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CHARTERED ACCOUNTANTS ACADEMY

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ICAZ CPD

Presented **by Anesu Daka CA (SA)(Z)**

CHARTERED ACCOUNTANTS ACADEMY

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- Trained Facilitator of Learning
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- Member of the ICAZ APC and Insurance APC sub-committee and ZAPB.
- Technical director for ICAZ
- Commissioner of enquiry in the conversion of pension funds from Z$ to US$.

MENU

1. IFRS 15- Revenue from Contracts with Customers
2. IFRS 9- Financial Instruments
3. Management Commentary

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Purpose of GPFS

OB2 The objective of general purpose financial reporting[1] is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.

Financial statement considerations in adopting new and revised pronouncements

1. Updates to accounting policies
2. Impact of transitional provisions
3. Disclosures about changes in accounting policies
4. Third statement of financial position
5. Earnings per share (EPS)
6. Impact on business process

1. Updates to accounting policies

- The terminology and substance of disclosed accounting policies may need to be updated to reflect new recognition, measurement and other requirements, e.g.:
  - **IFRS 15** contains a new model for recognising revenue,
  - **IFRS 9** contains a new model of classifying financial assets

IFRS 9 Disclosure

IAS1(119)
IFRS7(21)

(o) Investments and other financial assets

Accounting policies applied from 1 January 2015

(i) Classification

IFRS9(4.1.1)

From 1 January 2015, the company classifies its financial assets in the following measurement categories:

- those to be measured subsequently at fair value (either through other comprehensive income, or through profit or loss), and
- those to be measured at amortised cost.

The classification depends on the entity's business model for managing the financial assets and the contractual terms of the cash flows.

IFRS9(4.1.4)
IFRS9(5.7.1)

For assets measured at fair value, gains and losses will either be recorded in profit or loss or other comprehensive income. For investments in debt instruments, this will depend on the business model in which the investment is held. For investments in equity instruments, this will depend on whether the company has made an irrevocable election at the time of initial recognition to account for the equity investment at fair value through other comprehensive income.

See note 7 for details about each type of financial asset.

IFRS9(4.4.1)

The company reclassifies debt investments when and only when its business model for managing those assets changes.

IAS 39 Disclosure

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such financial assets are subsequently measured at amortised cost using the effective interest rate method (EIR), less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included in finance income in the income statement. The losses arising from impairment are recognised in the income statement in finance costs.

IAS 39.9
IAS 39.46(a)
IAS 39.56

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held-to-maturity when the Group has the positive intention and ability to hold them to maturity. After initial measurement, held-to-maturity investments are measured at amortised cost using the effective interest method, less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The EIR amortisation is included in finance income in the income statement. The losses arising from impairment are recognised in the income statement in finance costs. The Group did not have any held-to-maturity investments during the years ended 31 December 2011 and 2010.

IAS 39.9
IAS 39.56
IAS 39.46(b)

2. Impact of transitional provisions

- IAS 8 contains a general requirement that **changes in accounting policies are retrospectively applied**, unless an individual pronouncement has specific transitional provisions, e.g. **IFRS 9** give a choice on prospective and retrospective

3. Disclosures about changes in accounting policies

- IAS 8 requires the disclosure of a number of matters, e.g.:
  - the title of the IFRS,
  - the nature of the change in accounting policy,
  - a description of the transitional provisions,
  - and the amount of the adjustment for each financial statement line item affected

Model Financial Statements 2014 (1).pdf (SECURED) - Adobe Reader
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Source	International GAAP Holdings Limited
IAS 1.10(e), (ea), 51(b),(c)	**Notes to the consolidated financial statements for the year ended 31 December 2014**
	1. General information
IAS 1.138(a), (c) IAS 24.13	International GAAP Holdings Limited (the Company) is a limited company incorporated in A Land. Its parent and ultimate holding company is International Group Holdings Limited. Its ultimate controlling party is Mr. John Banks. The addresses of its registered office and principal place of business are disclosed in the introduction to the annual report. The principal activities of the Company and its subsidiaries (the Group) are described in note 6.
	2. Application of new and revised International Financial Reporting Standards (IFRSs)
	2.1 Amendments to IFRSs and the new Interpretation that are mandatorily effective for the current year
	In the current year, the Group has applied a number of amendments to IFRSs and a new Interpretation issued by the International Accounting Standards Board (IASB) that are mandatorily effective for an accounting period that begins on or after 1 January 2014.
IAS 8.28(a) IAS 8.28(b),(c) & (d)	**Amendments to IFRS 10, IFRS 12 and IAS 27 *Investment Entities***
	The Group has applied the amendments to IFRS 10, IFRS 12 and IAS 27 *Investment Entities* for the first time in the current year. The amendments to IFRS 10 define an investment entity and require a reporting entity that meets the definition of an investment entity not to consolidate its subsidiaries but instead to measure its subsidiaries at fair value through profit or loss in its consolidated and separate financial statements.

26 Changes in accounting policies [4-7,9]

IAS8(28)(c)

As indicated in note 25(a) above, the group has adopted IFRS 15 as issued in May 2014, which resulted in changes in accounting policies and adjustments to the amounts recognised in the financial statements. The main changes are explained below.

(i) Accounting for refunds

When the customer has a right to return the product within a given period, the group previously recognised a provision for returns which was measured on a net basis at the margin on the sale (CU100,000 at 31 December 2013 and CU72,000 at 31 December 2014). Revenue was adjusted for the expected value of the returns and cost of sales were adjusted for the value of the corresponding goods expected to be returned.

Under IFRS 15, if the customer returns a product, the entity is obliged to refund the purchase price. Therefore, a gross contract liability (refund liability) for the expected refunds to customers is recognised as adjustment to revenue (CU179,000 at 1 January 2014 and CU110,000 at 31 December 2014). At the same time, VALUE IFRS Plc has a right to recover the product from the customer where the customer exercises his right of return and recognises an asset and a corresponding adjustment to cost of sales (CU79,000 at 1 January 2014 and CU38,000 at 31 December 2014). The asset is measured by reference to the former carrying amount of the product. The costs to recover the products are not material because the customer usually returns the product in a saleable condition at the store.

To reflect this change in policy, the group reclassified CU100,000 from provisions to contract liabilities of CU179,000 and contract assets of CU79,000 at 1 January 2014 (CU72,000 from provisions to contract liabilities of CU110,000 and contract assets of CU38,000 as at 31 December 2014).

