interests in joint arrangements?

- The existence of undistributed profits of subsidiaries, branches, associates and joint arrangements
- Changes in foreign exchange rates when a parent and its subsidiary are based in different countries
- A reduction in the carrying amount of an investment in an associate to its recoverable amount

Deferred taxes and investments

Deferred tax accounting for equity accounted investments

Carrying amount of investment − Tax base of investment = Temporary difference

Equity accounting changes carrying amount

Often there is no direct impact on tax base

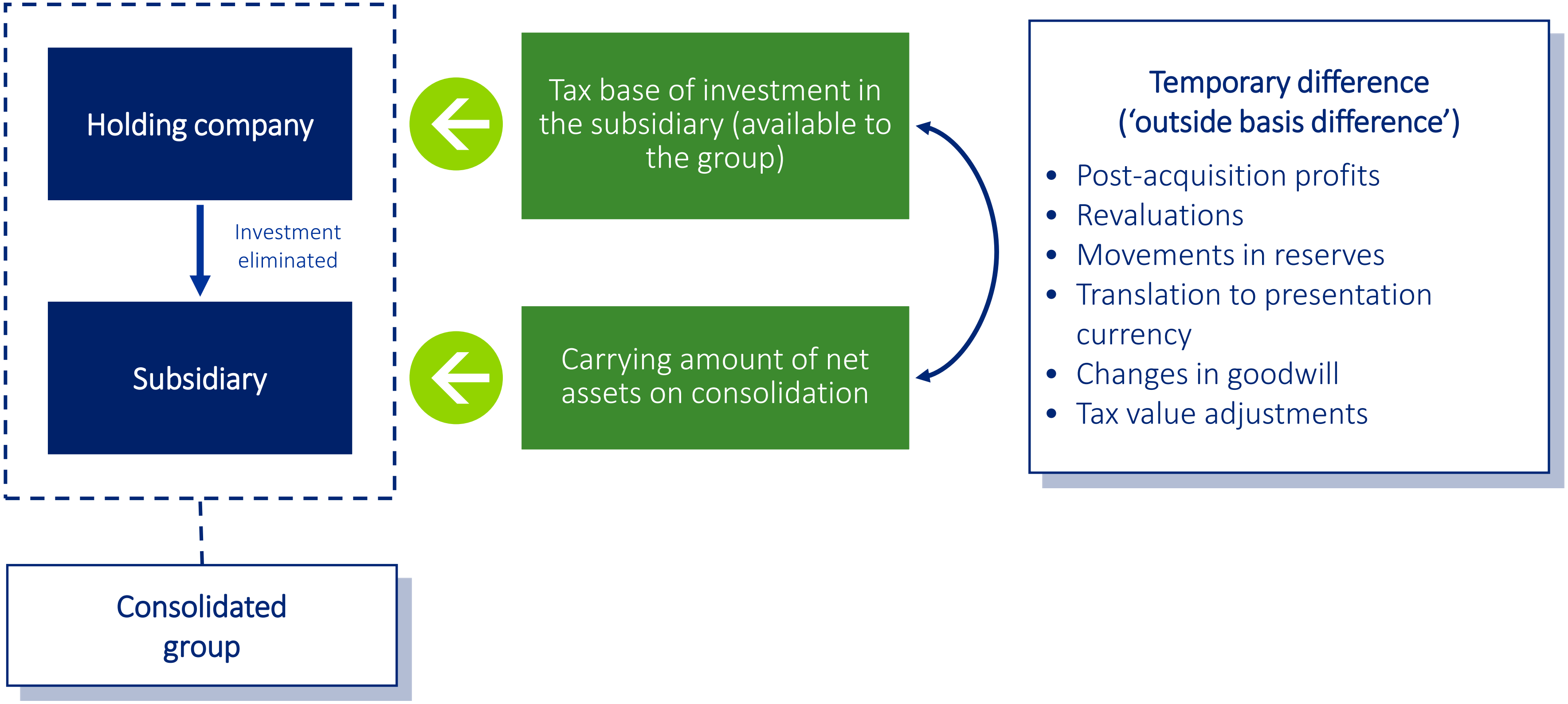
Unable to control distributions*

DTA Generally not recognized unless there is evidence that the temporary difference will reverse (e.g., commitment by investee to pay dividend, plan of disposal by investor)

DTL Generally recognized (investor cannot prevent a distribution that would trigger the reversal of the temporary difference, except sometimes in case of joint control)

Deferred taxes and investments

Temporary differences within consolidated groups



Deferred taxes and investments

Deferred tax accounting for investments in subsidiaries

Carrying amount − Tax base = Temporary difference

Carrying amount ↑

Net assets

Fair value adjustments

Goodwill

Deferred taxes at lower levels

Non-controlling interests

Tax base ↑

Tax value on sale of the subsidiary

Tax-free distributions

Tax credits available in relation to the investment

these items can adjust the tax base or the tax rate

Temporary difference ↓

May need to be split into 'use' ('revenue') and 'sale' ('capital')

Special recognition exceptions

If not recognized, still disclosed

Reflects tax consequences within the consolidated group ('outside basis differences')

Key learning points

- There are specific ‘investment recognition exceptions’ that must be applied when determining whether or not to recognize deferred taxes associated with investments in subsidiaries, branches, associates and interests in joint arrangements.

- Deferred tax liabilities arising in relation to investments in associates will normally be recognized, i.e., it is unlikely that the ‘control of the timing of reversal’ criteria will be met.

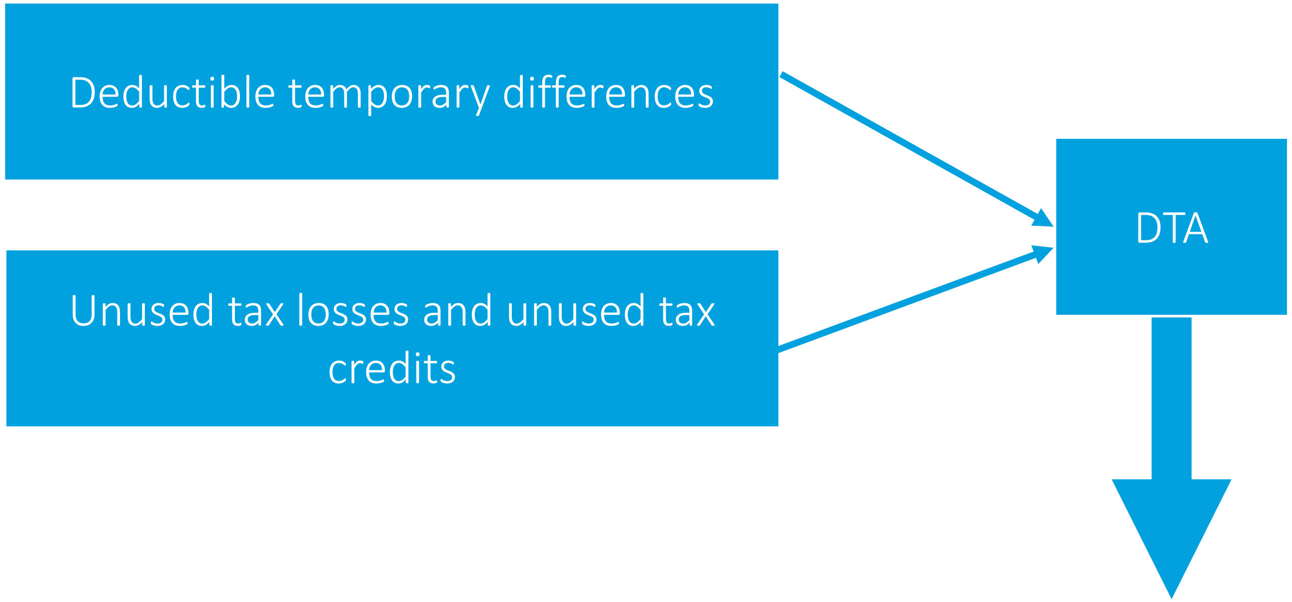
- Investments in subsidiaries can give rise to deferred taxes on consolidation–these deferred tax implications (sometimes referred to as ‘outside basis differences’) reflect the tax consequences to the group from the investment in the subsidiary that are in addition to the deferred tax implications of each asset and liability within the subsidiary itself, e.g., the capital gains tax consequences of disposing of the investment in the subsidiary

