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Partners for Financial Stability Program

International Accounting Standards (IAS) Seminar

Thursday, September 13, 2001
Tallinn, Estonia

In cooperation with

The Estonian Accounting Standards Board

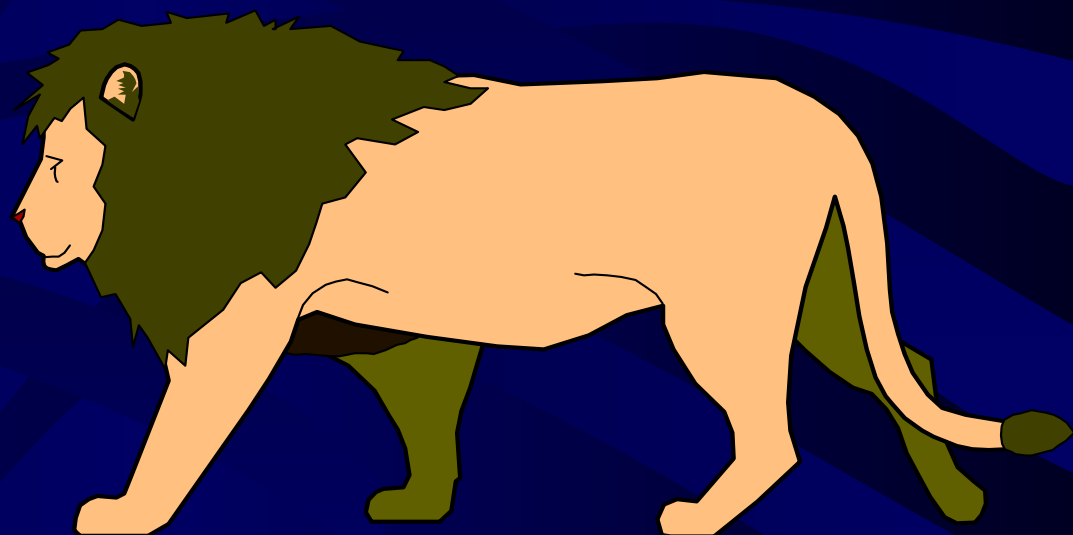
International Accounting Standards (IAS) Seminar

**Thursday, September 13, 2001
Tallinn, Estonia**

- 9:00 - 9:15** **Welcome**
Geoffrey Mazullo
Director, Partners for Financial Stability (PFS) Program
- 9:15 -9:45** **The International Accounting Standards Committee
and the Role of the Standards Advisory Council**
Rita Ilisson
Former Chair, Estonian Accounting Standards Board
And
Member, IASC Standards Advisory Council
- 9:45 - 10:00** **Questions and Discussion**
- 10:00 – 11:00** **Compliance with IAS:**
Lessons from the International Accounting Standards Survey 2000
David Cairns
Director, International Financial Reporting
Author, International Accounting Standards Survey 2000
Senior Visiting Fellow, London School of Economics and Political Science
Secretary-General, International Accounting Standards Committee (1985-94)
- 11:00 - 11:15** *C O F F E E B R E A K*
- 11:15 - 12:30** **Compliance with IAS:**
Lessons from the International Accounting Standards Survey 2000
David Cairns
- 12:30 – 12:45** **Questions and Discussion**
- 12:45 – 14:00** *L U N C H*
- 14:00 – 15:30** **IAS 39 - 41 Financial Instruments, Investment Properties and Agriculture**
David Cairns
- 15:30 - 15:45** **Questions and Discussion**
- 15:45 – 16:15** *C O F F E E B R E A K*
- 16:15 – 16:45** **Panel Discussion on the Implementation of IAS in the Baltic States**
Representatives from Estonia, Latvia, Lithuania
- 16:45 – 17:00** **Closing Remarks:**
Rita Ilisson
- 17:00 – 19:00** **Wine and Cheese**
Hosted by the Estonian Accounting Standards Board

The New International Accounting Standard Setter

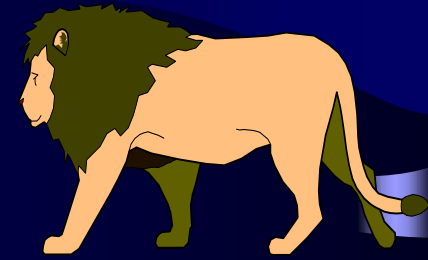
IASC, IASB, SAC, IFRIC



Rita Ilsson

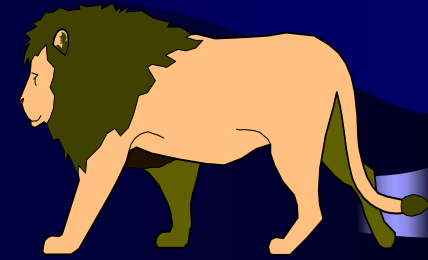
Former Chairman, EASB

Member, IASC Standards Advisory Council



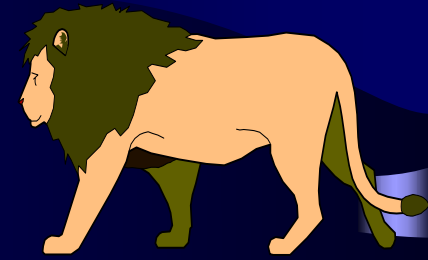
IASC 1973-2000

- Objectives 1973-2001
 - formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and promote their worldwide acceptance and observance
 - work generally for the improvement and harmonisation of regulations, accounting standards and procedures ...
 - do not override local regulations
- Members 1973-2001
 - members of IFAC - persuade and foster acceptance
 - 153 bodies in 112 countries Dec 2000



