Revaluation of assets
Table of Contents

We shall be looking at the treatment of revaluation in relation to the following;

• Revaluation of property plant and equipment (IAS16/IPSAS 17)

• Revaluation of Investment Property (IAS 40)

• Revaluation of Intangible Assets (IAS 38)

• Revaluation of Financial Instruments (IFRS 9)
Revaluation of Assets
Revaluation of property plant and equipment

• As per the revaluation model, assets can be carried in the books of accounts at fair value at date of revaluation less subsequent accumulated depreciation and impairment losses
• Fair value is usually market value as determined by professionally qualified valuers
• Revaluations shall be made with sufficient regularity such that the carrying amount does not differ materially from that which would be determined using fair value at the reporting date
• Must revalue ALL assets within class
• Revalued assets must continue to be depreciated
Accounting treatment of revaluations

- If the first time an asset is revalued is upwards, the revaluation surplus goes directly to equity under the heading of revaluation reserve (through OCI).
- Subsequent drops in value are recognised in profit or loss except in so far as covered by previous revaluation surpluses on the same asset.
- If the first time an asset is revalued is downwards, the decrease should be recorded as an expense.
- Subsequent reversals of losses are recognised in profit or loss.
## Revaluations - summary

<table>
<thead>
<tr>
<th></th>
<th>Surplus</th>
<th>Deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>First Revaluation</strong></td>
<td>Credit to equity (Include in ‘Other Comprehensive Income’)</td>
<td>Charge to SPLOCI in arriving at profit/loss</td>
</tr>
<tr>
<td><strong>Subsequent Revaluation</strong></td>
<td>Credit to equity (‘OCI’) unless reverses a previous deficit, then credit to SPLOCI in arriving at profit/loss</td>
<td>Debit to SPLOCI in arriving at profit/loss unless reverses a previous surplus, then charge to equity</td>
</tr>
</tbody>
</table>
Example

The following details are available in relation to a non-specialised property:

Carrying value  €960,000
Depreciated historic cost  €800,000
Open market value  €760,000
Existing use value  €700,000

Requirement
What revaluation loss would be recorded and how should this loss be accounted for?
Example: Suggested solution

- **Book value**: €960k
- **Deprec. historic cost**: €800k
- **Market value**: €760k

-- **Revaln Res.**: €160,000
-- **SPLOCI – P/L**: €40,000

- **DR** Equity – RR: €160,000
- **DR** SPLOCI – P/L: €40,000
- **CR** Non-current assets: €200,000
Example: First time downwards revaluation and subsequent upwards revaluation

Ben Limited, a company that prepares its financial statements to 31 March each year, purchased a tangible non-current asset for €200,000 on 1 April 2009. Depreciation is charged at 10% SL. The carrying value at 31 March 2011 is therefore €160,000, before taking account of a revaluation on this date, which showed a valuation of €130,000.

Requirement
How should this be reflected in the financial statements of Ben Limited for the years ended 31 March 2011 to 2013.
Examples: First time downwards revaluation and subsequent upwards revaluation

Solution
Dr SPLOCI – P/L €30,000
Cr Non-current asset €30,000

Depreciation per annum for the year ending 31 March 2012 and 2013:

\[
\frac{€130,000}{8} = €16,250
\]

If the asset was revalued to €120,000 on 31 March 2013:

Net Book Value 31 March 2013 (before valuation on this date):

\[
= €130,000 - (2 \times €16,250) = €97,500
\]

Dr Non-current asset €22,500
Cr SPLOCI – P/L €22,500

*The revaluation increase can be recognised in arriving at profit/loss to the extent of previous revaluation deficits in respect of the same asset (a further €7,500 of upwards revaluations may still be credited to SPLOCI – P/L).*
Depreciation/accumulated depreciation of revalued assets

Depreciation is calculated on the carrying amount of the asset

When PPE is revalued, any accumulated depreciation at the date of revaluation is treated in one of the following ways:

- The accumulated depreciation is restated proportionately with the gross carrying amount, so that the carrying amount after the revaluation equals the revalued amount; or
- The accumulated depreciation is eliminated against the gross carrying amount and the net amount restated to the revalued amount.
Depreciation and the revaluation reserve

- Companies have the option of transferring some of the revaluation gain/surplus from the revaluation reserve to retained earned earnings (through OCI) to offset the higher/additional depreciation.