IAS 12 Income Taxes

5

How to assess recoverability of deferred tax assets

Recognition criteria deferred tax assets



Recognition criteria
Probable that
• Sufficient future taxable profits or taxable temporary differences will exist
○ From the same taxation authority and same taxable entity
○ In the same period (taking into account tax carry back / forward)

Assessment of future taxable profits

Indicators of future taxable profits

+	−
(Long term) profitable sales contracts	History of recent losses
Acquisition of profitable entity for which profits can be offset with available losses	Start-up business: limited evidence of ability to meet budgets
Appreciated asset value (potential plus value)	History of expired tax credits carried forward or expired unused tax losses
Strong earnings history	Quality problems for one of your most profitable products

Requires careful judgement based on all facts & circumstances available, e.g.,:

- Source of historical losses?
- Likely to reoccur?
- Reliability of forecasts
- Other evidence (e.g., new contracts, disposal unprofitable segment)

Assessment of future taxable profits

Non-recurring items	Exclude from forecasted profit if unlikely to re-occur
Future events	• Consider all available information on future taxable profits • BUT: do not anticipate certain future events, e.g., expected business combination
Tax planning opportunities	Must be taken into account to support future profits, but: • Entity must have **ability** to implement the tax strategy • Benefits expected to be derived must be adjusted by the **cost** of implementing the tax strategy
Other attention points	• Number of years before expiration of tax losses / credits • Types of profits against which the losses can be offset

Unrealized losses on available-for-sale securities

Available for sale securities

Carrying amount = fair value < Tax base

Capital loss deduction

Assess whether realization of loss is probable based on available evidence, e.g.,:

- Available capital loss carryback recovery in prior years
- Tax-planning strategies

Key learning points

- Deferred tax assets can arise from deductible temporary differences or unused tax losses / tax credits.
- The main recognition criteria are:
  - It is probable that there will be sufficient future taxable profits or taxable temporary differences that reverse in the periods, which can be used to offset deductible temporary differences or unused tax losses/credits.
  - The offsetting should occur in the same tax jurisdiction, the same taxable entity, and the same period.
- The assessment on the recoverability of deferred tax assets requires careful judgment based on all facts and circumstances available.
- Future available profits should be taken into account, but anticipation on future events not within the control of the entity is not allowed.
- When preparing forecasted taxable profits, eliminate non-recurring items.
- Tax planning opportunities can be taken into account if management has the ability to execute the tax strategy and the cost of the implementation is also taken into account.
- Unrealized loss on available-for-sale securities could result in deferred tax assets (capital loss deductions).

6 Recognition of deferred tax assets or liabilities outside profit or loss and the application of backward tracing principle

Recognition of current and deferred tax

General rule → In profit or loss

Tax related to transaction or event which is recognized, in the same o a different period, in **OCI** → In OCI →

Examples:
- Revaluation of PP&E
- CTA on translation of F/S of a foreign operation

Tax related to transaction or event which is recognized, in the same or a different period, in **equity** → In equity →

Examples:
- Adjustment of opening balance of retained earnings resulting from retrospective change in accounting policy or correction of an error (IAS 8)
- Initial recognition of equity component of compound financial instrument

Backward tracing - example

Change in deferred tax to be recognized in profit or loss, except to the extent that it relates to items that were previously recognized outside profit or loss.

Background

- InvestCo holds a portfolio of available for sale securities.
- Unrealized gains and losses are recognized in OCI in accordance with IAS 39
- Under tax law, gains and losses affect taxable income only when realized (i.e., when the financial asset is sold).
- The applicable tax rate is 30% and InvestCo is profitable.
- Original cost of AFS securities: $100
  Fair value at 31 December 2016: $90
  Sold on 1 March 2017 at a price of $90

Questions

- Should deferred taxes be recognized at 31 December 2016? If yes, please provide the journal entries.
- What would be the journal entries with respect to deferred taxes upon disposal of the AFS on 1 March 2017?

Backward tracing – example (continued)

Journal entries at 31 December 2016		
Dr Unrealized loss on AFS securities (OCI)	10	
Cr AFS securities (B/S)		10
Dr Deferred tax asset (B/S)	3	
Cr Deferred tax benefit (OCI)		3

Backward tracing – example (continued)

Journal entries at 1 March 2017

Dr Loss on sale (P/L)	10	
Cr Unrealized loss on AFS securities (OCI)		10
Dr Deferred tax benefit (OCI)	3	
Cr Deferred tax asset (B/S)		3
Dr Current tax liability (B/S)	3	
Cr Current tax benefit (P/L)		3

Subsequent changes of deferred tax assets/liabilities

Possible reasons for changes in deferred tax, even if temporary difference remains the same

Change in tax rates/law	Change in expected manner of recovery of an asset	Reasssessment of recoverability DTA

Subsequent changes of deferred tax assets/liabilities (Cont'd)

Situations where it may be difficult to determine the amount of current/deferred tax that relates to items recognized outside P/L:

- Graduated income tax rates
- Change in tax rates/law
- Reassess recoverability of deferred tax asset
- Change in accounting policies

Pro rata allocation of tax between P/L and OCI may be required

Key Learning points

- Current tax and deferred tax shall be recognized outside profit or loss if the tax relates to items that are recognized, in the same or a different period, outside profit or loss. Therefore, current tax and deferred tax that relates to items that are recognized, in the same or a different period:
    - In OCI, shall be recognized in OCI
    - Directly in equity, shall be recognized directly in equity

This principle is referred to as 'backward tracing'.

- In some circumstances, it may be difficult to determine the amount of current and deferred tax that relates to items recognized outside profit or loss (in either OCI, or directly in equity). In this case, a pro-rata allocation may be required.

7 Deferred taxes on share-based payment transactions

Deferred taxes on share-based payments

Tax base = amount the taxation authorities will permit as a deduction in future periods

Carrying amount

Deductible temporary difference

Deferred tax (asset)

If the amount will only be known in the future: estimate based on information available at the end of the period

Deferred taxes on share-based payments – example 1

On 1 January 2020, Icepacker Ltd. grants 100 share options to its employees that vest after 3 years of service. Under the applicable tax law, a tax deduction will arise when the options are exercised and will be based on the intrinsic value of the options at that time.

On 31 December 2021:

- 100 options remain outstanding but Icepacker expects that only 50 of these will be exercised.
- The remainder are expected either not to vest (due to employees leaving service before the end of the vesting period) or to expire unexercised (due to employees choosing not to exercise their rights under the options).
- The intrinsic value of each option at 31 December 2021 is $10. The tax rate is 30%.