In summary, the following adjustments were made to the amounts recognised in the balance sheet at the date of initial application (1 January 2014) and at the end of the comparative period (31 December 2014):

	Notes	IAS 18 carrying amount 31 Dec 2013 CU'000	Reclassi-fication CU'000	Remeasure-ments CU'000	IFRS 15 carrying amount 1 January 2014 CU'000	Retained earnings effect 1 January 2014 CU'000
Trade and other receivables	(iv)	8,243	(1,897)	-	6,346	-
Other current assets	(i)	-	-	79	79	-
Contract assets	(iv)	-	1,897	-	1,897	-
Contract liabilities	(i),(ii),(iv)	-	2,655	79	2,734	-
Deferred revenue	(ii)	2,290	(2,250)	(40)	-	40
Trade and other payables	(iv)	12,930	(205)	-	12,725	
Provisions	(iv)	730	(200)	-	530	-

4. Third statement of financial position

- IAS 1 *Presentation of Financial Statements* requires the presentation of a third statement of financial position as at the beginning of the preceding period in addition to the minimum comparative financial statements in a number of situations, including if an entity applies an accounting policy retrospectively and the retrospective application has a material effect on the information in the statement of financial position at the beginning of the preceding period

Model Financial Statements 2014 (1).pdf (SECURED) - Adobe Reader

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Source	International GAAP Holdings Limited				
IAS 1.10(a),(ea),(f) 51(b),(c)	**Consolidated statement of financial position at 31 December 2014**				
IAS 1.113		Notes	31/12/14	31/12/13	01/01/13
IAS 1.51(d), (e)			CU'000	CU'000	CU'000
	Assets				
IAS 1.60	*Non-current assets*				
IAS 1.54(a)	Property, plant and equipment	15	105,215	130,541	157,212
IAS 1.54(b)	Investment property	16	4,968	4,941	4,500
IAS 1.55	Goodwill	17	20,485	24,260	24,120
IAS 1.54(c)	Other intangible assets	18	9,739	11,325	12,523
IAS 1.54(e)	Investments in associates	20	5,402	5,590	4,406
IAS 1.54(e)	Investment in a joint venture	20A	3,999	3,662	3,420
IAS 1.54(o)	Deferred tax assets	10	2,083	1,964	1,843
IAS 1.55	Finance lease receivables	26	830	717	739
IAS 1.54(d)	Other financial assets	22	10,771	9,655	7,850
IAS 1.55	Other assets	23	–	–	–
	Total non-current assets		163,492	192,655	216,613

5. Earnings per share (EPS)

- Where applicable to the entity, IAS 33 *Earnings Per Share* requires basic and diluted EPS to be adjusted for the impacts of adjustments result from changes in accounting policies accounted for retrospectively and IAS 8 requires the disclosure of the amount of any such adjustments.

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Case Study: Zimbo Ltd

- Zimbo Ltd has various business lines which includes the following:
  1. **Car dealership**: Zimbo acquires and assembles luxury cars in Zimbabwe. The price is settled over a 60 months on installment of $1000 p.m. Each car has a service package provided after every 5000 km up to a maximum of 100 000 km. The cash price of the car is $40 000, whilst the package could be sold separately at $8,000 for the first 100 000 km.

Case Study: Zimbo Ltd…..

2. **Telecom distributorship**: Zimbo was awarded a telecom services distribution licence from a local telecom service provider. The telecom services include sales of sim cards, sim swaps, data and voice bundles, airtime and hand sets. Airtime is sold through a monthly prepaid contract or monthly post-paid contracts. During 2015 Zimbo had a promotion where high-earning clients would get into a post-paid contract and get a iPhone 5s handset, sim card, 200 MB/s monthly data bundles and 250 voice minutes for $100 a month for 24 months. The iPhone 5s is priced at $995 if bought on cash and the voice and bundles contracts are only $30 and $20 per month. The sim card sold is sold for $1 in the street. Ignore time value of money.

QUIZ

How should Zimbo Ltd recognise revenue under IAS 18?

IAS 18: Revenue Recap

Sources of revenue:

- Sale of goods
- Rendering of services
- Interest
- Royalties
- Dividends

Recognition of the Sale of Goods

5 criteria that need to be met before revenue from the sale of the goods should be recognised

Risks and rewards	• Significant risks and rewards are transferred
Control	• Seller has no management involvement / effective control
Revenue	• reliably measure
Payment	• probable
Costs	• measured reliably

Recognition: Service revenue

(a) ~~Transfer of significant risks/rewards~~

(b) ~~No continuing managerial involvement~~

(c) Revenue can be measured reliably

(d) Probable future economic benefits

(e) Transaction costs can be measured reliably

Stage of completion can be measured reliably

Recognition for rendering of services over multiple financial periods

- Issues arise when completion for a contract extends beyond the end of the current accounting period.
- Three methods mentioned by IAS 18 (others permitted)

Surveys of work performed

Assessing the services performed to date against the total services to be performed under the contract

Assessing the costs incurred to date against the total costs to be incurred under the contract

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Measurement

- Fair value of the payment
- Difference between fair value and actual amount paid is classified as **interest revenue**
- Net of trade discounts or volume rebates given

Recognition of revenue generated on entity assets

Interest should be recognised on a time basis using the effective interest method

Dividends should be recognised when the entity, as a shareholder, has the right to receive payment.

This is usually when the dividends are declared, rather than when they are proposed

Royalties should be recognised on an accrual basis; i.e. they should be recognised as they fall due under the terms of the relevant agreement

IAS18 - Disclosure requirements

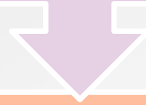
- Accounting policy for recognition must be set out in the notes to the financial statements
- Should include all methods used to access the stage of completion of transactions
- Each category of revenue should be recognised where amounts are significant

Specific guidance

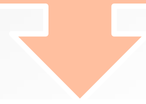
- Consignment sales
- Sale and repurchase
- Instalment sales
- Servicing fees
- Advertising commissions
- Admission fees
- Initiation, entrance & membership fees
- Customised software development

IFRIC 13 – Customer loyalty programs

If entity grants awards to its customers as part of a sales transaction



Original sales revenue should be split on a fair value basis



If entity supplies the awards, the deferred amount should be recognised as revenue when credits are awarded/redeemed

If third party supplies awards, it needs to be decided if acting as principal or agent

Why change IAS 18?

- Undefined scope "revenue"
- Numerous revenue requirements
- No appropriate guidance on contract costs
- No clear guidance on dealing with multi-package contracts
- Minimal disclosures
- Etc.

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Revenue from Contracts with Customers

IFRS 15

Revenue from Contracts with Customers (IFRS 15)

- Issued in 28 May 2014
- Joint project with FASB to replace IAS 18
- Effective - annual reporting periods beginning on or after 1 January 2018. Earlier application is permitted.