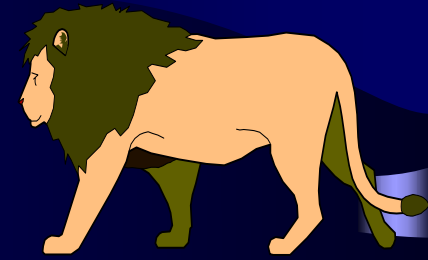
IASC 1973-2000

- Structure 1973-2000
 - Financing - IFAC, accounting firms, board ...
 - Board
 - 13 countries (groups), 4 organisations co-opted
 - member (up to 5 yrs), chairman - 2.5 years
 - issue - discussion documents, exposure drafts, standards (75% vote for)
 - Steering Committees
 - Consultative **Group** (1981)
 - Advisory Council (1995)



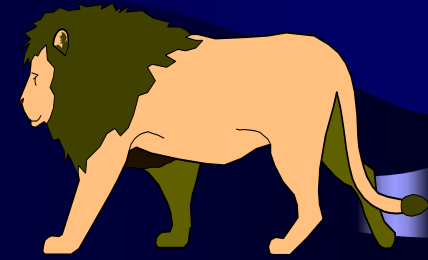
IASC 1973-2000

- 1973-1994
 - principles based standards (31)
 - anglo-saxon truisms
 - alternatives in national standards
 - 1995 - comparability and improvement project
 - revisions (10) - banned certain alternatives
 - 1993 - IOSCO and core standards
 - 7 in pipe-line FI, EPS, Income taxes,
 - impairment and discontinued operations
 - 4 new - interim reporting, R&D, GW, contingencies



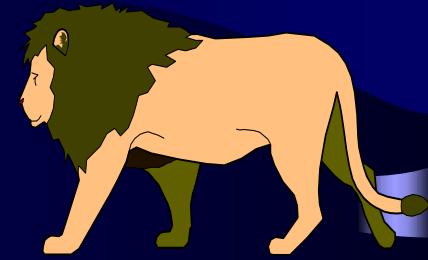
IASC 1973-2000

- European Union
 - 4th (1978) and 7th (1983) Directives
 - 1995 - harmonisation strategy
 - cross-continental listings ? US GAAP
 - join the IASC-IOSCO bandwagon?
 - US GAAP cook-book vs principles-based?
 - 1997 - IAS in the consolidated accounts
 - if still complied with directives
 - if allowed by national legislation
 - possible to merge the directives and IAS?



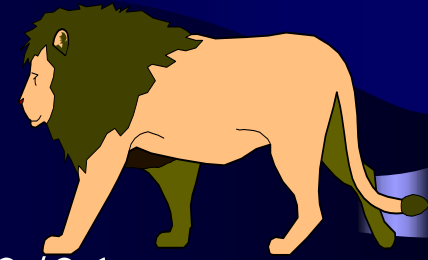
IASC 1973-2000

- IOSCO process culmination May 2000
 - allow the use of 30 IASC standards
 - “supplemental treatments” (120) - reconciliation
 - supplemental disclosure or presentation
 - interpretation - limit alternatives or interpret
 - waivers - 4 issues
 - timing issues and issues outside the scope of IASs
 - may not accept the true and fair override
 - enforcement issues
 - auditing and disclosure standards



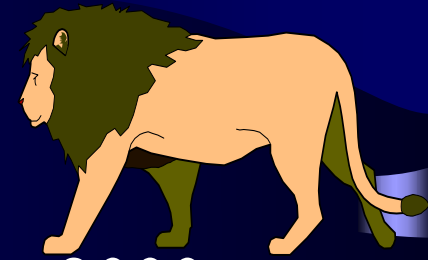
IASB 1973-2000

- SEC
 - comprehensive generally accepted basis of accounting
 - high quality standards - comparability/transparency
 - rigorously interpreted and applied
 - concept release 2000..if foreign firms use IAS
 - competitive disadvantage for US firms?
 - reconciliation to US GAAP - yes 3 /no 2
- G4+1 - UK, US, Canada, NZ + Australia + IASB
 - conceptual framework - prescriptive?
 - leasing, business combinations, share-based payments



