Deloitte.

Kenya School of Government

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Key Areas of Non-compliance

Presentation of Financial Statements:

- Statement of financial position – Period covered erroneously stated which is not per IPSAS/IAS 1.
- Presentation of items of SCE in the SCI – eg Dividends – such should be disclosed under SCE or under notes since they are transactions with the owners.
- Accounting policies & explicit and unreserved statement of compliance:
  - No statement of on compliance;
  - Generic A/c policies;
  - Significant items with no a/c policies;
  - Inconsistency in A/c policies & explanatory notes;
  - A/c policies not compliant with IFRS/IPSAS.

Key Areas of Non-compliance

Presentation of Financial Statements:

- Cross referencing – Non compliance with IPSAS/IAS 1 on referencing of items in the statements to relevant information in the notes. Cross referencing enhance understanding of the FS users. Some cross reference were wrong or did not exist.

- Materiality and Aggregation: Presentation of each material class of similar items – mainly on the statement of financial performance. Items of dissimilar nature or function should be presented separately unless immaterial.

- Classification of Expenses: Nature or function on the face of the statement. If by function, additional information on the nature of expenses should be disclosed. No hybrid.

Key Areas of Non-compliance

Presentation of Financial Statements:

- Comparative information: When relevant to an understanding of the CY FS narrative and descriptive information should be disclosed. Eg Capital commitments, effective tax rate etc. If no comparatives, a statement to such effect should be presented.
- Distinguishing financial statements from other information contained in the annual report and financial statements. Page numbers referencing the FS and other reports should be clear.

Key Areas of Non-compliance

Presentation of Financial Statements:

- SCNA items not explained what they relate to ie Description of the nature and purpose of each reserve within Equity.
- Disclosure of critical accounting estimates & judgments in application of accounting policies not done, eg estimated impairment of goodwill, DB obligations determined using actuarial.
- Capital management policies, objectives, qualitative and quantitative analysis not disclosed.

Key Areas of Non-compliance

Presentation of Financial Statements:

- Income tax disclosures and tax reconciliations – not done for many commercial entities.

Statement of Cash Flows IAS 7/IPSAS 2:

- Inclusion of items under cash and cash equivalents that does not meet the definition of same – eg advances and imprest.
- No commentary on cash and cash equivalent balances not available for use – with restrictions.
- No reconciliation of cash & cash equivalents reported in the Statement of Financial Position and in the Statement of Cash Flows.

Key Areas of Non-compliance

Property, Plant and Equipment IAS 16/IPSAS 17:

- Inconsistencies between the models disclosed in the a/c policy and that reported in the explanatory notes.eg indicating revaluation model, yet under the SCNA/SCE there is no respective revaluation reserve.
- Failure to disclose the carrying amount of the revalued assets has the assets been carried at cost model.
- Effective date of revaluation.
- Assets held as collateral.
- Fully depreciated assets.
- Nature of WIP not included under PPE.
- Computer software included under PPE.

Key Areas of Non-compliance

Related Party Transactions Disclosures:

- Key Management personnel compensation.
- Nature of the related party transactions and balances.
- Not included the disclosures at all.

Key Areas of Non-compliance

Financial Instruments:

- Disclosures necessary to make informed decisions on how an entity manages various risks were not done.
- Credit risk – no disclosure of maximum exposure
- Liquidity risk – analysis done using discounted cash flows, contrary to standard requirement of using undiscounted cash flows.
- No fair value hierarchy disclosures; wrong classification of financial instruments; financial risk management strategies related to agri.

Key Areas of Non-compliance

Provisions, Contingent liabilities & assets IPSAS 19/IAS 37:

- Provisions were aggregated in the carrying amount of payable or under deferred tax with no additional information.
- The standard requires a reconciliation of provisions showing the carrying amount at beginning and end of the period, additional provisions, amounts used, unused amounts reversed during the period and increase in the discounted amount arising from time passage and discount rate change.
- Quantitative effect of contingent liabilities not done even where assessments are done by KRA.
- No disclosure of brief description of the nature of obligation and expected timing and any resulting outflows of economic benefits and major assumptions concerning future events.