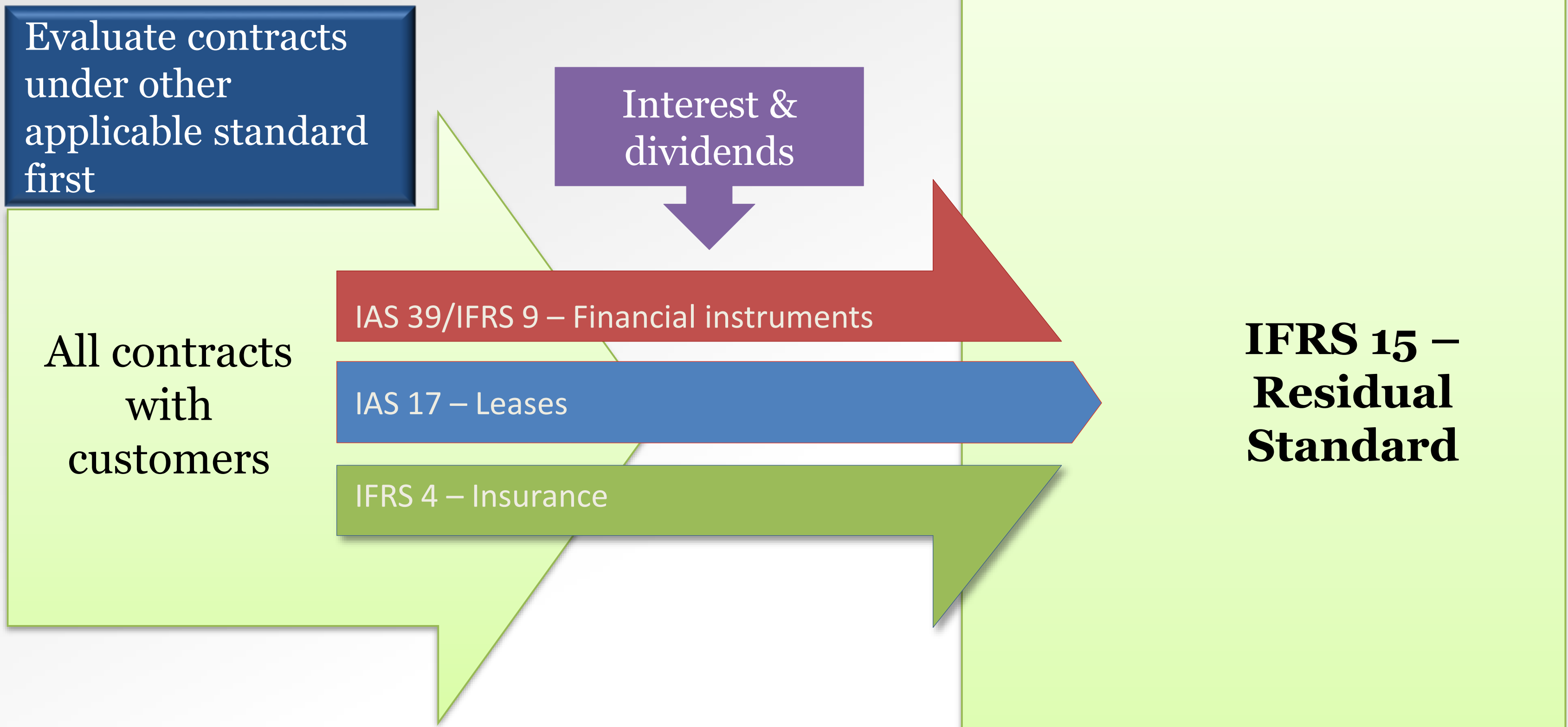
Revenue from Contracts with Customers (IFRS 15)

- IFRS 15 supersedes:
- (a) IAS 11 *Construction Contracts;*
- (b) IAS 18 *Revenue;*
- (c) IFRIC 13 *Customer Loyalty Programmes;*
- (d) IFRIC 15 *Agreements for the Construction of Real Estate;*
- (e) IFRIC 18 *Transfers of Assets from Customers; and*
- (f) SIC-31 *Revenue—Barter Transactions Involving Advertising Services.*

Why IFRS 15?

- remove inconsistencies and weaknesses in previous revenue requirements;
- provide a more robust framework for addressing revenue issues;
- improve comparability of revenue recognition practices across entities, industries, jurisdictions and capital markets;
- provide more useful information to users of financial statements through improved disclosure requirements; and
- simplify the preparation of financial statements by reducing the number of requirements to which an entity must refer.

IFRS 15 Revenue from contracts with customers Scope



Scope….

- IFRS 15.6 only applies to a contract with a "**customer**"
  - A party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration
- NB: IFRS 15 excludes a counterparty – a party that shares the risks and benefits of the entity's activities

revenue	Income arising in the course of an entity's ordinary activities.

IFRS 15 - Core Principle

An entity recognises revenue to depict the ***transfer*** of promised ***goods or services*** to customers in an amount that reflects the ***consideration*** to which the entity expects to be entitled in ***exchange*** for those goods or services.

Revenue is recognised in accordance with the core principle by applying a 5 step model.

The five step model

Step 1: Identify the contract(s) with the customer

Step 2: Identify the separate performance obligations in the contract(s)

Step 3: Determine the transaction price

Step 4: Allocate the transaction price

Step 5: Recognise revenue when (or as) a performance obligation is satisfied

Revenue

Overview

The five step model

1 Identify the contract

2 Identify the performance obligations

3 Determine the transaction price

4 Allocate the transaction price

5 Recognise revenue when (or as) a performance obligation is satisfied

Other Considerations

Identify the contract with the customer

01

Agreement between two or more parties that creates enforceable rights & obligations (not necessarily written)

Revenue recognition

Identifying the contract

9 An entity shall account for a contract with a customer that is within the scope of this Standard only when all of the following criteria are met:

(a) the parties to the contract have approved the contract (in writing, orally or in accordance with other customary business practices) and are committed to perform their respective obligations;

(b) the entity can identify each party's rights regarding the goods or services to be transferred;

(c) the entity can identify the payment terms for the goods or services to be transferred;

(d) the contract has commercial substance (ie the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract); and

(e) it is probable that the entity will collect the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer. In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession (see paragraph 52).

Identify the contract with the customer

Collectability
- Probable

Contract combination
- Price interdependence
- Negotiated as package with single commercial objective
- Single performance obligation

Contract modification
- New contract
- Modification prospectively
- Cumulative catch up

Combination of contracts

17 An entity shall combine two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) and account for the contracts as a single contract if one or more of the following criteria are met:

(a) the contracts are negotiated as a package with a single commercial objective;

(b) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or

(c) the goods or services promised in the contracts (or some goods or services promised in each of the contracts) are a single performance obligation in accordance with paragraphs 22–30.

Identify revenue contract in Zimbo Ltd

Step 1 – Identify the contract with the customer

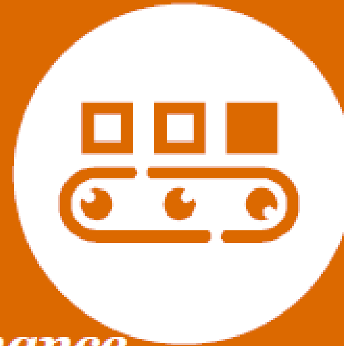
How is this different to IAS 18/11..?

- IFRS 15 provides guidance on what is a contract with a customer, and is in the scope of the standard.
- Clearer guidance as to what to do if an entity fails the collectability assessment.

RISK

What could go wrong?

How can it be addressed?



Identify the performance obligations

02

A promise in a contract with a customer to transfer a good or service to the customer

Step 2 – Identify the performance obligations

Is a good or service distinct?