- The amount transferred is the difference between depreciation based on the revalued carrying amount and depreciated calculated based on the asset’s original cost.
Revaluation of PPE

PRACTICAL CASE STUDY:

<table>
<thead>
<tr>
<th>Details</th>
<th>KES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of the Property as at 1 Jan 2014</td>
<td>309,404</td>
</tr>
<tr>
<td>Revalued Amount at At 31 Dec 2014</td>
<td>665,000</td>
</tr>
<tr>
<td>Accumulated Depreciation 1 Jan 2014</td>
<td>7,716</td>
</tr>
<tr>
<td>Charge for the year</td>
<td>7,703</td>
</tr>
<tr>
<td>Accumulated Depreciation 31 Dec 2014</td>
<td>15,419</td>
</tr>
</tbody>
</table>
Revaluation of PPE

PRACTICAL CASE STUDY:

QUESTION:
Based on the information provided, how will the extract of the following be:

- Property, Plant and Equipment Schedule.
- Statement of financial performance.
- Statement of changes in Equity.
- Excess Depreciation.
- Deferred taxation note.
Revaluation of PPE

**Guide:**

<table>
<thead>
<tr>
<th>Surplus from Revaluation</th>
<th>665,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revaluation</td>
<td>665,000</td>
</tr>
<tr>
<td>Cost</td>
<td>309,404</td>
</tr>
<tr>
<td>Less Accumulated Depreciation</td>
<td>- 15,419</td>
</tr>
<tr>
<td>Net Book Value</td>
<td>293,985</td>
</tr>
<tr>
<td>Surplus</td>
<td>371,015</td>
</tr>
<tr>
<td>Deferred tax there on @ 30%</td>
<td>111,305</td>
</tr>
<tr>
<td>Net effect</td>
<td>259,710</td>
</tr>
</tbody>
</table>
### Revaluation of PPE

**Extract from the Statement of Financial Performance:**

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sh’000</td>
<td>Sh’000</td>
</tr>
<tr>
<td><strong>OTHER COMPREHENSIVE INCOME/ (LOSS):</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Surplus arising from revaluation of land and</td>
<td>371,015</td>
<td>-</td>
</tr>
<tr>
<td>buildings</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred taxation on revaluation surplus</td>
<td>(111,305)</td>
<td>-</td>
</tr>
<tr>
<td>Exchange loss on translation of net assets of</td>
<td>(41,946)</td>
<td>(16,374)</td>
</tr>
<tr>
<td>subsidiaries to presentation currency</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>217,764</td>
<td>(16,374)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
# Revaluation of PPE

**Extract from the Statement of Changes in Equity:**

<table>
<thead>
<tr>
<th></th>
<th>Share capital</th>
<th>Share premium</th>
<th>Revaluation surplus</th>
<th>Revenue reserve/deficit</th>
<th>Translation reserve</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Shs‘000</td>
<td>Shs‘000</td>
<td>Shs‘000</td>
<td>Shs‘000</td>
<td>Shs‘000</td>
<td>Shs‘000</td>
</tr>
<tr>
<td><strong>At 1 January 2014</strong></td>
<td>7,724</td>
<td>33,515</td>
<td>155,391</td>
<td>(359,763)</td>
<td>43,533</td>
<td>(119,600)</td>
</tr>
<tr>
<td><strong>Total comprehensive income</strong></td>
<td>-</td>
<td>-</td>
<td>259,710</td>
<td>337,768</td>
<td>(41,946)</td>
<td>555,532</td>
</tr>
<tr>
<td><strong>Transfer of excess depreciation</strong></td>
<td>-</td>
<td>-</td>
<td>(4,385)</td>
<td>4,385</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>Deferred tax on excess depreciation</strong></td>
<td>-</td>
<td>-</td>
<td>1,315</td>
<td>(1,315)</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td><strong>At 31 December 2014</strong></td>
<td>7,724</td>
<td>33,515</td>
<td>411,998</td>
<td>(18,925)</td>
<td>1,587</td>
<td>435,932</td>
</tr>
</tbody>
</table>
### Revaluation of PPE