Key Areas of Non-compliance

Accounting policies, changes in accounting estimates and errors IAS 8/IPSAS 3:

- Prior period adjustments included in the financial statements were not explained.
- Comparative figures restated with no explanation to that effect.
- New and amended standards – limited disclosures on the effect of initial application of an IPSAS/IAS.

Key Areas of Non-compliance

Others:

- Statement of comparison of actual and budget not included in the financial report.
- Significant performance variance not explained on the statement of comparison of actual and budget.
- No explanation of material differences between the original budget and the final budget.
- Failure to include name and signature of the officer responsible for financial statements preparation.
- Appendix on progress on follow up of auditors recommendation.
- Management discussion and analysis – scanty for some entities.

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Q1

Does IAS 1(2007) prescribe a fixed format for the presentation of the statement of comprehensive income, the statement of financial position and the statement of changes in equity?

No.

It does, however, set out line items that should be presented in those statements. In addition, it establishes further items that may be presented either in those financial statements or in the notes.

Q2

IAS 1(2007).79(b) states that an entity should disclose “a description of the nature and purpose of each reserve within equity” either in the statement of financial position or in the notes. What level and type of detail is required to meet this disclosure requirement?

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While IAS 1 requires financial statements to include additional information as to the nature and purpose of each reserve, it does not provide any further clarification regarding what information is needed.

Thus, reserves that are commonly encountered (revaluation reserves on property, plant and equipment, share premium account, translation reserves in respect of foreign operations, etc.) generally do not need to be explained further in order for investors to understand the nature and purpose of the reserves.

However, if, for example, the entity wishes to designate special reserves within equity that are not familiar to users of financial statements, supplementary information should be provided regarding the purpose of the reserve and how it will be utilised.

Deloitte.

IAS 1(2007).39 clarifies that, when the requirements of IAS 1(2007).10(f) are triggered, the entity should present "as a minimum, three statements of financial position, two of each of the other statements, **and related notes**" (emphasis added).

Question 3

Which 'related notes' are required to be presented in respect of the additional statement of financial position?

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- Note that the section of IAS 1 dealing with comparative information has been rewritten as part of *Annual Improvements to IFRSs: 2009–2011 Cycle* (the 2009–2011 Improvements).
- In particular, the requirements regarding supporting notes for a third statement of financial position have been amended to state that;

"when an entity presents a third statement of financial position in its financial statements in one of the circumstances specified in IAS 1(2007).40A (previously IAS 1(2007).39)), the entity is not required to present supporting notes for that third statement of financial position. [IAS 1(2007).40C]"

Q4

Does Management Commentary published with financial statements fall within the scope of IFRSs/IPSAS?

Deloitte.

No.

IAS 1.13 and 14 describe the reports and statements that many entities present outside of the financial statements.

- Information presented in the MC, or another supplementary statement, may repeat information in the financial statements.
- All information required under IFRSs should be presented in the notes or elsewhere in the financial statements.
- Omission of a disclosure in the financial statements because it is included in the MC, or a similar statement, is not permitted.
- However, this may be included by way of cross-reference if allowed by specific Standards (e.g. paragraph B6 of IFRS 7 *Financial Instruments: Disclosures*).

Q5

Is it acceptable to include exchange differences arising from the recent acquisition of inventories invoiced in a foreign currency in the cost of purchase of those inventories?

Deloitte.

No.

Although this matter is not addressed directly in the body of IAS 2, the introduction to the Standard states that the capitalisation of such exchange differences is not permitted.

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Q6

IAS 8.30 specifies disclosure requirements "[w]hen an entity has not applied a new IFRS that has been issued but is not yet effective". Is the application of this paragraph limited to IFRSs issued before the end of the reporting period, or are the disclosures also required in respect of IFRSs issued between the end of the reporting period and the date when the financial statements are authorised for issue?

Deloitte.

- The disclosures required by IAS 8.30 should be made in respect of all IFRSs issued before the date of issue of the financial statements that are not yet effective.
- It will be helpful if the relevant note to the financial statements either specifies the date at which the details are given or refers explicitly to them being as at the date of authorisation of the financial statements.