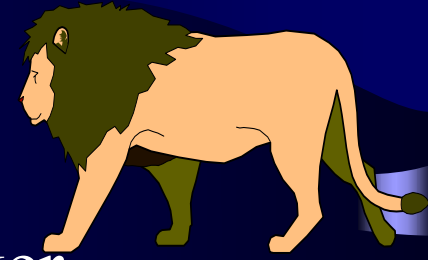
IASC 1973-2000

- European Union process culmination 2000/01
 - all listed EU companies must publish IAS consolidated accounts by 2005
 - amendments to the directives
 - endorsement mechanism
 - Accounting Regulatory Committee (political)
 - European Financial Reporting Advisory Group
 - enforcement infrastructure
 - implementation guidance
 - high quality audit
 - coordinated regulatory oversight



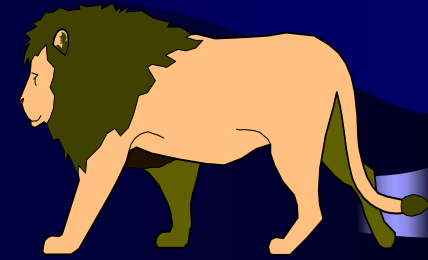
The new IASC

- New constitution - approved by IFAC May 2000
- IASC Objectives 2001 ...
 - develop, in the public interest, single set of high quality, understandable and enforceable global accounting standards ...help participants in the world's capital markets /others make economic decisions
 - promote use of /rigorous application of these standards
 - work actively with national standards setters to bring about **convergence** of national accounting standards and IFRS to high quality solutions
- “The Crucible of Convergence”



The new IASC structure

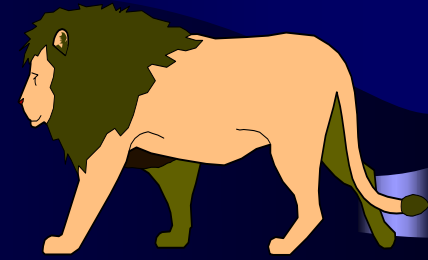
- Trustees (19) - Chairman = Paul A. Volcker
 - appoint Board Chairman - Sir David Tweedie
 - appoint Board (professional), SAC and SIC
 - establish IASC Foundation (US nonprofit 2001)
- IASB (April 2001)
 - 12 full-time + 2 part-time members, 7 national liaisons
 - approve IASs (IFRSs) and Pronouncements
- SAC - Standards Advisory Council - (June 2001)
 - 49 members (6 WB, IMF, IFAC, IOSCO, Basel)
- SIC (IFRAC)
 - 12 members



The new IASC structure

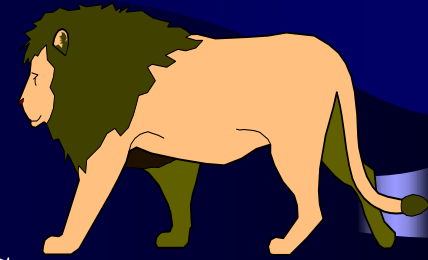
- IASB meetings - 1/mth
- Regular meetings with liaison standard setters
- SAC meetings - 3 x a year
- SIC meetings - 6 x a year
- New Director of Technical Activities and Director of Research
- Technical Staff of 18
- Funding - ample

IASB = The Crucible of Convergence



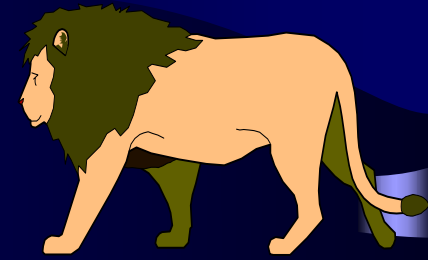
- international acceptance?
 - compromises vs high quality standards?
 - comparability/prescriptiveness/eradicating alternatives?
 - eradicating inconsistencies?
 - framework approach?
 - quality, ease of use and enforceability!
 - level playing field?
- convergence
 - comparable accounting for comparable transactions
 - common conceptual framework
 - eradicating alternative treatments

Initial Agenda of 9 Technical Projects (02.08.01)



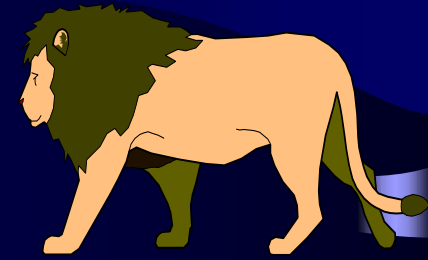
- after consultation with SAC, national ASS
 - leadership and convergence
 - Accounting for Insurance Contracts
 - consistency with the conceptual framework
 - Business Combinations
 - pooling/purchase, goodwill and intangibles
 - amend/replace IAS 22
 - Performance Reporting
 - comprehensive income - display and presentation of all transactions except those related to transactions with owners
 - holding gains/losses, operating/nonoperating items

Initial Agenda of 9 Technical Projects (02.08.01)