**Extract from the Property, Plant and Equipment:**

<table>
<thead>
<tr>
<th>Cost</th>
<th>Freehold</th>
<th>Buildings on leasehold</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sh’000</td>
<td>Sh’000</td>
<td>Sh’000</td>
</tr>
<tr>
<td><strong>At 1 January 2014</strong></td>
<td>134,000</td>
<td>175,404</td>
<td>309,404</td>
</tr>
<tr>
<td><strong>Revaluation</strong></td>
<td>81,000</td>
<td>274,596</td>
<td>355,596</td>
</tr>
<tr>
<td><strong>At 31 December 2014</strong></td>
<td>215,000</td>
<td>450,000</td>
<td>665,000</td>
</tr>
</tbody>
</table>
# Revaluation of PPE

## Extract from the Property, Plant and Equipment:

<table>
<thead>
<tr>
<th>Depreciation</th>
<th>Freehold</th>
<th>Buildings on land and leasehold</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sh’000</td>
<td>Sh’000</td>
</tr>
<tr>
<td><strong>At 1 January 2014</strong></td>
<td>3,300</td>
<td>4,416</td>
</tr>
<tr>
<td><strong>Charge for the year</strong></td>
<td>3,300</td>
<td>4,403</td>
</tr>
<tr>
<td><strong>Eliminated on revaluation</strong></td>
<td>(6,600)</td>
<td>(8,819)</td>
</tr>
<tr>
<td></td>
<td>(15,419)</td>
<td></td>
</tr>
<tr>
<td><strong>At 31 December 2014</strong></td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

Total:

<table>
<thead>
<tr>
<th></th>
<th>Sh’000</th>
<th>Sh’000</th>
<th>Sh’000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>At 1 January 2014</strong></td>
<td>7,716</td>
<td>7,716</td>
<td>7,716</td>
</tr>
<tr>
<td><strong>Charge for the year</strong></td>
<td>7,703</td>
<td>7,703</td>
<td>7,703</td>
</tr>
<tr>
<td><strong>Eliminated on revaluation</strong></td>
<td>(15,419)</td>
<td>(15,419)</td>
<td>(15,419)</td>
</tr>
</tbody>
</table>
### Revaluation of PPE

**Extract from the Note on Deferred Tax:**

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>At 1 January 2014</td>
<td>52,701</td>
<td></td>
</tr>
<tr>
<td>Credit for the year</td>
<td>(426)</td>
<td></td>
</tr>
<tr>
<td><strong>Deferred tax on revaluation surplus</strong></td>
<td>(111,305)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>---</td>
</tr>
<tr>
<td>At 31 December 2014</td>
<td>(59,030)</td>
<td></td>
</tr>
</tbody>
</table>

## Revaluation of PPE

Extract from the Note on Deferred Tax:

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General inventories provision</td>
<td>7,955</td>
<td>14,439</td>
</tr>
<tr>
<td>General bad debts provision</td>
<td>29,339</td>
<td>29,339</td>
</tr>
<tr>
<td>Unrealised exchange loss</td>
<td>30,210</td>
<td>-</td>
</tr>
<tr>
<td>Tax losses available for future offset</td>
<td>41,034</td>
<td>76,905</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accelerated capital allowances</td>
<td>-1,456</td>
<td>-2,721</td>
</tr>
<tr>
<td>Revaluation surplus on investment property</td>
<td>-166,147</td>
<td>-49,916</td>
</tr>
<tr>
<td>Unrealised exchange gain</td>
<td>0</td>
<td>-15,345</td>
</tr>
<tr>
<td></td>
<td>-59,030</td>
<td>52,701</td>
</tr>
</tbody>
</table>