In complying with the general requirements of IAS 8.30 to disclose information about the possible impact of new IFRSs not yet effective, IAS 8.31 states that an entity considers disclosing the following:

- the title of the new IFRS;
- the nature of the impending change or changes in accounting policy;
- the date by which application of the IFRS is required;
- the date as at which it plans to apply the IFRS initially; and

either

- a discussion of the impact that initial application of the IFRS is expected to have on the entity's financial statements; or
- if that impact is not known or reasonably estimable, a statement to that effect.

Question 7

Is all of this detail required for each new or amended IFRS in issue but not yet effective?

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No.

It is clear from IAS 8.BC31 that the matters listed in IAS 8.31 are not intended to be mandatory disclosure requirements; they are instead matters that an entity “should consider” in applying IAS 8.30.

However, a briefer disclosure may be acceptable in some circumstances; for example, it may be acceptable to not mention a pronouncement that plainly does not affect the entity because of its scope. Another factor to consider is that when a new pronouncement has no material effect, it may be acceptable to adopt it in advance of its effective date (which would have no material effect) and so exclude it from the scope of IAS 8.30. **When a complete list is not provided, it may be wise to include a statement to the effect that the impact of all other IFRSs not yet adopted is not expected to be material.**

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IAS 10.17 requires entities to disclose the date when the financial statements are authorised for issue and who gave that authorisation.

Question 8

Where should these disclosures be located in the financial statements?

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IAS 10 does not specify the location of these disclosures. This is subject to the local legal and regulatory requirements and may be presented;

1. On the face of the statement of financial position or another primary statement,
2. In the notes, or
3. In a statement of directors' responsibilities but only if that statement forms part of the financial statements.

Deloitte.

Paragraph 54 of IAS 38 *Intangible Assets* states that "[e]xpenditure on research (or on the research phase of an internal project) shall be recognised as an expense when it is incurred".

Question 9

Does that mean that all property, plant and equipment used in research activities should be recognised as an expense in profit or loss when acquired?

Deloitte.

No.
Property, plant and equipment used in research activities should be accounted for in the same way as other property, plant and equipment under IAS 16.

However, the ***depreciation*** of property, plant and equipment used in research activities constitutes a ***research expense*** to which IAS 38 applies.

Deloitte.

Q10

When an entity incurs capital expenditure on an item of property, plant and equipment in respect of which an impairment loss has previously been recognised, is it appropriate to include that expenditure in the cost of the asset under IAS 16.7?

The expenditure should be recognised in accordance with IAS 16 and included in the cost of the asset if the criteria in IAS 16.7 are met.

NB:

In order for those criteria to be met, it must be probable that the future economic benefits associated with the expenditure will flow to the entity.

Q11

- An entity has installed two turbines. One turbine produces energy for the plant, and the other is used as a backup in case the first turbine fails or is otherwise rendered out of service.

- The probability that the spare turbine will be used is very low. The spare turbine is necessary, however, to ensure the continuity of the production process if the first turbine fails.

- The useful life of the stand-by turbine will equal the life of the plant, which is the same as the useful life of the primary turbine.

IAS 16.8 states that stand-by equipment qualifies as property, plant and equipment when it meets the definition of property, plant and equipment, i.e. tangible items that;

1. are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and

2. are expected to be used during more than one period. [IAS 16.6]

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An entity buys five new machines for use in its production facility. Simultaneously, it purchases a spare motor to be used as a replacement if a motor on one of the five machines breaks.

Q12

Should the spare motor be classified as property, plant and equipment and, if so, when should depreciation commence?

Deloitte.

Items such as spare parts, stand-by equipment and servicing equipment should be recognised as property, plant and equipment when they meet the definition of property, plant and equipment. Otherwise, they should be classified as inventories in accordance with IAS 2 *Inventories*. [IAS 16.8]

In the circumstances described, the motor will be used in the production of goods and, once brought into service, will be operated during more than one period. It is therefore classified as property, plant and equipment.

1. The useful life of the motor commences when it is available for use within the machine rather than when it is acquired.
2. It should be depreciated over the period starting when it is brought into service and continuing over the shorter of its useful life and the remaining expected useful life of the asset to which it relates.
3. If the asset to which it relates will be replaced at the end of its useful life and the motor is expected to be used or usable for the replacement asset, a longer depreciation period may be appropriate.