Question

Calculate the deductible temporary difference at 31 December 2021 and the DTA on the share-based payments at that date.

Deferred taxes on share-based payments – example 1

Question

Calculate the deductible temporary difference at 31 December 2021 and the DTA on the share-based payments at that date.

Answer

Deductible temporary difference = 50 options x $10 x 2/3 of vesting period elapsed = $333

DTA = $333 * 30% = $100

Deferred taxes on share-based payments

(Estimated) future tax deduction

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Related cumulative remuneration expenses

Excess of the associated current or deferred tax should be recognized directly in equity (instead of in P/L)

Key learning points

- The initial recognition exception prevents the recognition of deferred taxes in limited circumstances.
- Accounting for business combinations must include deferred taxes arising and will therefore affect the amount of goodwill or bargain purchase recognized.
- There are specific ‘investment recognition exceptions’ for investments in subsidiaries, branches, associates and interests in joint arrangements which mean that deferred taxes arising in respects of these items are not always recognized.
- Deferred tax assets can arise from deductible temporary differences or unused tax losses / tax credits.
- The main recognition criteria for deferred tax assets are:
    - It is probable that there will be sufficient future taxable profits or taxable temporary differences that reverse in the periods in which they can be used to offset deductible temporary differences or unused tax losses/tax credits.
    - The offsetting should occur in the same tax jurisdiction, the same taxable entity, and the same period.

Key learning points (continued)

- Current tax and deferred tax shall be recognized outside profit or loss if the tax relates to items that are recognized, in the same or a different period, outside profit or loss. Therefore, current tax and deferred tax that relates to items that are recognized, in the same or a different period:
  - In OCI, shall be recognized in OCI
  - Directly in equity, shall be recognized directly in equity.

  This principle is referred to as 'backward tracing'.
- In some circumstances, it may be difficult to determine the amount of current and deferred tax that relates to items recognized outside profit or loss (in either OCI or directly in equity). In this case, a pro-rata allocation may be required.
- Share-based payments may result in deductible temporary differences, e.g., because the tax deduction may only occur when the share options are exercised. The temporary differences shall be estimated, based on information available at the end of the period (e.g., expected vesting percentage, share price at the end of the period).

Key learning points (continued)

- If the amount of the (estimated) tax deduction exceeds the amount of the related cumulative remuneration expense, this indicates that the tax deduction relates not only to remuneration expense but also to an equity item. In this situation, the excess of the associated current or deferred tax should be recognized directly in equity.
- Where delivered, the key points arising from the country-specific session should be addressed.

Questions?


Ask
Answer
Who
Understand
Where
How
Question
Apply
Why
What
When
Answers
Query
Questions

Deloitte.

IAS 19
Employee Benefits

Presentation by:
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Partner, Deloitte & Touche LLP

Objectives

You will be able to:

- Distinguish between short-term and other long-term employee benefits
- Classify post-employment benefit plans as defined benefit or defined contribution plans
- Define and explain how to account for multi-employer plans, state plans, and insured benefit plans
- Explain and apply the asset ceiling requirements to the value of the defined benefit liability when it is negative (an asset)
- Describe the requirements and impact of IFRIC 14
- Identify key issues in the determination of the discount rate

Topic 1: Distinguishing between short-term and other long-term employee benefit plans

Short-term and other long-term employee benefits

Definition

Short-term employee benefits:

Employee benefits … that are **expected to be settled wholly** before 12 months after the end of the annual reporting period in which the employees render the related service

↔

Other long-term employee benefits:

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

Short-term and other long-term employee benefits
Examples

Short-term employee benefits

(if expected to be settled wholly before 12 months after the end of the annual reporting period in which the employees render the related services)

- Wages, salaries, and social security contributions
- Paid annual leave and paid sick leave
- Profit-sharing and bonuses
- Non-monetary benefits (medical, housing, car) for current employees

Short-term and other long-term employee benefits

Examples (cont'd)

Other long-term employee benefits

(if not expected to be settled wholly before 12 months after the end of the annual reporting period in which the employees render the related service)

Long-term paid absences such as long service or sabbatical leave

Jubilee or other long–service benefits

Long- term disability benefits

Short-term and other long-term employee benefits

Reclassification

An entity need not reclassify a short-term employee benefit

If the entity's expectations of the timing of settlement change temporarily

An entity considers whether the benefit still meets the definition of short-term employee benefits

If the characteristics of the benefit change (such as a change from a non-accumulating benefit to an accumulating benefit) or

If a change in expectations of the timing of settlement is not temporary

Short-term employee benefits
Recognition and measurement

All short-term benefits

Recognize the undiscounted amount of short-term employee benefits, when an employee has rendered service

- As a liability after deducting any amount already paid
- As an expense unless another Standard requires/permits the inclusion of benefits in the cost of an asset (e.g., IAS 2, IAS 16)

[Based on IAS 19 (2011).11]

Short-term employee benefits

Recognition and measurement (cont'd)

Short-term paid absences

Category	Description	Recognize the obligation when…
Accumulating paid absences (vesting and non-vesting)	Can be carried forward to a future period if not used in full in the current period	…employees render service that increases their entitlement to future paid absence
Non-accumulating paid absences	Cannot be carried forward: lapse if not used in the period earned	…the absence occurs

[Based on IAS 19 (2011).13-15]

Short-term benefit plans

Recognition and measurement (cont'd)

Profit-sharing and bonus payments

Expected cost is recognized when:

- Entity has a present legal or constructive obligation
- Reliable estimate of the obligation can be made

Profit-sharing and bonus obligation result from employees' service, hence, they are expense and not a distribution of profits.

[Based on IAS 19 (2011).19 & 22]

Other long-term employee benefits

Recognition and measurement

Same measurement principles as post-employment benefits

The surplus or deficit is the difference between

- PV of the obligation
- Minus the fair value of plan assets, if any

- BUT, difference from post-employment benefit accounting: total of service cost, net interest and remeasurements, shall be recognized in profit or loss (except when another IFRS requires/permits capitalization)

[Based on IAS 19 (2011).155 & 156]

Other long-term employee benefits

Recognition and measurement (cont'd)

Long-term disability

Timing for the recognition of a liability depends on how the level of benefit is determined:

Level of benefit depends on length of service–obligation arises when the service is rendered

Level of benefit does not depend on the length of service–obligation arises when an event occurs that causes a long-term disability

Other long-term employee benefits

Example

Indigo Manufacturing Company produces heavy machinery products. The employees of Indigo are covered for any long-term disability due to an accident in their normal course of work. The level of benefit due to an employee of the company does not depend on the length of the service. So, it is the same for any disabled employee regardless of the years of service.

On December 22, 2020, an employee of Indigo suffered a serious injury resulting in a long-term disability.

When should Indigo recognize the cost of the benefit?

Since the level of benefit does not depend on the length of the service, Indigo has to recognize the cost of the benefit on December 22, 2020, being the date of the accident.

Other long-term employee benefits

Example (cont'd)

Will the answer be different if Indigo Co Ltd had a scheme where the level of benefit depends on the length of service?

Indigo has to recognize, for each year, the cost of benefit considering:

- The probability that payment will be required
- The length of time for which payment is expected to be made.

Exercise–Scenario 1: Accumulated annual leave

Facts:

Employees accumulate annual leave over each calendar year.

They can take their accumulated annual leave at any time or carry it forward indefinitely.

The accumulated annual leave must be paid up in cash in case of departure of the employee.

Experience demonstrates that employees use their accumulated annual leave over a period longer than two years.