=====  =====
Revaluation of Assets

Investment Property
INVESTMENT PROPERTY

Definition:
An investment property is property (land or a building – or part of a building – or both) that meets the following conditions:

(a) the property is held to earn rentals or for capital appreciation or both

Rather than for:

(i) use in the production or supply of goods or services or for administrative purposes; or
(ii) sale in the ordinary course of business.
INVESTMENT PROPERTY

Investment property also includes those:

• held by a lessee under a finance lease
• held by a lessee under an operating lease where certain conditions are met
• held by a lessor and rented out under an operating lease
When is property investment property?

**YES**

- Land held for Long Term capital appreciation rather than Short Term sale in the ordinary course of business;
- Land held for a currently, undetermined future use;
- Building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases;
- Building that is vacant but is held to be leased out under one or more operating leases; and
- Property being constructed or developed for future use as investment property.

**NO**

- Property intended for sale in the ordinary course of business or in the process of construction or development for such sale (Inventories);
- Property being constructed or developed on behalf of third parties (*Construction Contracts*);  
- Owner-occupied property (*Property, Plant and Equipment*); and
- Property leased to another entity under a finance lease.
Initial recognition and measurement

• Investment property should be recognised initially as an asset when and only when:
  ➢ it is probable that the future economic benefits that are attributable to the investment property will flow to the entity; and
  ➢ the cost of the investment property can be measured reliably.

• Investment property should initially be measured at cost. This includes the purchase price and any directly attributable expenditure (e.g. professional fees and property taxes).
Measurement after initial recognition

- An entity has the choice between the:
  - Fair value model
  - Cost model

- The selected policy should be applied to all investment properties

- Fair value model
  - Price at which the property could be exchanged between knowledgeable willing parties in an arm’s length transaction
  - No depreciation
  - Gains or losses should be recognised in arriving at profit or loss

- Cost model
  - At cost less accumulated depreciation
Applying the fair value model

Floyd Limited commenced trading on 1 January 2012 and its non-current assets at 31 December 2012 include two investment properties, Gilmore and Waters, that are let on an arm’s length basis to a third party. Floyd Limited applies the fair value model in accounting for investment properties, which are professionally valued for the first time on 31 December 2012. The valuation details are as follows:

<table>
<thead>
<tr>
<th>Property</th>
<th>Cost €m</th>
<th>Fair value €m</th>
<th>Increase / (Decrease) €m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gilmore</td>
<td>210</td>
<td>345</td>
<td>135</td>
</tr>
<tr>
<td>Waters</td>
<td>390</td>
<td>280</td>
<td>(110)</td>
</tr>
</tbody>
</table>

**Requirement**

Explain and set out the journal entries necessary to record the movements between cost and fair value in respect of each of the properties for the period ended 31 December 2012.
Applying the fair value model

Suggested Solution:
Under the fair value model, changes in valuation are taken to the Statement of profit or loss and other comprehensive income – profit or loss:

*Gilmore*

DR Investment Property  €135m
CR SPLOCI – P/L Gain on Investment Property  €135m

*Waters*

DR SPLOCI – P/L Loss on Investment Property  €110m
CR Investment Property  €110m
Applying the cost and fair value models

ABC, a manufacturing company, purchases a property for €1m on 1 January 2012 for its investment potential. The land element of the cost is believed to be €400,000 and the buildings element is expected to have a useful life of 50 years. At 31 December 2012, local property indices suggest that the fair value of the property has risen to €1.1m.