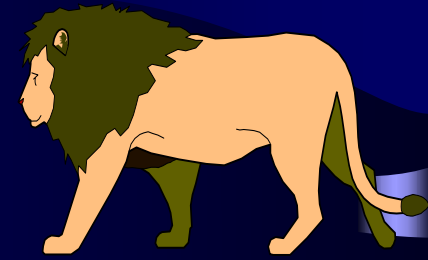


- Accounting for Share-Based Payments
 - discussion paper
 - easier application of IFRSs
- Guidance of First-Time application
 - EEC commitment to require listed companies to apply IFES by 2005
 - retrospective contra prospective application
- Activities of Financial Institutions: Disclosure and Presentation
 - amendments to IAS 30
 - supported by Basel/other financial institutions

Initial Agenda of 9 Technical Projects (02.08.01)



- improvements
 - Preface to IFRSs
 - format and style of future IFRS
 - changes in constitution
 - Improvements to existing IFRS
 - clarity and consistency of IASs
 - IOSCO concerns
 - comparisons of international and national standards
 - Amendments to IAS 39 Financial Instruments:
 - clarify application of IAS 39



Other topics (02.08)

- Other topics
- accounting for financial instruments - comprehensive project
- accounting for leases
- accounting for SMEs and in emerging economies
- accounting for taxes on income
- business combinations phase 2
- impairment of assets
- managements' discussion and analysis



Compliance with IAS

Lessons From the IAS Survey 2000

David Cairns



Compliance with IAS

- ◆ Where are we now?
- ◆ Where are we going?
- ◆ What can we learn?

International Accounting Standards Survey 2000

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Policy - where are we now?

◆ International Accounting Standards

- ◆ significant improvements from 1987 onwards
- ◆ high-quality standards that provide relevant and reliable information for investment decisions

◆ Harmonisation and convergence projects

Policy - where are we now?

- ◆ IOSCO endorsement of 'IAS 2000'
 - ◆ allows use of IAS financial statements for cross-border offerings and other foreign listings
- ◆ SEC concept release on IAS
 - ◆ considers whether to allow foreign issuers in the USA to file IAS financial statements *without a US GAAP reconciliation*

Policy - where are we now?

◆ European Commission

- ◆ allow use of IAS instead of national GAAP (1995)
- ◆ modernise EU Directives to make remove obstacles to full IAS compliance
- ◆ require listed EU companies to publish IAS consolidated financial statements from 2005 subject to EU endorsement process (2000)

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Policy - where are we going?

◆ IASB

- ◆ ‘Best of breed’ standards
- ◆ Convergence of national and international standards through extensive links with national standard setting bodies
- ◆ Greater enforcement of full compliance

Compliance - where are we now?

◆ Country survey

- ◆ use of IAS by major listed companies
- ◆ 30+ countries

◆ Growing number of listed companies use IAS

- ◆ Continental Europe
- ◆ Emerging markets

IAS Survey 2000

Country Survey: Europe

Company use of IAS

- ◆ Only 20% FTSE Eurotop 300
- ◆ Only 30% EASDAQ companies
- ◆ *growing*: Austria, Germany, Switzerland
- ◆ *declining*: France, Nordic countries
- ◆ *virtually none*: Netherlands, Spain, UK
- ◆ *residual standards*: Italy

Company Survey

- ◆ What did we look at?
 - ◆ 1999 IAS financial statements
 - ◆ 165 major listed companies
- ◆ What did we look for?
 - ◆ disclosed level of compliance
 - ◆ undisclosed non-compliance
 - ◆ audit opinions on IAS compliance

Disclosed Level of Compliance

11 different categories of disclosed compliance

- ◆ full compliance (two categories)
- ◆ full compliance with exceptions (two categories)
- ◆ accounting policies comply
- ◆ accounting policies comply with exceptions
- ◆ residual standards
- ◆ selected IAS; summary IAS financial statements
- ◆ reconciliations to/differences from IAS



Full Compliance with IAS

‘The financial statements ... are prepared in accordance and in compliance with IAS.’

Stora Enso (Finland/Sweden)



Full Compliance with IAS

‘The consolidated financial statements have been prepared in conformity with the accounting rules and principles applicable in France ... As applied by the group, these principles conform ... with those of the IASC.’

DMC (France)

Accounting Policies Comply ...

‘The valuation principles applied ... conform with IAS. It should be noted that the notes do not in all respects conform with the disclosure requirements of IAS and therefore the financial statements as a whole are not in full compliance with them.’

Richemont (Switzerland)

IAS Used as Residual Standards

‘Accounting policies are consistent with legislation ... principles established by the Italian accounting profession and, in their absence, by the IASC.’

Olivetti (1999 and 2000)

Other Categories

IAS used for selected items

- ◆ Colruyt, Delhaize, Valeo, ING

Reconciliation from domestic GAAP to IAS

- ◆ Fujitsu, Kajima, Bergesen, Antisoma, SurfControl

Summary IAS financial statements

- ◆ Ceske Radiokumikace, Bank Pekao, Hellenic Telecom

Unquantified differences from IAS

- ◆ Partek, Kajima, Kobe Steel, Sakura Bank, Atlas Copco

Full Compliance with Exceptions

Pension costs

- ◆ Kemira, Metra, TEGE

Development costs

- ◆ Metra, Micronas

Goodwill

- ◆ Wienerberger, Disetronic

Deferred taxes

- ◆ Recordati

Hyperinflation

- ◆ PKN ORLEN

Consolidation

- ◆ OTP Bank

Segment disclosures

- ◆ Erste Bank, SanoChemia, Micronas

Related party disclosures

- ◆ Merck

Initial adoption of IAS

- ◆ Schindler

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Accounting Policies Comply ...