Question:

How should the unused accumulated annual leave be classified under IAS 19?

Exercise–Scenario 1: Accumulated annual leave

Suggested solution

Classification

The accumulated annual leave should be classified as an other long-term benefit, because it is not *expected* to be settled wholly within 12 months after the end of the annual period in which the employee renders service.

However, the accumulated annual leave should still be classified as a current liability under IAS 1.

[Based on Deloitte Q&A IAS 19 (2011): 8-1]

Exercise–Scenario 2: Long service leave

Facts:

An entity grants employee B a long service leave if B provides seven years of continuous service.

After seven years of service, B becomes entitled to payment of the long service leave if employment is terminated. It is not expected that B will terminate his service or take his long service leave entitlement in year 7 or year 8.

Questions:

1. **At the end of the 7th year of continuous service, should the long service leave be classified as short-term or long-term employee benefit under IAS 19?**
2. **How should the liability be measured?**

Exercise–Scenario 2: Long service leave

Suggested solution

Classification

The long service leave should be classified as a long-term employee benefit under IAS 19

Classification of the benefit is done on day 1 (when employer and employee enter into the contract) => classified as a long-term benefit

No reclassification after vesting has occurred

However, starting in the 7th year, the liability is presented as current under IAS 1.

[Based on Deloitte Q&A IAS 19 (2011): 8-1]

Topic 2: Classification of post-employment benefit plans

Post-employment benefit plans
Classification

PLAN 1:

- Contributions fixed in advance, based on, e.g., salary, are paid to pension funds.
- Beneficiaries are entitled to the pension funds.
- The employer has no obligation beyond contribution payments.

Answer: Defined contribution plan (“DCP”)

PLAN 2:

- Beneficiaries are promised a set level of retirement benefits by the employer.
- Premiums payable by employer are not fixed in advance.

Answer: Defined benefit plan (“DBP”)

Post-employment benefit plans
Multi-employer plans

Features

- Pool assets contributed by various entities (not under common control)
- Assets provide benefits to employees of more than one entity
- Contributions/benefits are not linked to a specific employer

Accounting treatment

- As DCPs or DBPs based on the characteristics of the plan
- If insufficient information is available to apply DBP accounting to a multi-employer DBP:
  - Apply DCP accounting
  - Provide additional disclosures
  - If there is a contractual agreement to cover the surplus or deficit in the plan ➔ recognize asset or liability and the resulting income or expense in profit or loss

Disclosure

- For all multi-employer DBPs ➔ specific additional disclosures are required

[Based on IAS 19 (2011).8, 32-34, 37, 148]

Post-employment benefit plans
State plans

Features

- Established by legislation to cover all entities (or those in a category)
- Operated by government or a body free from control/influence by reporting entity

Accounting treatment

Account for in the same way as multi-employer plans

- Either DCP or DBP based on the characteristics of the state plan
- Many state plans are funded on a pay-as-you go with no legal obligation beyond contributions due ➔ DCPs

[Based on IAS 19 (2011).43-45]

Post-employment benefit plans
Insured benefit plans

Features

- An entity pays insurance premiums to fund a post-employment benefit plan.

Accounting treatment

DCP unless the entity has a legal or constructive obligation to either:

- Pay the employee benefits directly when they fall due; or
- Pay further amounts if insurer does not pay all future benefits

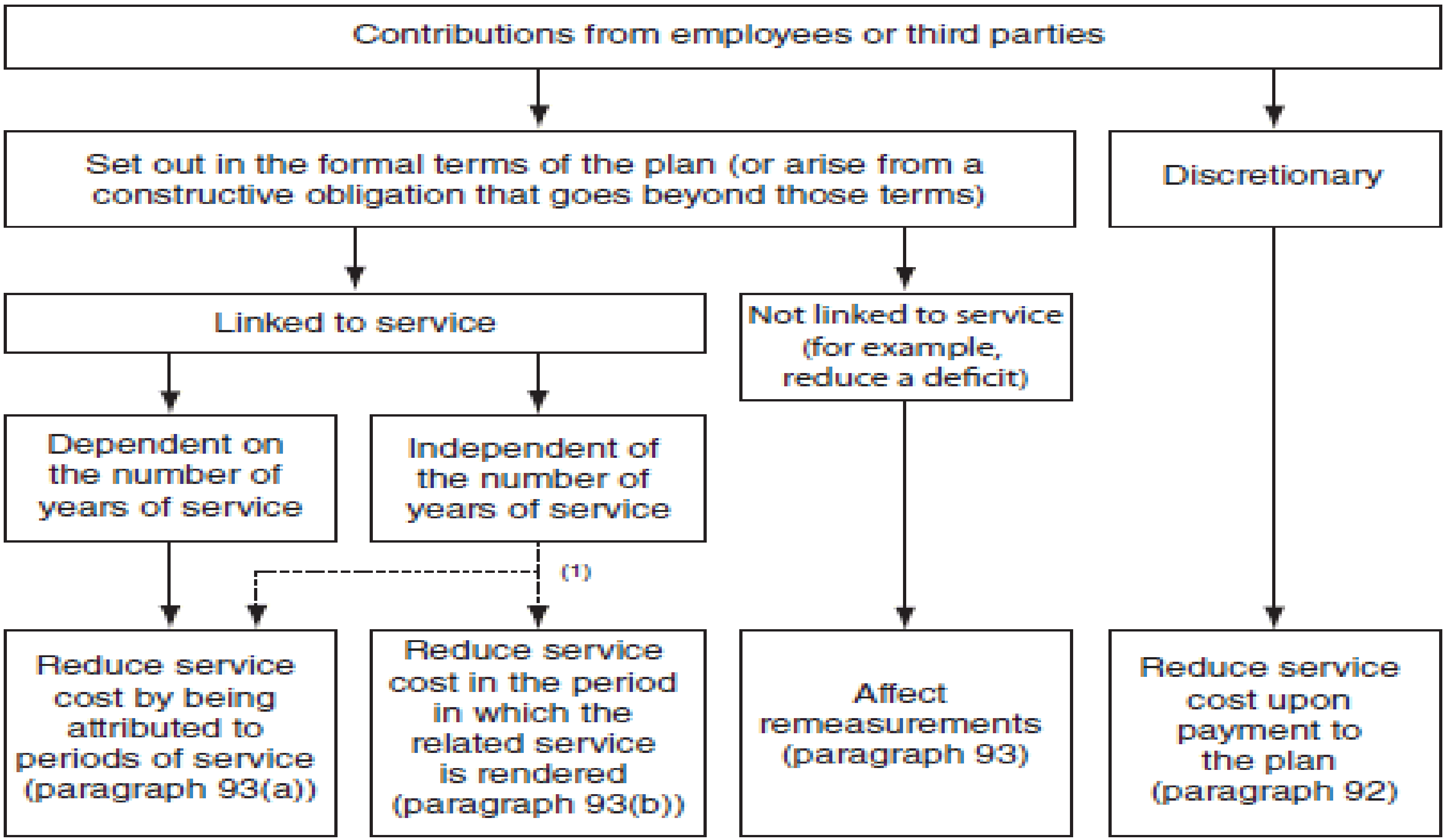
If the entity retains such a legal or constructive obligation ➔ DBP

[Based on IAS 19 (2011).46]

Topic 3: Defined benefit plan: employee contributions

Employee contributions (amendments to IAS 19)

Requirements for contributions from employees or third parties



(1) This dotted arrow means that an entity is permitted to choose either accounting.