Requirement
Show how the property would be presented in the financial statements as at 31 December 2012 if ABC adopts the fair value model.
Example: Applying the cost and fair value models

**Suggested Solution:**

Statement of Financial Position = property shown at fair value of €1.1m; and
Statement of Profit or Loss and Other Comprehensive Income = gain of €0.1m representing the fair value adjustment.
Example

Kerr Limited holds a building for its investment potential. This building originally cost €250,000.

The fair value at 31 December 2012 was €500,000. At 31 December 2013 the fair value has risen to €600,000.

The property was purchased on 1 January 2009. Assume a useful economic life of 25 years.

How should this change in fair value be accounted?
Example: Suggested Solution

Fair Value Model:

• Carry at fair value (2012 = €500,000; 2013 = €600,000)

• Gain of £100,000 to Statement of Profit and Loss and Other Comprehensive Income
Note on Investment Property

• If the property is being held to earn rentals or for capital appreciation in future then it qualifies to be an investment property.

• If the building/offices to be built are to be used by the entity for service delivery objectives (100%) then the property should be accounted as PPE and not investment property.
Note on Investment Property

• If the use is not 100% and is insignificant then the property qualify to be an Investment Property.

• Judgment need to be used to determine whether the portion is significant or not. 

*IPSAS 16: Par 14 and 18.*
Revaluation of Assets
Intangible Assets
Definition Of Intangible Assets

These are assets that have the following characteristics;

a. with future economic benefits,

b. no physical substance,

c. with high degree of uncertainty concerning the future benefit.
Common Examples of Intangibles

- Patents,
- copyrights,
- franchises,
- start-up costs,
- trade names,
- trademarks,
- goodwill etc..
Measurement

• Intangible assets are usually measured using the cost model

• An entity may choose to revalue (measure the asset at fair value), only if fair value can be determined by reference to an active market.
  
  • *If an intangible asset is revalued, all assets within that class of intangible assets must be revalued.*
  
  • *The principles of the revaluation model in IAS 16 apply to IAS 38.*
Measurement (Contd.)

• An intangible asset with a finite useful life is amortised.

• An intangible asset with an indefinite useful life
  • is not amortised
  • is tested annually for impairment.
Costs of Intangibles

• Costs of Intangibles include acquisition costs plus any other expenditures necessary to make the intangibles ready for the intended uses (i.e., purchase price, legal fees, filing fees etc.; not including internal R&D).

• Essentially, the accounting treatment of valuation for intangibles closely parallels that followed by tangible assets.
Intangibles Assets with Finite lives

- **Patents** (20 years), **copyrights** (the life of the creator plus 70 years), **franchise and license** (the contractual life).

- The costs are subjected to amortization (a process of cost allocation) over the **shorter** of the legal or useful life, not to exceed 40 years.
Amortization of Intangibles

- The impairment test needed only when events indicate that the book value may not be recoverable.

- Amortization Method: Straight-line method.

- Other method can be applied if it is more appropriate than the S-L method.

- Residual value: Usually zero.
Amortization of Intangibles (contd.)

Journal Entry:

Amortization Expense \( xxx \)

Intangible Asset \( xxx \)

(or Accumulated Amortization)
Intangibles Assets with Indefinite Lives

- Trade names, trademarks, goodwill, in-process R&D.
- The costs are **not** subject to amortization.
- Impairment test is required at least annually.
Computer Software Costs

- Computer software costs including planning, designing, coding, testing, documentation and preparation of training materials.

- Expense **most** of the costs if the software is to be **sold**.
Costs Associated With a Software

- Costs occurred after the establishment of technological feasibility but before the software is ready for general release are capitalized as an intangible asset.

- Costs occurred after the software is ready for general release and production are recognized as produce costs (will be expensed as CGS later).
Impairment of Intangible Assets

Thus, when changes in circumstances indicate that the book value of the intangibles may not be reconcilable (i.e., fair value of intangible < carrying amount), a write-down should be performed to recognize the loss.
Impairment of Intangible Assets (contd.)