During the period before the motor is available for service, any reduction in value should be reflected as an impairment loss under IAS 36 *Impairment of Assets* at the time impairment is indicated.

Q13

- In 20X1, Company E purchased land for CU40 million and a building for CU60 million. The building is used by Company E in its business. It is classified as property, plant and equipment and is depreciated over its estimated useful life.
- In 20X3, Company E demolishes the building and constructs a new building for its own use on the same piece of land. The carrying amount of the old building before demolition is CU55 million.

Should the CU55 million be written off to profit or loss or be capitalised as part of the cost of the new building?

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- The carrying amount of CU55 million should be written off to profit or loss.
- Under IAS 16, Company E is required to depreciate the building to its residual value over its useful life.

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- On 20 September 20X0, Company A completed the construction of a building intended for use as its administrative headquarters.
- By law, the local health and safety authority must approve the offices for occupation before any activity can commence.
- This approval can be requested only when the building is physically complete, and it takes on average three months to obtain the approval.

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The health and safety authority issued the approval for occupation on 20 December 20X0. In the three months from 20 September 20X0, Company A incurred CU10 of building management costs (e.g. utility and security expenses) and interest expenses. (The building is identified as a qualifying asset under IAS 23 *Borrowing Costs*.)

Q14

Should the costs incurred by Company A between 20 September 20X0 (when the building was physically completed) and 20 December 20X0 (when the approval for occupation was issued) be included in the initial cost of the building?

Yes.

- The management costs incurred are considered "*directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management*" (IAS 16.16(b)).

- In addition, obtaining the approval for occupation is considered to be an activity "*necessary to prepare the qualifying asset for its intended use or sale*" (IAS 23.25);

therefore, Company A should continue to capitalise borrowing costs until the approval is obtained.

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- An entity acquires equipment of a type that its employees have never operated before. During the installation period, the employees receive extensive training on the equipment.
- The cost to the entity includes the incremental cost of hiring experts to conduct the training, and the directly attributable cost of wages to the employees during the training period.
- The equipment could not be used by the entity unless its employees received the training.

Q15

Do these training costs qualify as a component of the cost of the equipment?

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No

The training costs do not fall within the scope of costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by the management.

This equipment would be capable of operating in the manner intended by the management without the entity incurring the training cost

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Q16

When accounting for a self-constructed asset under IAS 16, how should the concept of ‘directly attributable’ costs be applied?

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IAS 16.22 states that "[i]f an entity makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing an asset for sale", in accordance with the principles of IAS 2 *Inventories*.

However, if the entity does not construct similar assets for sale, only those elements of costs described in IAS 16.16 can be incorporated in the cost of a self-constructed asset. **Accordingly, costs which can be included are:**

- **direct materials;**
- **direct labour costs; and**
- **unavoidable costs that are directly attributable to the construction activity (i.e. costs that would have been avoided if the asset had not been constructed).**

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Q17

How often should an item of property be revalued when applying the revaluation approach?

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IAS 16.31 requires that revaluations should "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 end of the reporting period". The Standard therefore does not require annual revaluations.

The frequency of revaluations will depend upon fluctuations in the fair values of the items of property, plant and equipment under consideration.
IAS 16.34 – 3 – 5 years, not required annually.

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Voluntary Disclosure of Revalued Amounts

Q18

Does IAS 16 specify any particular requirements when an entity applying the cost model for property, plant and equipment voluntarily discloses the fair value of its property, plant and equipment?

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Entities that adopt the cost model of accounting for their property, plant and equipment may wish to disclose the fair value of their property, plant and equipment in a note to the financial statements when the fair value is materially different from the carrying amount. **Such disclosures are encouraged by IAS 16.79(d).**

In disclosing such fair values, entities are not strictly bound by IAS 16's revaluation rules. However, when the amounts disclosed do not represent current fair values, they could mislead users of the financial statements. **Therefore, the entity should either disclose the current fair values of the assets concerned, or not disclose revalued amounts at all.**

Got More Questions?