Topic 4: Asset ceiling and IFRIC 14

The asset ceiling and IFRIC 14

Determination of the asset ceiling

When an entity has a surplus in a DBP, IAS 19 (2011).64 restricts the amount that can be recognized as an asset to the lower of:

- The surplus in the DBP
- The asset ceiling, i.e., the present value of any economic benefits available in the form of refunds or reductions in future contributions to the plan

Guidance under IFRIC 14

- When refunds or reductions in future contributions should be regarded as "available", as the term is used in IAS 19.8
- How a minimum funding requirement might affect the availability of reductions in future contributions
- When a minimum funding requirement gives rise to a liability

The asset ceiling and IFRIC 14

Availability of economic benefits–basic principles

Consider terms of plan and statutory requirements:

Facts and circumstances determine availability of a refund or reduction in future contributions

Maximum amount available:

NOT dependent on how the entity intends to use the surplus

Assumptions used in assessing availability through refunds or reductions in future contributions should be consistent with those used to determine the defined benefit obligation:

Significant estimates required

Disclose key sources of estimation uncertainty

The asset ceiling and IFRIC 14

Right to a refund

Must be unconditional

Consider factors not wholly within the control of entity that may restrict ability of entity to withdraw surplus, for example whether

- The government has established minimum funding requirements
- The plan documents prescribe how an entity must contribute to a fund
- Plan trustee may imposed improvements to the defined benefits in case of a surplus
- Amounts funded cannot be withdrawn without the approval of a regulator

At some point:

During the life of the plan

Assuming gradual settlement of the plan

Assuming full settlement of the plan in a single event (this may require the purchase of annuities at a cost in excess of the obligation)

Amount of the economic benefits for which a right to refund exists at the end of the reporting period

Net of costs (e.g., tax, professional fees, insurance premiums)

The asset ceiling and IFRIC 14

Contribution reduction

If there is no minimum funding requirement, the amount of the economic benefit available as a reduction of future contributions is the lower of:

The surplus in the plan

Present value of future service cost, that is:

- Excluding contributions of employees
- Over the life of the plan (or the life of the entity, if shorter)

IFRIC 14 – Minimum funding requirements

Need to distinguish obligation to provide minimum funding:

With respect to future services:

- Affects economic benefits available from a reduction in future contributions

With respect to past services:

- May give rise to a liability (or an increase in the existing liability if the plan is in deficit)

IFRIC 14 – Minimum funding requirements
Future contribution reduction due to prepayments

If there is a minimum funding requirement, the amount of the economic benefit available as a reduction in future contributions comprises:

a) Any amount that reduces future minimum funding requirement contributions for future services because the entity made a prepayment

b) The estimated future service cost in each period less the estimated minimum funding requirement contributions that would be required for future service in that period if there were no prepayment of those contributions as described in (a).

IFRIC 14 – Minimum funding requirements
Additional liability

If:

- **Current shortfall in minimum funding with respect to services already received; and**
- **Once paid, the contributions will not be available to the entity**

then:

- **The entity will recognize a (an additional) liability when the funding obligation arises, which may result in:**
    - Reduction of the net defined benefit asset
    - Increase of the net defined benefit liability
- The change in net defined benefit liability (asset) above is recognized as a remeasurement (in OCI)

Determination of the discount rate

Determination of the discount rate

- IAS 19 requires use of an interest rate based on the market yield at the end of the reporting period on high quality corporate bonds to discount the post-employment obligations
- Absence of a deep market for high quality corporate bonds?
  - Use the market yield on government bonds
  - The assessment of the yields is performed at the currency level. The currency and the term of the corporate bonds or government bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations
- Indices used in practice: iboxx €, Bloomberg, Reuters, etc.
- Significant differences may be observed between the interest rates provided by the various indices

Issue: **What is the impact of these discrepancies on the determination of the discount rate?**

Determination of the discount rate (cont'd)

Recommendations:

Determine appropriate discount rate

Review the methodology used to determine the discount rate

In forming judgment, consider the outcome of various methodologies

Consider whether there is a need for a more detailed methodology than used in the past

Sufficient appropriate disclosure is required in the notes to the financial statements

Related issues discussed by IFRS IC:

- Pre-tax or post-tax discount rate (July 2013)
- Actuarial assumptions: Determination of discount rate (November 2013)

Questions?


Ask
Answer
Who
Understand
Where
How
Question
Apply
Why
What
When
Answers
Query
Questions

Deloitte.

IAS 33
Earnings Per Share

Presentation by:
CPA Freda Mitambo
Partner, Deloitte & Touche LLP

Introduction

Earnings per share is perceived to be the single measure that can best summarize the performance of a company.

It is reported most frequently in the media and receives the most attention by investors and other stakeholders.

Overview and Scope

IAS 33 Earnings Per Share sets out how to calculate both basic earnings per share (EPS) and diluted EPS. The calculation of Basic EPS is based on the weighted average number of ordinary shares outstanding during the period, whereas diluted EPS also includes dilutive potential ordinary shares (such as options and convertible instruments) if they meet certain criteria.

IAS 33 was reissued in December 2003 and applies to annual periods beginning on or after 1 January 2005.

IAS 33 applies to entities whose securities are publicly traded or that are in the process of issuing securities to the public. [IAS 33.2] Other entities that choose to present EPS information must also comply with IAS 33. [IAS 33.3]

If both parent and consolidated statements are presented in a single report, EPS is required only for the consolidated statements. [IAS 33.4]

Key definitions

Ordinary share: also known as a common share or common stock. An equity instrument that is subordinate to all other classes of equity instruments.

Potential ordinary share: a financial instrument or other contract that may entitle its holder to ordinary shares e.g convertible debt, convertible preferred shares, share warrants, share options, share rights, employee stock purchase plans, contractual rights to purchase shares, contingent issuance contracts or agreements (such as those arising in business combination)

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

Antidilution: an increase in earnings per share or a reduction in loss per share resulting from the assumption that convertible instruments are converted, that options or warrants are exercised, or that ordinary shares are issued upon the satisfaction of specified conditions.

Requirement to present EPS

An entity whose securities are publicly traded (or that is in process of public issuance) must present, on the face of the statement of comprehensive income, basic and diluted EPS for: [IAS 33.66]

- profit or loss from continuing operations attributable to the ordinary equity holders of the parent entity; and
- profit or loss attributable to the ordinary equity holders of the parent entity for the period for each class of ordinary shares that has a different right to share in profit for the period.

If an entity presents the components of profit or loss in a separate income statement, it presents EPS only in that separate statement. [IAS 33.4A]

Basic and diluted EPS must be presented with equal prominence for all periods presented. [IAS 33.66]

Basic and diluted EPS must be presented even if the amounts are negative (that is, a loss per share). [IAS 33.69]

If an entity reports a discontinued operation, basic and diluted amounts per share must be disclosed for the discontinued operation either on the face of the of comprehensive income (or separate income statement if presented) or in the notes to the financial statements. [IAS 33.68 and 68A]

How to calculate Basic EPS

Basic EPS is calculated by dividing profit or loss attributable to ordinary equity holders of the parent entity (the numerator) by the weighted average number of ordinary shares outstanding (the denominator) during the period. [IAS 33.10]

The earnings numerators (profit or loss from continuing operations and net profit or loss) used for the calculation should be after deducting all expenses including taxes, minority interests, and preference dividends. [IAS 33.12]

The denominator (number of shares) is calculated by adjusting the shares in issue at the beginning of the period by the number of shares bought back or issued during the period, multiplied by a time-weighting factor. IAS 33 includes guidance on appropriate recognition dates for shares issued in various circumstances. [IAS 33.20-21]

Contingently issuable shares are included in the basic EPS denominator when the contingency has been met. [IAS 33.24]

Basic EPS

A company with a simple capital structure may have ordinary shares and preference shares.