Capable of being distinct?
i.e. Benefit from good or service on its own or with other readily available goods or services

Distinct in the context of the contract?
i.e. Good/service not being used as an input to create an output

Distinct

Separate performance obligations

Individual distinct good or service

Sold separately
or
can be used
separately

- Post customer support / maintenance
- Loyalty point schemes
- Free goods or gifts

Group of integrated goods or service

Dependent on
or interrelated with
other items in the
contract

- Construction contracts
- Complex installations
- Customised software solutions

Series of homogeneous 'services'

Homogeneous
and
consistent pattern
of transfer over
time

- Daily cleaning service
- Security service
- Call centre processing

Identify performance obligations in Zimbo Ltd contracts

RISK

What could go wrong?

How can it be addressed?

Determine
the transaction
price
03

Revenue recognition

- **Phase 3**
- **Determine the Transaction price (The total revenue)**

Determining the transaction price

47 An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes). The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

Mobile phone handset and service contract

Transaction price

1. **The basic contractual minimum revenue**

   plus

1. **All the expected other revenue (Roaming charges, SMS, Data plan etc.)**

Factors that may affect the transaction price

Variable consideration

Significant financing component

Non-cash consideration

Consideration payable to customers

Transaction price = Amount of consideration to which the entity expects to be entitled to in exchange for transferring goods or services

Step 3 – Determine the transaction price

Variable consideration

- **Estimate** an amount of variable consideration
- Measure at either **most likely** outcome or **expected value**
- Variable consideration **constraint**

Included in the transaction price only if **highly probable** that there will not be a significant revenue reversal

- Uncertainty over long period of time
- Limited experience with similar contracts
- Susceptible to factors outside control
- Broad range of outcomes

Must recognise minimum amount

Reassessment

Significant financing component

- Customer **or entity** receives significant benefit of financing

No adjustment when

- Period between performance and payment is one year or less
- Variable based on factors outside control of customer or entity e.g. sales-based royalty
- Timing is at discretion of customer e.g. gift vouchers
- Timing difference arises for reasons other than providing financing e.g. secure the right to a product

Step 3 – Determine the transaction price

How is this different to IAS 18/11..?

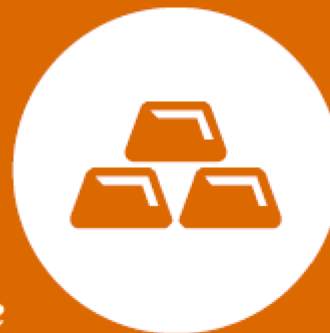
- Time value of money must be considered in both directions (upfront receipts).
- Introduction of 12 month practical expedient.
- Clearer guidance on when to recognise variable consideration.

Determine transaction price of revenue contracts in Zimbo Ltd

RISK

What could go wrong?

How can it be addressed?



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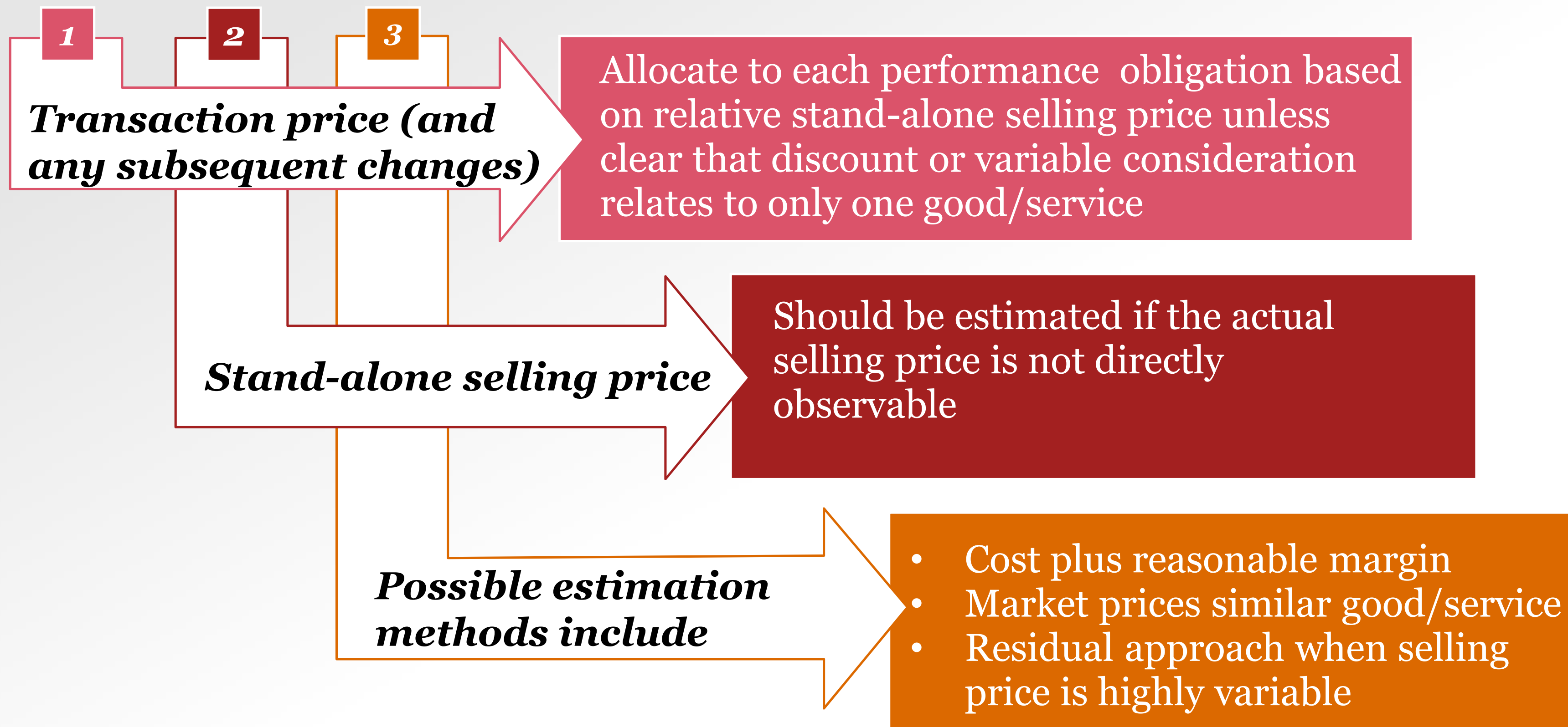
Allocate the transaction price

How to allocate the transaction price



Step 4 – Allocate the transaction price

How is this different to IAS 18/11..?

- Under IAS 18, several allocation methods are acceptable, e.g. fair value, residual.
- Under IFRIC 13, residual approach is included as the default position
- IFRS 15 contains more prescriptive guidance, generally only allows a relative stand alone selling price method.

Allocate transaction price for Zimbo Ltd contracts

RISK

What could go wrong?

How can it be addressed?