... with Exceptions

Development costs

- ◆ Renault, Compart, Montedison

Deferred taxes

- ◆ Delta Corporation

Hyperinflation

- ◆ Delta Corporation

Consolidation

- ◆ Compart

Treasury Shares

- ◆ Renault

Disclosed Compliance

Where should we be going?

- ◆ Full compliance without exceptions
 - ◆ IAS 1 *Presentation of Financial Statements*
 - ◆ EU enforcement mechanism from 2005
 - ◆ SEC enforcement for IAS registrants
 - ◆ national regulatory authorities

Undisclosed Non-Compliance

- ◆ About 50 presentation, recognition and measurement and disclosure issues
 - ◆ application of IAS
 - ◆ choice of alternatives
 - ◆ impact of new and revised IAS
 - ◆ IAS versus US GAAP information
 - ◆ audit opinions

Presentation

- ◆ Definition of ‘operating profit’ (IAS 1)
 - ◆ profit before finance costs, equity accounted investments and tax
- ◆ Survey results - exclusions
 - ◆ goodwill amortisation
 - ◆ gains and losses on disposals
 - ◆ restructuring costs
 - ◆ impairment losses

Presentation

- ◆ **Extraordinary items (IAS 8)**
 - ◆ clearly distinct from ordinary activities and, therefore, not expected to recur
- ◆ **Survey results - non-compliance**
 - ◆ site abandonment and restoration costs
 - ◆ effects of change in accounting policy
 - ◆ capital gains
 - ◆ merger related expenses

Presentation

- ◆ Cash and cash equivalents (IAS 7)
 - ◆ cash, short-term (3months) deposits/debt securities
- ◆ Survey results - non-compliance
 - ◆ equity securities
 - ◆ unit trust funds
 - ◆ specialised funds
 - ◆ (deduction of) debt other than bank overdrafts

Consolidated Financial Statements

Survey results

- ◆ ‘Parent only’ financial statements
 - ◆ OTP Bank
- ◆ Exclusions from consolidation
 - ◆ temporary control
 - ◆ dissimilar activities
 - ◆ disproportionate expense or delay

Business Combinations

Survey results

- ◆ Use of pooling of interests method
 - ◆ possible acquisitions
- ◆ Application of purchase method
 - ◆ 'book value' method
 - ◆ date of acquisition
 - ◆ acquired assets and liabilities
 - ◆ goodwill

Pooling of Interests Method

◆ BCT.TELUS

- ◆ Canadian/IAS pooling; US GAAP acquisition
- ◆ merger costs to equity (conflicts with IAS 22)

◆ ING

- ◆ Dutch/IAS(?) pooling; US GAAP acquisition

◆ Novartis

- ◆ IAS pooling (pre-SIC 9); US GAAP acquisition

Pooling of Interests Method

Panafon

‘In accordance with IAS, the [cash] acquisition of Panafox was accounted for in a manner similar to the pooling of interests method.’

Deloitte & Touche - unqualified IAS audit opinion

Pooling of Interests Method

Hypo Vereinsbank

- ◆ created by merger of Bayerische Vereinsbank and HYPO-BANK
- ◆ at the merger date, Bayerische Vereinsbank held a 44.2% interest in HYPO-BANK
- ◆ pooling of interests method

KPMG - unqualified IAS audit opinion

Purchase Method

- ◆ **Book value method**
 - ◆ cost of acquisition compared with book values
 - ◆ surplus allocated to assets and liabilities up to fair value
 - ◆ residual is goodwill
- ◆ **Common in Austrian and German companies**
- ◆ **Unqualified IAS audit opinions**

Purchase Method

Adidas

- ◆ acquisition in December 1997
- ◆ consolidated from 1/1/1998
- ◆ wrote off acquired r&d to income statement

KPMG - unqualified IAS audit opinion

Purchase Method

Roche

- ◆ agreed to make acquisition in May 1997
- ◆ regulatory clearances, February/March 1998
- ◆ consolidated from 31/12/1997
- ◆ wrote off acquired r&d and restructuring costs to 1997 income statement

PwC - unqualified IAS audit opinion

Property, Plant and Equipment

- ◆ Upward revaluations (IAS 16)
 - ◆ fair value, up-to-date, classes of assets
- ◆ Survey results - possible non-compliance
 - ◆ partial valuations
 - ◆ out of date valuations
 - ◆ statutory revaluations

Property, Plant and Equipment

- ◆ Depreciation (IAS 16)
 - ◆ systematic basis over useful life
 - ◆ reflect pattern in which asset's benefits consumed
- ◆ Survey results - possible non-compliance
 - ◆ use of tax methods

Depreciation

Schering

‘In Germany, these fixed assets are depreciated at the higher of the declining balance basis and the straight line method ..’