It may not have any potentially dilutive securities (i.e. stock options, warrants, convertible bonds, convertible preferred stock).

Basic earnings per share (EPS) computation is:

$$\frac{\text{Net profit after tax} - \text{Preference dividends}}{\text{Weighted average outstanding ordinary shares}}$$

Example

Weighted average shares:

A company reported a profit after tax of Ksh.318,000 for the year ended 30th June 2020 and had 12,000 shares of ordinary shares outstanding on 1st July 2019.

On 1/9/2019, it issued 2700 shares; on1/1/2020, it issued another 3,300 shares

a) Compute the weighted average no of shares

b) Compute the basic earning per shares

Months shares are outstanding	Shares outstanding *	Fraction of Year Outstanding	= Equiv. Units
Jul - August	12,000	2/12	2,000
Sep.- Dec	14,700	4/12	4,900
Jan- June	18,000	6/12	9,000
Total Weighted Average Common Shares			15,900

Basic Earning Per share = 318,000/15900

= Ksh.20 per share

Capital Structure with dilutive securities

- The capital structure of some companies includes convertible securities, stock options and warrants.
- Since conversion of these securities into ordinary shares may decrease EPS, these securities are referred to as potentially dilutive securities.
- These potentially dilutive securities are also referred to as common shares equivalents (CSE).
- A CSE is a security that is not an ordinary share now, but contains a provision enabling its holders to acquire ordinary shares at predetermined terms which, at issuance, makes it, in substance, equivalent to an ordinary shares.
- Companies with complex capital structures are required to present both basic (no consideration of CSE) and diluted earnings per share (consider the potential impact of CSE) .
- In computing diluted EPS (DEPS), the potential impact (i.e., the assumed conversion) of CSE is considered in addition to the weighted average shares.
- The impact of assumed conversion of CSE on EPS will be on both numerator and denominator of EPS computation.

  DEPS = Diluted Earning / WANOS+CSE

- To be included in the diluted EPS calculation, the CSE must have dilutive effect on EPS .
- That is, the assumed conversion of the CSE has a negative impact on the EPS (i.e., reduce the EPS)
- Note CSE with antidilutive potential are not considered (holders have no incentive to convert / it violate prudence)

Diluted Earnings Per Share

- Stock options and warrants are always considered to be Common Shares Equivalents
- Stock options and warrants are first to be included in the computation of DEPS if they are dilutive.
- This is because the increase shares and have no effect on earnings
- Note if warrants and option are exercisable at prevailing market prices they are not CSE and have no dilutive potential
- the options and warrants are assumed to have been exercised at the beginning of the period (or at the time of issuance of the options if it is later).
- If the option are exercisable at a price but lower than the market price compute the bonus element to the equivalent CSE.
- Therefore, warrants or option causes dilution if the market price is greater (less) than the option price for a firm with profit (loss).

How to calculate Diluted EPS

Diluted EPS is calculated by adjusting the earnings and number of shares for the effects of dilutive options and other dilutive potential ordinary shares. [IAS 33.31] The effects of anti-dilutive potential ordinary shares are ignored in calculating diluted EPS. [IAS 33.41]

Convertible securities. The numerator should be adjusted for the after-tax effects of dividends and interest charged in relation to dilutive potential ordinary shares and for any other changes in income that would result from the conversion of the potential ordinary shares. [IAS 33.33] The denominator should include shares that would be issued on the conversion. [IAS 33.36]

Options and warrants. In calculating diluted EPS, assume the exercise of outstanding dilutive options and warrants. The assumed proceeds from exercise should be regarded as having been used to repurchase ordinary shares at the average market price during the period. The difference between the number of ordinary shares assumed issued on exercise and the number of ordinary shares assumed repurchased shall be treated as an issue of ordinary shares for no consideration. [IAS 33.45]

Contingently issuable shares. Contingently issuable ordinary shares are treated as outstanding and included in the calculation of both basic and diluted EPS if the conditions have been met. If the conditions have not been met, the number of contingently issuable shares included in the diluted EPS calculation is based on the number of shares that would be issuable if the end of the period were the end of the contingency period. Restatement is not permitted if the conditions are not met when the contingency period expires. [IAS 33.52]

Contracts that may be settled in ordinary shares or cash. Presume that the contract will be settled in ordinary shares, and include the resulting potential ordinary shares in diluted EPS if the effect is dilutive. [IAS 33.58

Procedure for DEPS

The following sequence of steps should be followed for DEPS computation:

Step 1: Compute the basic EPS.

Step 2: Identify all the dilutive stock options and warrants to compute a tentative dilution potential.

Step 3: Rank based on the assumed conversion impact of each Common Shares Equivalent (CSE) from the most dilutive (lowest potential) to the least dilutive (highest value).

Step 4: Include CSE in DEPS in a sequential order based on the ranking and compute a new tentative DEPS.

Step 5: One CSE is included in the DEPS at a time to compute a tentative DEPS and the inclusion is cumulative.

Step 6: Select the lowest tentative DEPS as the diluted EPS.

Retrospective adjustments

The calculation of basic and diluted EPS for all periods presented is adjusted retrospectively when the number of ordinary or potential ordinary shares outstanding increases as a result of a capitalisation, bonus issue, or share split, or decreases as a result of a reverse share split. If such changes occur after the balance sheet date but before the financial statements are authorised for issue, the EPS calculations for those and any prior period financial statements presented are based on the new number of shares. Disclosure is required. [IAS 33.64]

Basic and diluted EPS are also adjusted for the effects of errors and adjustments resulting from changes in accounting policies, accounted for retrospectively. [IAS 33.64]

Diluted EPS for prior periods should not be adjusted for changes in the assumptions used or for the conversion of potential ordinary shares into ordinary shares outstanding. [IAS 33.65]

Why?

- The purpose of the retroactive adjustment is to result in comparable EPS for all periods presented in terms of the most recent capital structure.
- This is because such share transaction do not result in change in net assets (revenue generating capacity)
- Compute the effect of each transaction on the weighted average outstanding equity shares

Example

- Assume a corporation has 10,000 common shares and options to purchase 1,000 ordinary shares at sh 20 per share outstanding for the entire year.
- The average market price for the shares was Ksh.25 per share.
- The company reported a profit after tax of Ksh.30 000:

i) Compute the basic earnings per shares

ii) Compute the diluted earnings per shares

Shares assumed issued through the exercise of options	1,000
Shares assumed acquired:	
$\frac{\text{Proceeds}}{\text{Avg. market price}} = \frac{20 * 1,000}{25} =$	(800)
Assumed increase in common shares for computing DEPS	200

Example

The following is selected data of BiZ Ltd. for year ended 30th June 2020:

- Net income after tax = Sh 12,000,
- Preference divided = Sh 2,000,
- Weighted Average Shares Outstanding.= 10,000,
- Convertible preference shares outstanding. = 1,000,
- Each share of preference shares is to be converted into four ordinary shares

Working

- Basic EPS = $\frac{(12,000-2000)}{10,000 \text{ Shares}} = 1$
- Impact of the assumed conversion: 2000/4,000 shares = sh 0.5 which is less than Basic EPS
- Thus, this CSE is dilutive and should be considered in the computation of DEPS as follows:
- DEPS = 12,000/(10,000+4,000)=0.857

Important to remember

- A CSE may appear to be individually dilutive may be anti-dilutive in combination with other CSE.
- Therefore, a ranking is performed to determine the sequence in which the CSE (other than options) should be included in the DEPS computation.
- This ranking is determined by comparing the impact on the EPS from the assumed conversion of each CSE at the beginning of the earliest period reported (or at the date of issuance of the CSE, if later).
- If conversion rate is different for different period, choose the highest conversion rate.
- Anti-dilutive convertible securities or warrants should NOT be included in the computation of DEPS.
- Contingent issue agreement (contingently issuable shares): if all conditions for issuing additional shares are met, these shares should be included in the diluted EPS computation.
- Partial year applies to the assumed conversion of convertible securities and the assumed exercise of options.
- Retrospective adjustment of comparative figures only applies to issues of shares for no consideration such as shares split and bonus issues.