05

Recognise revenue when / (as) a performance obligation is satisfied

Revenue recognition

- **Phase 5**
- **Recognise revenue when the performance obligation is satisfied**

Satisfaction of performance obligations

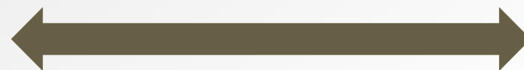
31 An entity shall recognise revenue when (or as) the entity satisfies a performance obligation by transferring a promised good or service (ie an asset) to a customer. An asset is transferred when (or as) the customer obtains control of that asset.

- Upon completion of the obligation and control is transferred to the client/customer

  e.g. when I take control of my new house

Revenue recognition

Versus

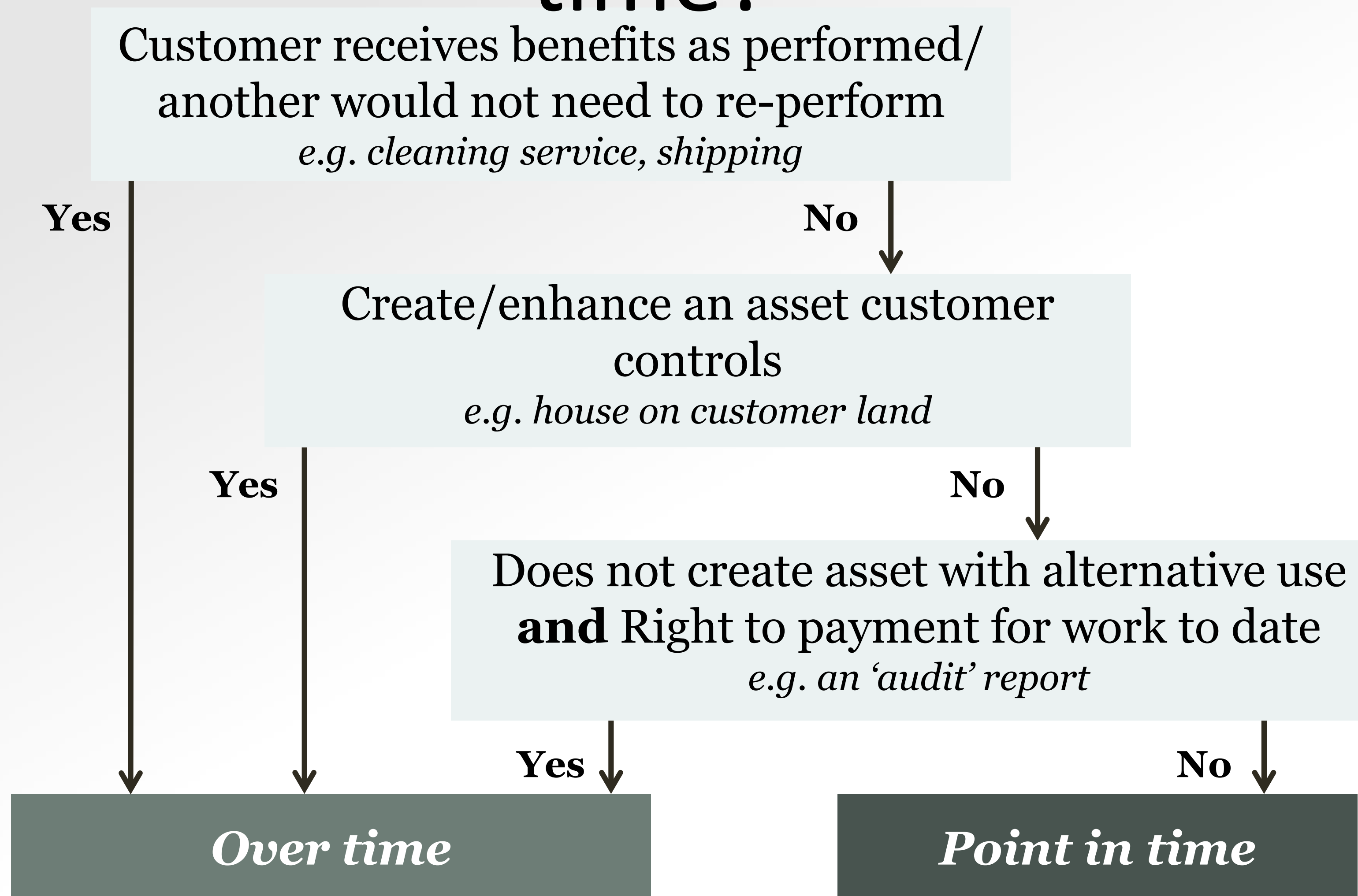


Timing of when revenue is recognised might be consistent with current practice for most entities.

This should however **not be assumed for all contracts**.

This implies that timing could differ?

Revenue over time or at a point in time?



Step 5 – Recognise revenue when (as) a performance obligation is satisfied

How is this different to IAS 18/11..?

- Under IAS 18, revenue is recognised based on transfer of risk and rewards, now it is based on transfer of control.
- IFRS 15 effectively provides guidance as to what is a good and what is a service (over time versus point in time).

Recognise revenue contract in Zimbo Ltd

RISK

What could go wrong?

How can it be addressed?

Other considerations

Other considerations

Further guidance

- *Warranties*
- *Right of return*
- *Disclosure*
- *Licenses*
- *Transition*
- *Customer option to obtain additional goods or services*
- *Agent vs Principal*
- *Repurchase agreements*
- *Contract costs*
- *Bill-and-Hold and Consignment arrangements*

Contract costs

Incremental Costs- IFRS15.91

- **Definition:** Costs incurred to obtain a contract with a customer that it would not have incurred if the contract had not been obtained.- e.g. sales commission
- **Acc Treatment**: capitalise as an asset and amortise of the contract term

Cost to fulfil a contract

- **Definition**- refer para 97-98
- **Acc treatment**: refer to para 95

Cost to fulfil a contract

97 Costs that relate directly to a contract (or a specific anticipated contract) include any of the following:

(a) direct labour (for example, salaries and wages of employees who provide the promised services directly to the customer);

(b) direct materials (for example, supplies used in providing the promised services to a customer);

(c) allocations of costs that relate directly to the contract or to contract activities (for example, costs of contract management and supervision, insurance and depreciation of tools and equipment used in fulfilling the contract);

(d) costs that are explicitly chargeable to the customer under the contract; and

(e) other costs that are incurred only because an entity entered into the contract (for example, payments to subcontractors).

Acc Treatment

Costs to fulfil a contract

95 **If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example, IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*), an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:**

(a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);

(b) the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and

(c) the costs are expected to be recovered.

RISK

What could go wrong?

How can it be addressed?

Effective date

- Effective 1 Jan 2018
- Earlier application is permitted

Transition to IFRS 15

- **Key principles to note:**
  - Date of initial application- 1st day of reporting period of first application
  - Completed contract- full satisfied contract
- Method of transition (OPTIONAL):
  a) C3a)Retrospective subject to para C5 expedients
  b) C3b)Retrospective cumulative- C7&C8- RE adjustment

  Exemption from full compliance with IAS8.28 disclosure (disclose (f) only).

RISK

What could go wrong?

How can it be addressed?