BDO - unqualified IAS audit opinion

Revenue Recognition

- ◆ Rendering of services (IAS 18)
 - ◆ percentage of completion method
- ◆ Survey results - Preussag
 - ◆ Recognise revenue from tour operations
 - ‘by reference to stage of completion of holiday’ (until 1999)
 - ‘as of the start of the holiday’ (from 2000)

Changes in Accounting Policy

Preussag (2000)

- ◆ Revenue from tour operations
- ◆ Costs of brochures and other selling aids
- ◆ Costs of 'empty leg' flights at beginning/end season
- ◆ Inventories (abandons LIFO)

Effects of changes added □ 34 million to profit

Changes in Accounting Policy

Preussag

- ◆ ‘all-time high’ divisional results
- ◆ profit rose by 16.5%

but

- ◆ effects of accounting changes added 10% to profit
- ◆ no IAS 8 pro-forma restatement of prior year

Auditors and IAS Compliance

Audit opinion on IAS compliance (64%)

No audit opinion on IAS compliance (36%)

- ◆ includes 11 companies that claim full IAS compliance
- ◆ includes 12 Italian companies using IAS as residual standards

No Audit of IAS Compliance

BHP	Andersen	Norbert Dentressangle	
BCT.TELUS			PwC
	Andersen	Technip	Andersen
Enbridge	PwC	Pharming	E&Y
DMC	DTT	AECI	D&T, KPMG
Essilor	PwC	Harmony	PwC
Moulinex	Andersen	Iscor	KPMG, PwC

Compliance - where are we going?

Companies should comply fully with IAS

- ◆ eliminate disclosed non-compliance
- ◆ eliminate undisclosed non-compliance ('IAS lite')

When a company uses IAS

- ◆ auditor should express opinion on IAS compliance

Audit opinions should comply with ISA 700



IAS Update



IAS 39, IAS 40 and IAS 41

David Cairns



IAS 39 *Financial Instruments*

Recognition and Measurement





Financial Instruments

Contract that gives rise to both:

- ◆ financial asset of one enterprise; and
- ◆ financial liability of another enterprise.



Financial Asset

- ◆ Cash
- ◆ Contractual right to receive cash or another financial asset
- ◆ Contractual right to exchange financial instruments under potentially favourable conditions
- ◆ Equity instrument of another enterprise

Financial Liability

- ◆ Contractual obligation to deliver cash or another financial asset
- ◆ Contractual right to exchange financial instruments under potentially unfavourable conditions
- ◆ Obligation to deliver own equity securities if total value of equity securities always equals amount of contractual obligation

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Equity Instrument

Any contract which evidences residual interest in assets after deducting all liabilities

Derivatives

Financial instrument

- ◆ whose value changes in response to change in specified ‘underlying’
- ◆ requires little or no initial investment
- ◆ settled at future date

Futures, forwards, swaps, options etc

Hybrid Financial Instruments

Two components

- ◆ embedded derivative
- ◆ host contract

Examples

- ◆ investment in convertible debt
- ◆ put option on an equity instrument held
- ◆ equity/commodity indexed interest

Hybrid Financial Instruments

Account for embedded derivative separately when

- ◆ characteristics different from host contract;
- ◆ would meet definition of derivative; and
- ◆ hybrid instrument not measured at fair value and gains/losses not included in the income statement

Initial Recognition

- ◆ When enterprise is a party to the contractual provisions of instrument
- ◆ ‘Regular way’ contracts - for all purchases and sales, use either
 - ◆ trade date accounting *or*
 - ◆ settlement date accounting

Initial Measurement

◆ Cost

- ◆ fair value of consideration given for asset
- ◆ fair value of consideration received for liability

◆ Include

- ◆ transaction costs
- ◆ hedging gains and losses on hedge of related firm commitment or expected transaction

Subsequent Measurement

- ◆ Held for trading
- ◆ Originated loans and receivables
- ◆ Held-to-maturity investments
 - ◆ an ‘exception’ to the IASC’s intended approach
- ◆ Available-for-sale financial assets
 - ◆ residual category

IAS 39 - Simple Approach

- ◆ Trading and available for sale
 - ◆ measure at fair value
 - ◆ all gains and losses to income statement
- ◆ Originated loans and receivables
 - ◆ amortised cost
- ◆ *No* held to maturity investments
- ◆ *No* hedge accounting

Held for Trading

- ◆ *Acquired or incurred* for generating profit from short-term fluctuations in price or margins
- ◆ Includes all derivatives
- ◆ Cannot be reclassified later

- ◆ Fair value (unless fair value cannot be determined)
- ◆ Gains and losses included in profit

Originated Loans and Receivables

- ◆ Financial assets created by providing money, goods or services to debtor
- ◆ Amortised cost (fixed maturity) or cost
- ◆ Amortisation gains and losses in profit
- ◆ Other gains and losses in profit when assets derecognised or impaired