Disclosures

If EPS is presented, the following disclosures are required: [IAS 33.70]

- the amounts used as the numerators in calculating basic and diluted EPS, and a reconciliation of those amounts to profit or loss attributable to the parent entity for the period
- the weighted average number of ordinary shares used as the denominator in calculating basic and diluted EPS, and a reconciliation of these denominators to each other
- instruments (including contingently issuable shares) that could potentially dilute basic EPS in the future, but were not included in the calculation of diluted EPS because they are antidilutive for the period(s) presented
- a description of those ordinary share transactions or potential ordinary share transactions that occur after the balance sheet date and that would have changed significantly the number of ordinary shares or potential ordinary shares outstanding at the end of the period if those transactions had occurred before the end of the reporting period. Examples include issues and redemptions of ordinary shares issued for cash, warrants and options, conversions, and exercises [IAS 34.71]

An entity is permitted to disclose amounts per share other than profit or loss from continuing operations, discontinued operations, and net profit or loss earnings per share. Guidance for calculating and presenting such amounts is included in IAS 33.73 and 73A.

Questions?

Ask
Answer
Who
Question
Apply
Why
Understand
Where
What
How
When
Answers
Query
Questions

Deloitte.

IAS 34
Interim Financial Reporting

Presentation by:
CPA Freda Mitambo
Partner, Deloitte & Touche LLP

Structure and Content of Financial Statements

❑ Identification of the financial statements

An entity shall clearly identify the financial statements and distinguish them from other information in the same published document.

For the information presented to be understandable, an entity shall display the following information prominently, and repeat it when necessary:

a. the name of the reporting entity or other means of identification, and any change in that information from the end of the preceding reporting period;

b. whether the financial statements are of an individual entity or a group of entities;

c. the date of the end of the reporting period or the period covered by the set of financial statements or notes;

d. the presentation currency; and

e. the level of rounding used in presenting amounts in the financial statements.

Structure and Content of Financial Statements *(cont'd)*

❑ Statement of financial position

Assets shall be classified as current and non-current.

- **Current Assets** are assets the entity:
  - a. expects to realize, consume or sell in its normal operating cycle.
  - b. holds primarily for trading
  - c. expects to realize within 12 months after the reporting period.
  - d. cash or cash equivalent
- **Other assets are non-current, although the use of 'long term' is not prohibited.**

Liabilities shall be classified as current and non-current

- **Current liabilities** are liabilities the entity:
  - a. Expects to settle in its normal operating cycle
  - b. Holds primarily for trading
  - c. Is due to settle within 12 months after the reporting period.
  - d. Does not have unconditional right to defer for at least 12 months after its reporting period.
- **Other liabilities are non current.**

IAS 1 Presentation of Financial Statements

Structure and Content of Financial Statements *(cont'd)*

A must note!!!!!!!!!!!

IAS 1 requires presentation of current and non-current assets, and current and non-current liabilities, as separate classifications in its balance sheet except when a presentation based on liquidity provides information that is reliable and more relevant. When that exception applies, an entity shall present all assets and liabilities in order of liquidity.

E.g Banks presentation of their financial statements based on liquidity would ordinarily provide information that is more reliable and more relevant, this is the format that is ordinarily adopted.

IAS 1 Para 61 Whichever method of presentation is adopted, an entity shall disclose the amount expected to be recovered or settled after more than twelve months for each asset and liability line item that combines amounts expected to be recovered or settled:

- (a) no more than twelve months after the reporting period, and
- (b) more than twelve months after the reporting period.

Introduction to IAS 34: Interim Financial Reporting

Interim Financial Reporting came into effect on 1st January, 1999.

Amendment was made as part of Annual Improvements to IFRS 2009/2011 to clarify the total assets and total liabilities for segment information in interim financial reporting. The amendment was effective for annual periods beginning on or after 1 January 2013 with earlier application permitted.

To implement the standard, one needs a good knowledge of all Standards

Being familiar with *IAS 1* will allow you to see its strong interaction with *IAS 34*, as each addresses the requirements for the presentation of financial statements

Let's now look briefly at some of the details of *IAS 34*, focusing mainly on why we have it, its scope, and benefits.

IAS 34: Definition

IAS 34 addresses interim financial reports. So first, let's clarify what's meant by an interim financial report.

Definition:

An interim financial report is a financial report containing either:

- a complete set of financial statements (as described in *IAS 1: Presentation of Financial Statements*) for an interim period (period shorter than an entity's full financial year)

or

- a set of condensed financial statements for an interim period

IAS 34 - Purpose

Let's now look at the **purpose** of interim financial statements, and what this Standard **prescribes**...

Interim financial reports are intended to provide an update on the period since the latest complete set of annual financial statements, or since the previous interim financial statements.

The focus should be new activities, events, or circumstances.

It should not be a duplication of information relating to the previous year-end.

For an interim report, *IAS 34* prescribes:

- a minimum content of the statement of financial position, statement of comprehensive income, changes in equity and statement of cash flows (form , content and components)
- selected explanatory notes (specified by *IAS 34*)
- periods for which an entity is required to present an interim financial statement
- that materiality should be set
- the principles for recognition and measurement
- which periods to restate, if there is a change in accounting policy

Benefits of IAS 34

The benefits of understanding and knowing how to apply *IAS 34*,are that you will be able to:

understand the basis of preparation of an interim report

evaluate whether the published information at an interim period is relevant

IAS 34 specifies the **content** for an interim financial report, but does **not** prescribe:

which entities should publish interim financial reports

how frequently

how soon after the end of an interim period

Scope of IAS 34

Why do entities need to publish interim financial reports

- Governments, securities regulators, stock exchanges, and standard setting bodies often require enterprises whose debt or equity securities are publicly traded to publish interim financial reports.

When does this standard apply?

- *IAS 34* applies if an entity is required or elects to publish an interim financial report in accordance with International Financial Reporting Standards.
- The fact that an entity may not have provided interim financial reports during a financial year or may have provided interim financial reports that do not comply with this standard, does not prevent the entity's annual financial statements from conforming to International Financial Reporting Standards if they otherwise do so.

What does this standard encourage entities to publish?

- *IAS 34* encourages publicly traded entities to provide interim financial reports that conform to the **recognition**, **measurement**, and **disclosure** principles set out in the Standard. Specifically, publicly traded entities are encouraged to:
  - provide interim financial reports at least as of the end of the first half of their financial year **and**
  - make their interim financial reports available not later than 60 days after the end of the interim period.

Scope of IAS 34 (Cont'd)

Interim reports should include interim financial statements (condensed or complete) for specific periods.