CAA

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Financial Instruments

IAS 32, IAS 39/IFRS9, IFRS7

Industry Scoping

- Banking Sector
- Insurance
- Asset management
- Other

Introduction

Accounting for financial instruments

- IAS 32 *Presentation* (1995)
- IAS 39 Recognition and measurement (1998)
- IFRS 7 Disclosures (2005)
- IFRS 9 Recognition and measurement (2014)

Case study

- Zed Ltd obtain a loan from a local bank ZBC of $2 million which attracts interest at 15% p.a.
- Zed has $5 million in receivable at YE
- Zed is holding $500 000 treasury bills received from the RBZ. It intends to hold these to maturity.
- Zed also has a portfolio of equity instruments held for trading ($50 000 listed on ZSE) and capital appreciation ($150 000 unlisted).

Financial Instrument

*a **contract***

Share Certificate

10 m shares

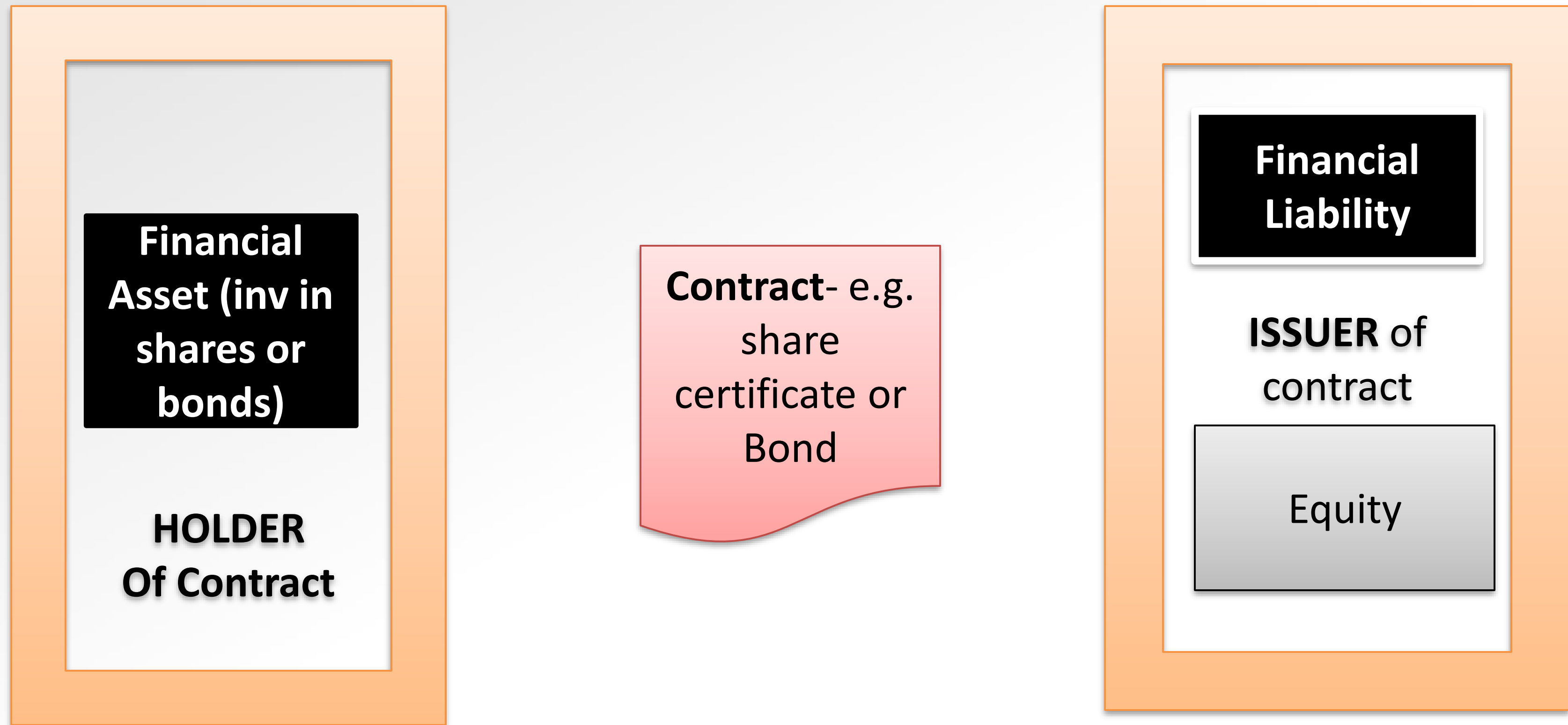
Bond

US$10 m

*that gives rise to a **financial asset** of one entity (**Holder**)*

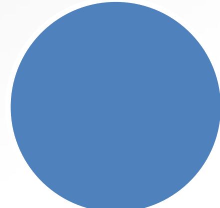
*and a **financial liability** or **equity instrument** of another entity (**Issuer**).*

Financial Instrument Diagram

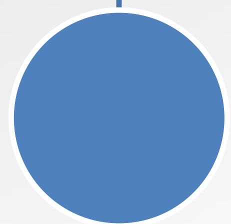


Financial Instrument

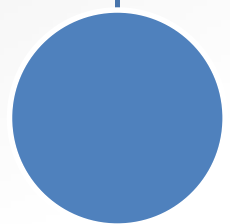
Issuer



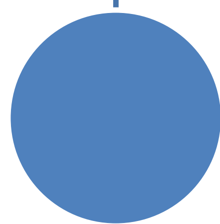
Holder



Liability



Equity



Financial Asset

Types of Financial Instruments

1. Equity Instruments:
   - shares
2. Debt Instruments
   - Loan
   - Receivable
   - Payable
   - Debentures
   - Preference shares
3. Derivatives: forwards, futures, options, swaps

Definitions

- **Financial asset** – any asset that is:
  - cash
  - a contractual right to receive cash (or another financial asset) from another entity
  - a contractual right to exchange financial instruments with another entity under conditions that are potentially favourable
  - an equity instrument of another entity.

Definitions, cont.

- A **financial liability** – any liability that is a contractual obligation:
  - to deliver cash (or another financial asset) to another entity, or
  - to exchange financial instruments with another entity under conditions that are potentially unfavourable.

- An **equity instrument** – any contract that evidences a residual interest in the assets of an entity (after deducting all liabilities).

Definitions, cont.

- A **derivative** – a financial instrument:
  - whose value changes in response to the change in a specified
    - interest rate
    - security price
    - commodity price
    - foreign exchange rate, or
    - similar variable
  - that requires little or no initial net investment relative to other types of contracts
  - that is settled at a future date.

RISK

What could go wrong?

How can it be addressed?