Example:
Carrying amount of a copyright $1,200,000
Fair value 500,000
Loss on Impairment $700,000

The journal entry to record the loss:
Loss on Impairment 700,000
Copyright 700,000
Revaluation of assets

Financial Instruments
Financial instrument
This is a contract that gives rise to a **financial asset** of one entity and a **financial liability** or **equity instrument** of another entity.

Financial asset
This is any asset that is:
- cash;
- an equity instrument of another entity;
- a contractual right:
  - to receive cash or another financial asset from another entity; or
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
a contract that will or may be settled in the entity’s own equity instruments and is:

- a non-derivative for which the entity is or may be obliged to receive a variable number of the entity’s own equity instruments; or
- a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity’s own equity instruments. For this purpose the entity’s own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity’s own equity instruments.
Financial liability
This is any liability that is:
a contractual obligation:
  ➢ to deliver cash or another financial asset to another entity; or
  ➢ to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
a contract that will or may be settled in the entity’s own equity instruments.

Equity instrument
This is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.
Definition of a financial instrument

Explain whether each of the following meet the definition of a financial instrument:

(a) Issue of ordinary share capital
(b) Issue of debt
(c) Sale of goods on credit
(d) Purchase of goods on credit
Solution

(a) Issue of ordinary share capital represents an **equity instrument** since the shareholders own a financial asset and the company has an equity instrument in the form of new share capital.

(b) Issue of debt creates a **contractual obligation** between the company and the lender for the debt to be repaid in the future. Therefore the company has a financial liability and the lender has a financial asset.

(c) Sale of goods on credit creates a **contractual obligation** between the customer and the company. The customer has a financial liability and the company has a financial asset.

(d) Purchase of goods on credit creates a **contractual obligation** on the part of the company to pay for the goods. Therefore the company has a financial liability and the supplier has a financial asset.
A financial instrument should be classified as either an *equity instrument* or a *financial liability* according to the substance of the contract, not its legal form.

An entity must make this decision at the time the instrument is initially recognised and the classification cannot be subsequently revised based on changed circumstances.
Equity instrument or financial liability

A financial instrument is *an equity instrument only if*:

- the instrument includes *no contractual obligation* to deliver cash or another financial asset to another entity; and

- if the instrument will or may be settled in the issuer’s own equity instruments, it is either:
  - a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
  - a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.
MEASUREMENT OF FINANCIAL ASSETS

In accordance with IFRS 9, financial assets may be classified under the following three headings:

1. Financial assets measured at FVTPL
2. Financial assets measured at fair value through other comprehensive income (FVTOCI)
3. Financial assets measured at amortised cost

Classification is made at the time the financial asset is initially recognised, namely when the entity becomes a party to the contractual provisions of the instrument.
1. Financial assets measured at FVTPL

Default classification

Initially measured at fair value, with transaction costs being expensed as incurred in arriving at profit or loss in the period

Financial assets measured at FVTPL include:

- financial assets *held for trading* purposes;
- *derivatives*, unless they are part of a properly designated hedging arrangement (*see Derivatives later*); and
- *debt instruments*, unless they have been correctly designated to be measured at amortised cost
A debt security that is held for trading is purchased for €8,000. Transaction costs are €600. The initial carrying amount is €8,000 and the transaction costs of €600 are expensed.

This treatment applies because the debt security is classified as held for trading and, therefore, measured at fair value with changes in fair value recognised in profit or loss (i.e. measured at FVTPL).
Financial asset at FVTPL

An entity acquires for cash 1,000 shares at €10 per share and can designate them as at fair value through profit or loss. At the year end 31 December 2012, the quoted price increases to €16. The entity sells the shares €16,400 on 31 January 2013.
## Financial asset at FVTPL

### Initial recognition:
- **DR Financial assets at FVTPL** €10,000
- **CR Cash** €10,000

### 31 December 2012:
- **DR Financial assets at FVTPL** €6,000
- **CR SPLOCI – P/L** €6,000

### 31 January 2013:
- **DR Cash** €16,400
- **CR Financial assets at FVTPL** €16,000
- **CR SPLOCI – P/L** €400
2. Financial assets measured at FVTOCI

Default = SFP @ FV and value changes recognised in SPLOCI – P/L (i.e. FVTPL).