Held-to-maturity Investments

- ◆ Fixed or determinable payments
- ◆ Fixed maturity
- ◆ Positive *intent* to hold to maturity
- ◆ Positive *ability* to hold to maturity
- ◆ Review at each balance sheet date
- ◆ May reclassify as trading/available for sale

Held-to-maturity Investments

- ◆ Two year ‘sin bin’ for misuse of category
 - ◆ Do not classify *any* financial assets as held-to-maturity if, during two preceding financial years
 - ◆ sold
 - ◆ transferred
 - ◆ exercised put option
- any held-to-maturity investments

Held-to-maturity Investments

- ◆ Amortised cost (fixed maturity) or cost
- ◆ Amortisation gains and losses in profit
- ◆ Other gains and losses in profit when:
 - ◆ investments derecognised
 - ◆ investments impaired

Available for Sale Investments

- ◆ Residual category
- ◆ Fair value unless cannot be determined
- ◆ Gains and losses in *either*:
 - ◆ profit *or*
 - ◆ equity until disposal or impairment when transferred to profit

Fair Value

Exchanged or settled between knowledgeable parties in an arm's length transaction

- ◆ Published prices
- ◆ Rated debt instruments when cash flows can be estimated
- ◆ Appropriate valuation models
- ◆ Bid price for asset to be acquired
- ◆ Offer price for asset to be sold
- ◆ Excludes transaction costs

Amortised Cost

Amount at initial recognition adjusted by amortisation of difference between initial amount and maturity amount

- ◆ Use effective interest rate
- ◆ Use same interest rate for impairment
- ◆ Deal with foreign exchange rates and differences in accordance with IAS 21

De-recognition of Assets

- ◆ De-recognise asset (or portion of asset) only when lose control of contractual rights that comprise the asset (or portion of asset)
- ◆ Lose control when
 - ◆ realise rights to benefits
 - ◆ rights expire
 - ◆ surrender rights

De-recognition of Assets

Not lost control when

- ♦ retain right to reacquire the asset; and
 - ♦ asset *not* readily obtainable in market
- or*
- ♦ retain right to reacquire the asset; and
 - ♦ cost of reacquisition will *not* be market value at the time of re-acquisition

De-recognition of Assets

Not lost control when

- ♦ entitled *and* obligated to repurchase asset on basis of paying ‘lender’s return’ *or*
- ♦ retain risks and rewards of ownership through
 - ‘total return swap’ with transferee
 - unconditional put option held by transferee

De-recognition of Liability

- ◆ De-recognise liability only when liability (or portion of liability) extinguished
- ◆ Liability extinguished when
 - ◆ payment made
 - ◆ legal release of obligation
 - ◆ expiry of obligation

Hedge Accounting

- ◆ Hedging instrument
- ◆ Hedged item
 - ◆ specific and identified risk
 - ◆ affects profit or loss
 - ◆ *not* enterprise business risks
- ◆ Hedging relationship

Hedging Instrument

- ◆ Fair values or cash flows expected to offset changes in fair value or cash flows of hedged position
- ◆ Can be:
 - ◆ Derivatives (other than written options)
 - ◆ Written options (only to hedge purchased options)
 - ◆ Non-derivative financial assets and liabilities (only to hedge foreign currency risks)

Hedged Item

- ◆ Exposure to risk of changes in fair value or cash flows
- ◆ Designated as being hedged
- ◆ Can be:
 - ◆ Asset
 - ◆ Liability
 - ◆ Firm commitment
 - ◆ (Highly probable) forecasted future transaction

Hedging Relationship

- ◆ Formal documentation *at the inception of the hedge*
- ◆ Hedge expected to be highly effective
- ◆ Effectiveness of hedge can be measured reliably
- ◆ Regular assessment of effectiveness

Hedges

Fair value hedge

- ◆ exposure to changes in *fair value*
- ◆ recognised asset or liability

Cash flow hedge

- ◆ exposure to variability in *cash flows*
- ◆ recognised asset or liability
- ◆ *forecasted transaction*

Fair Value Hedges

- ◆ Hedging instrument and hedged item at fair value, with gains and losses included in profit
 - ◆ no problems
- ◆ Example:
 - ◆ hedged item is debt security held for trading
 - ◆ hedging instrument is interest rate swap

Fair Value Hedges

- ◆ Hedged position and hedging instrument at fair value
 - ◆ gains and losses on hedged position to equity
 - ◆ gains and losses on hedging item to profit
- ◆ Include gains and losses on hedged position in profit
- ◆ Example
 - ◆ hedged item is ‘available for sale’ debt security
 - ◆ hedging instrument is interest rate swap

Fair Value Hedges

- ◆ Hedged position at cost or amortised cost
- ◆ Hedging instrument at fair value
- ◆ Re-measure hedged position to fair value
- ◆ Include gains and losses on hedged position in profit
- ◆ Example
 - ◆ hedged item is long-term debt
 - ◆ hedging instrument is interest rate swap

Cash Flow Hedges

- ◆ Hedged position is asset or liability
- ◆ Hedging instrument is derivative
- ◆ Reclassify gains and losses on hedging instrument
 - ◆ include gains and losses in equity
 - ◆ include ineffective portion in profit