Classification

Financial assets are classified in IFRS 9/IAS39 as amortised cost or Fair value thru P&L or OCI

Financial Liabilities are classified as Fv thru P&L or other under IFRS 9/IAS39

Classification as **financial liability** or **equity** is done in IAS 32

Financial Asset (inv in shares or bonds)

HOLDER Of Contract

Contract- e.g. share certificate or Bond

Financial Liability

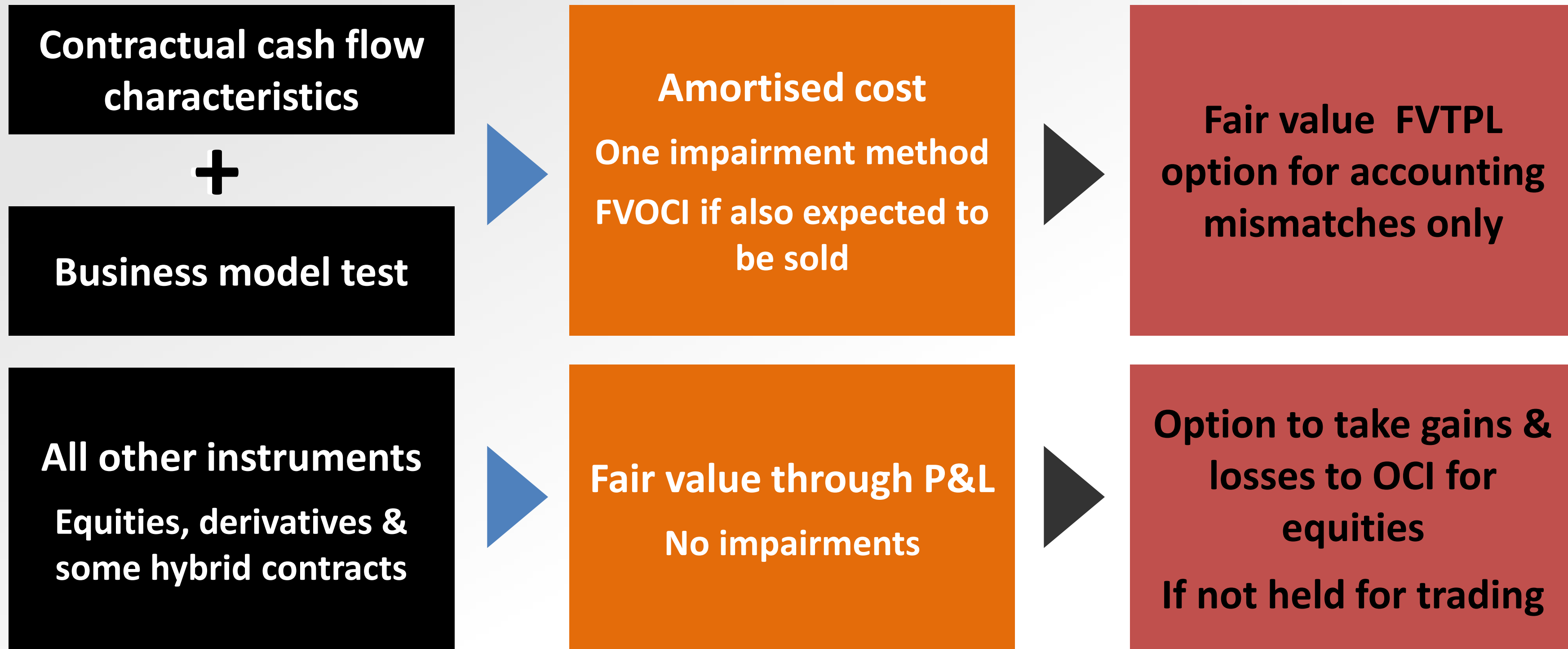
ISSUER of contract

Equity

Financial assets- IAS 39 Recap

	Initial measurement	Subsequent measurement
Loans & receivables Fixed or determinable payments Not quoted in an active market	Fair value Include transaction costs	Amortised cost
Held to maturity Long-term Fixed maturity Positive intent & ability		
Available for sale Medium to long-term Sell as and when		Fair value with gains & losses to OCI
At FV through P/L Short-term Held for trading	Fair value Exclude transaction costs	Fair value with gains & losses to profit or loss

IFRS9-Financial assets: summary



Classify into a measurement category at inception

Reclassification required where business model changes.

IFRS 9's debt instrument model

Is the objective of the entity's business model to hold the financial asset to collect contractual cash flows?

NO → Is the financial asset held to achieve an objective by both collecting contractual cash flows and selling financial assets?

NO → FVPL

YES ↓ (from both questions)

Do contractual cash flows represent solely payments of principal and interest

NO → FVPL

YES ↓

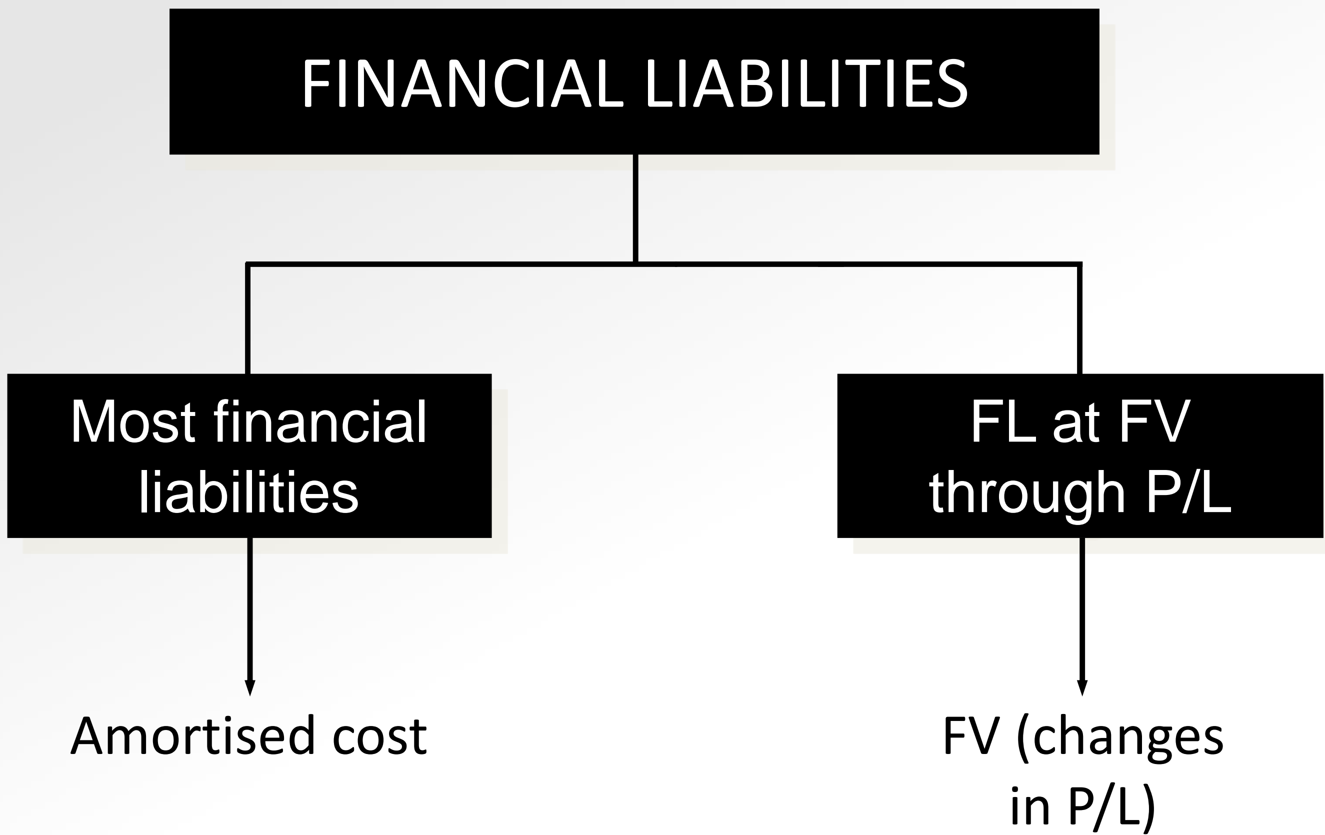
Does the company apply the fair value option to eliminate an accounting mismatch?