However, at initial recognition, an entity may make an **irrevocable** election to report **value changes** in OCI; only dividend income is recognised in arriving at profit or loss in the period.

This applies to **equity instruments only**. It will typically be applicable for equity interests that an entity intends to retain ownership of (i.e. those that are **not** held for trading). Initial recognition at fair value normally includes the associated transaction costs of purchase.
3. Financial assets measured at amortised cost

Amortised cost is the cost of an asset or liability adjusted to achieve a constant effective interest rate over the life of the asset or liability.

Amortised cost is calculated using the effective interest method.

Financial assets that are *not* carried at FVTPL (e.g. those carried at amortised cost) are subject to an annual impairment test. Any impairment identified must be charged in full in SPLOCI – P/L.
3. Financial assets measured at amortised cost (Contd.)

The ‘financial assets measured at amortised cost’ classification applies **only to debt instruments** and must be designated upon initial recognition. In this instance, the financial assets are initially measured at **fair value plus transaction costs**.

A debt instrument that meets the following two tests **may be** measured at amortised cost (net of any write-down for impairment):

- The business model test
- The cash flow characteristics
Reclassification of financial assets

For financial assets, reclassification is required between **FVTPL and amortised cost**, or vice versa, *if and only if* the entity’s business model objective for its financial assets changes so that its previous model assessment no longer applies.

If reclassification is appropriate, it must be done *prospectively* from the reclassification date. An entity does not restate any previously recognised gains, losses or interest.

IFRS 9 does *not* allow reclassification where the:

- OCI option has been exercised for a financial asset; or
- fair value option has been exercised in any circumstance for a financial asset or financial liability.
Impairment

IFRS 9 effectively incorporates an impairment review for financial assets that are measured at fair value, as any fall in fair value is taken to profit or loss or OCI in the period (depending upon the classification of the financial asset).

For financial assets designated to be measured at amortised cost, an entity must make an assessment at each reporting date whether there is evidence of possible impairment.

If impairment is identified, it is charged in arriving at profit or loss immediately.
Impairment

The recoverable amount would normally be based upon the present value of the expected future cash flows estimated at the date of the impairment review and discounted to their present value based on the original effective rate of return at the date the financial asset was issued.
Derecognition of a financial asset

Once an entity has determined that the asset has been transferred, it then determines whether or not it has transferred *substantially all of the risks and rewards of ownership* of the asset.

If substantially all the risks and rewards have been *transferred*, the asset is derecognized.

If substantially all the risks and rewards have been *retained*, DE recognition of the asset is precluded.

If the entity has *neither retained nor transferred* substantially all of the risks and rewards of the asset, then the entity must assess whether it has relinquished control of the asset or not.
Derecognition of a financial asset (Contd.)

If the entity does not control the asset then DE recognition is appropriate; however if the entity has retained control of the asset, then the entity continues to recognize the asset to the extent to which it has a continuing involvement in the asset.
Example: Derecognition of a financial asset

If a company sells an investment in shares, but retains the right to repurchase the shares at any time at a price equal to their current fair value then it should derecognise the asset.