Cash Flow Hedges

- ◆ Hedged position is asset or liability
- ◆ Hedging instrument is *not* a derivative
- ◆ Reclassify gains and losses on hedging instrument
 - ◆ include gains and losses in equity
 - ◆ include ineffective portion in profit *or* equity

Cash Flow Hedges

- ◆ Hedged position is firm commitment or forecasted transaction
- ◆ If asset or liability results
 - ◆ include gains and losses on hedging instrument in 'cost' of asset or liability
 - ◆ (if necessary) include gains and losses in equity until asset/liability acquired

Cash Flow Hedges

- ◆ Hedged position is firm commitment or forecasted transaction
- ◆ If asset or liability does *not* result
 - ◆ include gains and losses on hedging instrument in profit when commitment or transaction affects profit
 - ◆ (if necessary) include gains and losses in equity until commitment/transaction occurs

IAS 39 - Simple Approach

- ◆ Trading and available for sale
 - ◆ measure at fair value
 - ◆ all gains and losses to income statement
- ◆ Originated loans and receivables
 - ◆ amortised cost
- ◆ *No* held to maturity investments
- ◆ *No* hedge accounting



IAS 40 *Investment Property*



Investment Property

- ◆ Land or buildings
- ◆ Held as owner or under finance lease:
 - ◆ to earn rentals and/or for capital appreciation
- ◆ *Excludes* land and buildings
 - ◆ used for business (including property trading)
 - ◆ in course of construction or development
 - ◆ held under operating lease

Initial Recognition

- ◆ Probable that future economic benefits associated with property will flow to the enterprise
- ◆ Cost can be measured reliably

Same criteria as IAS 16

Initial Measurement

- ◆ Cost
- ◆ Cost includes:
 - ◆ purchase price
 - ◆ transaction costs
 - ◆ borrowing costs (IAS 23 ‘benchmark treatment’)

Same requirements as IAS 16

Subsequent Measurement

◆ Fair value model

- ◆ measure at fair value at each balance sheet date
- ◆ include all gains and losses in income statement

◆ Cost model

- ◆ measure at cost less depreciation and impairment losses (same as IAS 16)
- ◆ disclose fair value

Fair Value

Exchanged or settled between knowledgeable willing parties in an arm's length transaction

- ◆ Market value as at balance sheet date
- ◆ *Excludes*
 - ◆ effects of special financing terms or circumstances
 - ◆ transaction costs

Transfers and Disposals

- ◆ **Changes in circumstances may require:**
 - ◆ transfer of investment property to property (IAS 16) or inventories (IAS 2)
 - ◆ transfer of property (IAS 16) to investment property
- ◆ **On disposal or permanent withdrawal from use:**
 - ◆ eliminate from balance sheet
 - ◆ include gain or loss in income statement



IAS 41 *Agriculture*



Agricultural Activity

- ◆ Management of the biological transformation of biological assets:
 - ◆ for sale
 - ◆ into agricultural produce
 - ◆ into additional biological assets

Agricultural Activity

- ◆ **Biological asset**
 - ◆ living animal
 - ◆ plant
- ◆ **Agricultural produce**
 - ◆ harvested product of biological assets

IAS 41 *Agriculture*

◆ Applies to:

- ◆ biological assets
- ◆ agricultural produce at point of harvest
- ◆ related government grants

◆ Does *not* apply to:

- ◆ land related to agricultural activity (see IAS 16)
- ◆ agricultural produce after harvest (apply IAS 2)

Initial Recognition

- ◆ Controls biological asset/agricultural produce as a result of past events
 - ◆ includes purchase, growth, birth of new animals
- ◆ Probable that future economic benefits associated with asset will flow to the enterprise
- ◆ Fair value or cost can be measured reliably

Measurement

Biological assets

- ◆ Measure at fair value less point-of-sale costs
- ◆ All gains and losses in income statement
- ◆ If fair value cannot be measured reliably
 - ◆ measure at cost less any depreciation and any impairment losses
 - ◆ *possible only on initial recognition*

Measurement

Harvested agricultural produce

- ◆ Fair value less point-of-sale costs
- ◆ All gains and losses in income statement
- ◆ ‘Cost’ for subsequent application of IAS 2
- ◆ *No exception - fair value can always be measured reliably*



Fair Value

- ◆ Active market - use quoted price in market
- ◆ No active market - consider:
 - ◆ most recent market transaction price
 - ◆ market prices for similar assets
 - ◆ sector benchmarks
 - ◆ present value of expected future cash flows



Point-of-sale Costs

◆ Includes:

- ◆ commissions
- ◆ levies
- ◆ transfer taxes and duties

◆ *Excludes:*

- ◆ cost of transport to market

Government Grants

Biological asset carried at fair value

- ◆ Unconditional government grants
 - ◆ recognise as income when grant becomes receivable
- ◆ Conditional government grants
 - ◆ recognise as income when conditions are met



IAS 41 *Agriculture*