- You should present income statements for the current interim period and cumulatively for the current financial year to date, with comparative income statements for the comparable interim periods (current and year-to-date) of the preceding financial year.

- You should present the statement of profit or loss and other comprehensive income at the end of the current interim period, and the comparative information in respect of the preceding period as specified in paragraphs 38 and 38A of *IAS 1*.

  Note that the titles of financial statements used are as reflected in IAS 1 *Presentation of Financial Statements*. Entities are permitted to use titles for the statements other than those used in the *IAS 34* (for example, an entity may use "statement of comprehensive income" instead of "statement of profit or loss and other comprehensive income". An entity would be expected to use the same titles in its interim financial report as are used in its annual financial statements.

- You should disclose the statement of changes in equity cumulatively for the current financial year to date, with a comparative statement for the comparable year-to-date period of the financial year which immediately precedes it.

Scope of IAS 34 (Cont'd)

- You should present income statements for the current interim period and cumulatively for the current financial year to date, with comparative income statements for the comparable interim periods (current and year-to-date) of the preceding financial year.

- You should present the statement of profit or loss and other comprehensive income at the end of the current interim period, and the comparative information in respect of the preceding period as specified in paragraphs 38 and 38A of *IAS 1*.

- Note that the titles of financial statements used are as reflected in IAS 1 *Presentation of Financial Statements*. Entities are permitted to use titles for the statements other than those used in the *IAS 34* (for example, an entity may use "statement of comprehensive income" instead of "statement of profit or loss and other comprehensive income". An entity would be expected to use the same titles in its interim financial report as are used in its annual financial statements.

Matters left to local regulators

IAS 34 specifies the **content** of an interim financial report that is described as conforming to International Financial Reporting Standards. However, IAS 34 does not mandate:

- **which entities should publish interim financial reports,**
- **how frequently, or**
- **how soon after the end of an interim period.**

Such matters will be decided by national governments, securities regulators, stock exchanges, and accountancy bodies. [IAS 34.1]

However, the Standard encourages publicly-traded entities to provide interim financial reports that conform to the recognition, measurement, and disclosure principles set out in IAS 34, at least as of the end of the first half of their financial year, such reports to be made available not later than 60 days after the end of the interim period. [IAS 34.1]

Minimum content of an interim financial report

Definition: *IAS 34* defines the **minimum content** of an interim financial report as including condensed financial statements and selected explanatory notes.

IAS 34 does not prohibit or discourage an enterprise from:

- publishing a complete set of financial statements (as described in *IAS 1*) in its interim financial report.
- including in condensed interim financial statements more than the minimum line items, **or**
- including selected explanatory notes as set out in this Standard

The interim financial report is intended to provide an update on the latest complete set of annual financial statements. Accordingly, it focuses on new activities, events, and circumstances and does not duplicate information previously reported.

Bearing this in mind, can you recall what's included in a complete set of financial statements under *IAS 1*?

Components of an Interim financial report

IAS 1 defines a complete set of financial statements as including the components listed below:

- statement of financial position
- statement of profit or loss and other comprehensive income
- statement of changes in equity
- statement of cash flows
- accounting policies and explanatory notes
- comparative information in respect of the preceding period as specified in paragraphs 38 and 38A of *IAS 1*
- a statement of financial position as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements, in accordance with paragraphs 40A-40D of *IAS 1*

Components of an Interim financial report (Cont'd)

Minimum components of an Interim Financial Report

What is the difference between a complete set of interim financial statements under *IAS 1* and a condensed set under *IAS 34*? The major difference is the word "condensed", but additionally no detailed accounting policies need to be disclosed if they are the same as the previous reported period. Let's now look at what "condensed" means under *IAS 34*

So, an entity can adopt one of two different sets of statements from an interim period.

- *A complete set of financial statements*
  - If the entity decides to report a complete set of financial statements, the form and the content of those statements should conform to the requirements of *IAS 1*.
  - In the statement that presents the components of profit or loss for an interim period, an entity shall present basic and diluted earnings per share for that period.

Components of an Interim financial report (Cont'd)

Minimum components of an Interim Financial Report (Cont'd)

- *A condensed set of set of financial statements*
  - If the entity opts for a condensed set, the statements should include, at a minimum:
  - each of the headings and subtotals that were included in its most recent annual financial statements
    and
  - the significant events and transactions and other disclosures, as required in this Standard
  - In the statement that presents the components of profit or loss for an interim period, an entity shall present basic and diluted earnings per share for that period, if the entity is within the scope of IAS 33.

Comparison IAS 1/IAS 34 Presentation

Complete set of financial statements (IAS 1)

(a) statement of financial position;
(b) statement of profit or loss and other comprehensive income;
(c) statement of changes in equity;
(d) statement of cash flows;
(e) accounting policies and explanatory notes, and;
(f) comparative information in respect of the preceding period as specified in paragraph 38 and 38A of IAS 1

Condensed set of financial statements (IAS 34)

(a) condensed statement of financial position;
(b) condensed statement of profit or loss and other comprehensive income;
(c) condensed statement of changes in equity;
(d) condensed statement of cash flows; and
(e) Selected explanatory notes

If the entity decides to report a complete set of financial statements, the form and the content of those statements should conform to the requirements of IAS1.

Recognition

Applying consistent accounting policies

- An entity should apply the same accounting policies in its interim financial statements as are applied in its annual financial statements. The only exception to this is when accounting policy changes are made after the date of the most recent annual financial statements that are to be reflected in the next annual financial statements.
- However, the frequency of an entity's reporting (annual, half-yearly, or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes should be made on a year-to-date basis.
- The principles for recognising assets, liabilities, income and expenses for interim periods are the same as in annual financial statements.

Recognition (Cont'd)

- **Principle:** Under the Conceptual Framework for Financial Reporting (the Framework), recognition is the "process of incorporating in the statement of financial position or statement of comprehensive income an item that meets the definition of an element and satisfies the criteria for recognition".
- The definitions of assets, liabilities, income, and expenses are fundamental to recognition, both at annual and interim financial end of the reporting period.
- In measuring the assets, liabilities, income, expenses, and cash flows reported in its financial statements, an entity that reports only annually is able to take into account information that becomes available throughout the financial year.
- Its measurements are, in effect, on a year-to-date basis

Disclosures

Disclosures are related to the **materiality** of the events.

Materiality should be assessed in relation to the interim period financial data. In making assessments of materiality, you should recognise that interim measurements may rely on estimates to a greater extent than measurements of annual financial data.

Let's look at two definitions of "materiality".

The Framework

- The Preface to IAS states that "*International Accounting Standards are not intended to apply to immaterial items*".
- The Framework states that "*information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements*".

IAS 1 and IAS 8

- IAS 1 requires separate disclosure of material items, including (for example) discontinued operations, and IAS 8 requires changes in accounting estimates, errors, and changes in accounting policies, but does not contain quantified guidance as to materiality.
- Recognition and disclosure should be based on materiality in relation to interim period data to avoid misleading inferences that might result from nondisclosure.

Disclosures (Cont’d)

Conclusion

- While judgement is always required in assessing materiality for financial reporting purposes, *IAS 34* bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures.
- The overriding goal is to ensure that an interim financial report includes all information that is relevant to understanding an enterprise’s:
- financial position at the period end
  and
- performance during the interim period

Questions?


Ask
Answer
Who
Question
Apply
Why
Understand
Where
What
How
When
Answers
Query
Questions