If a company sells an investment in shares and enters into an agreement whereby the buyer will return any increases in value to the company and the company will pay the buyer interest plus compensation for any decrease in the value of the investment, then the company should not derecognise the investment as it has retained substantially all the risks and rewards.
MEASUREMENT OF FINANCIAL LIABILITIES

IFRS 9/IPSAS 29 requires that financial liabilities should be accounted for as follows:

1. Financial liabilities measured at FVTPL; and

2. Financial liabilities at amortised cost.
Measurement

• If a financial asset is not measured at amortised cost, it is measured at fair value
• Gains or losses in financial assets are recognised in profit or loss unless:
  • *The financial asset is part of a cash-flow hedging relationship*
  • *The financial asset is an equity instrument and the entity has elected to present its gains and losses in other comprehensive income*
1. Financial liabilities measured at FVTPL

Includes financial liabilities *held for trading* and derivatives that are *not* part of a hedging arrangement.

All other financial liabilities are measured at amortised cost unless the fair value option is applied.

Classification is made at the time the financial liability is initially recognised.

IFRS 9 requires gains and losses on financial liabilities designated as FVTPL to be split into:

- the amount of change in the fair value that is attributable to changes in the credit risk of the liability, which is presented in OCI; and
- the remaining amount of change in the fair value of the liability which is presented in arriving at profit or loss in the period.
If the accounting treatment for the credit risk (i.e. taken through OCI) creates or enlarges an accounting mismatch in profit or loss then the gain or loss relating to credit risk should also be taken to profit or loss. This determination is made at initial recognition and is not reassessed.

Amounts presented in OCI should not be subsequently transferred to profit or loss; the entity may only transfer the cumulative gain or loss within equity.
Offsetting

IAS 1 *Presentation of Financial Statements* states that assets and liabilities, and income and expenses, should not be offset (i.e. netted against each other) unless required or permitted by a standard

IAS 32 specifies that a financial asset and a financial liability should be offset and the net amount reported when an enterprise:

- currently has a legally enforceable right of set-off; and
- intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.
Derecognition of a financial liability

A financial liability should be removed from the statement of financial position when, and only when, it is extinguished, that is, when the obligation specified in the contract is either discharged, cancelled, or expired.

Where there has been an exchange between an existing borrower and lender of debt instruments with substantially different terms, or there has been a substantial modification of the terms of an existing financial liability, this transaction is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

A gain or loss from extinguishment of the original financial liability is recognised in SPLOCI – P/L.
HEDGE ACCOUNTING

**Hedging Instruments**

All *derivative contracts* with an external counterpart may be designated as hedging instruments except for some written options.

An *external non-derivative* financial asset or liability may not be designated as a hedging instrument except as a hedge of foreign currency risk.

A *proportion* of the derivative may be designated as the hedging instrument.
HEDGE ACCOUNTING

**Hedged Items**
A hedged item can be a:

- single recognised asset or liability, firm commitment, highly probable transaction, or a net investment in a foreign operation
- group of assets, liabilities, firm commitments, highly probable forecast transactions, or net investments in foreign operations with similar risk characteristics
- held-to-maturity investment for foreign currency or credit risk (but not for interest risk or prepayment risk)
- portion of the cash flows or fair value of a financial asset or financial liability or
- non-financial item for foreign currency risk only or the risk of changes in fair value of the entire item
DISCLOSURE REQUIREMENTS

An entity must group its financial instruments into classes of similar instruments.

The two main categories of disclosures required are information about the:

1. significance of financial instruments
2. nature and extent of exposure to risks arising from financial instruments
1. Significance of financial instruments

Statement of Financial Position

Details of financial instruments measured at fair value through profit/loss, reclassified, derecognised, pledged as collateral and terms breached

SPLOCI and Equity

Items of income, expense, gains, and losses

Other Disclosures

Accounting policies for financial instruments

   Information about hedge accounting

   Information about the fair values of each class of financial asset and financial liability
2. Nature and extent of exposure to risks arising from financial instruments

Qualitative Disclosures

• Risk exposures for each type of financial instrument
• Management’s objectives, policies, and processes for managing those risks
• Changes from the prior period

Quantitative Disclosures

• Credit Risk
• Liquidity Risk
• Market Risk
Q&A
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