YES → FVPL

NO ↓

Amortised Cost | **FVOCI** | **FVPL**

Financial Liabilities - Subsequent measurement



Financial liabilities

Retain IAS 39 measurement requirements

Maintain fair value option – but with one amendment regarding 'own credit risk'

RISK

What could go wrong?

How can it be addressed?

Initial measurement

- On initial recognition measure at cost, which is the fair value of consideration
  - given (for an asset) or
  - received (for a liability)
- Transaction costs are included, **except** if asset/liability classed as FVTPL.

Subsequent measurement

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Fair value (P+L)

Fair value (OCI)

Amortised Cost

Fair value

Amortised cost

IFRS 9, Para 5.2.1

Amortised cost

- Amount measured at initial recognition
  minus
- Principal repayments
  plus or minus
- Cumulative amortisation of any difference between initial amount and maturity amount
  minus
- Any write-down for impairment or uncollectability.

Presentation

- Financial instruments should be classified as:
  - liabilities, or
  - equity

  in accordance with their substance on initial recognition.

Compound instruments

- E.g. convertible debt
- Contains some characteristics of equity and some of a financial liability
- Equity and debt components need to be estimated separately:
  - **First** determine carrying value of **debt component**
  - The **equity component** is the **residual amount**
- Issue costs are deducted in proportion to carrying value of the components

RISK

What could go wrong?

How can it be addressed?

Impairment of Financial Assets

Financial assets - impairments

Investments need to be reviewed for impairment

Held for trading	Already measured at fair value, therefore not an issue
Available for sale	Already measured at fair value, but any loss has been taken to OCI If impairment arises transfer loss to profit or loss
Held to maturity	If indication of impairment, compare carrying amount to present value of future cash flows. Loss to profit or loss

IASB's intention

Incurred Loss Model (IAS 39)

Expected Loss Model (IFRS 9)

Under the impairment approach in IFRS 9 it is no longer necessary for a credit event to have occurred before credit losses are recognised. Instead, an entity always accounts for expected credit losses, and changes in those expected credit losses. The amount of expected credit losses is updated at each reporting date to reflect changes in credit risk since initial recognition and, consequently, more timely information is provided about expected credit losses.

IFRS 9, IN 9

IASB's intention - previously

T1 T2 T3 T4 T5

Initial recognition of a financial asset

IAS 39: recognise loss only on the occurrence of the 'trigger loss event'

Dr Impairment Expense (P&L)

Cr Financial Asset

IASB's intention – currently

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T1 T2 T3 T4 T5

Initial recognition of a financial asset

IFRS 9: assess credit risk constantly and start recognising losses earlier

Dr Impairment Expense (P&L)

Cr Expected Credit Loss Allowance

Scope: which assets are subject to the ECL model?

- Financial assets measured at amortised cost;

  Exception: Purchased / originated credit impaired financial assets

- Financial assets measured at FV through OCI;

- Trade receivables, contract assets and lease receivables;

IFRS 9 para 5.5.1.

Overview of requirements

Stage 1
No significant increase in credit risk
Performing
ECL Allowance
12 month expected credit losses
Interest revenue
Gross basis

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Overview of requirements

Stage 2
Significant increase in credit risk
Under-performing
ECL Allowance
Lifetime expected credit losses
Interest revenue
Gross basis

Overview of requirements

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A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired include observable data about the following events:

(a) significant financial difficulty of the issuer or the borrower;

(b) a breach of contract, such as a default or past due event;

(c) the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;

IFRS 9 Appendix A

Stage 3
Credit impaired
Non-performing
Lifetime expected credit losses
Net basis

Overview of requirements

(d) it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;

(e) the disappearance of an active market for that financial asset because of financial difficulties; or

(f) the purchase or origination of a financial asset at a deep discount that reflects the incurred **credit losses**.

It may not be possible to identify a single discrete event—instead, the combined effect of several events may have caused financial assets to become credit-impaired.

IFRS 9 Appendix A

Stage 3
Credit impaired
Non-performing
Lifetime expected credit losses
Net basis

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Overview of req

IFRS 9 5.5.9 – 5.5.11

Change in credit quality since initial r gnition of financial asset

Stage 1 (IFRS 9 par 5.5.5)	Stage 2 (IFRS 9 par 5.5.3)	Stage 3
No significant increase in credit risk	Significant increase in credit risk	Credit impaired
Performing	Under-performing	Non-performing
Expected Credit Losses Recognised (ECL Allowance)		
12 month expected credit losses	Lifetime expected credit losses	Lifetime expected credit losses
Interest revenue		
Gross basis	Gross basis	Net basis

General deterioration of the credit quality of the financial asset

General approach

- Recognise a loss allowance for expected credit losses on all financial assets within the scope;

- If:
  - Credit risk has increased significantly since initial recognition, the loss allowance will be at an amount equal to lifetime expected credit losses
  - Credit risk has NOT increased significantly since initial recognition, the loss allowance will be at an amount equal to 12month expected credit losses

More useful terms

- Credit risk

….the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

IFRS 7 Appendix A

More useful terms

- Expected Credit Losses

The weighted average of **credit losses** with the respective risks of a default occurring as the weights.

IFRS 9 Appendix A

General approach

- Expected Credit Losses

An entity shall measure expected credit losses of a financial instrument in a way that reflects:

(a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;

(b) the time value of money; and

(c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

IFRS 9 par 5.5.17

General approach *continued*

- Lifetime expected losses

The **expected credit losses** that result from all possible default events over the expected life of a financial instrument.

IFRS 9 Appendix A

i.e. the loss which will arise should default take place!

General approach *continued*

- 12-month expected losses

The portion of **lifetime expected credit losses** that represent the **expected credit losses** that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

IFRS 9 Appendix A

General approach *continued*

- Loss allowance:

	R
Dr Expected credit losses	XXX
Cr Impairment allowance	XXX
Recognition of an impairment in a financial asset	

  - The expected credit loss / impairment is presented separately on the face of the Statement of P&L.
  - The allowance is presented separately on the face of the Statement of Financial Position.

Measurement of Expected Credit Losses

PV of expected cash flows (discounted at original EIR)

−

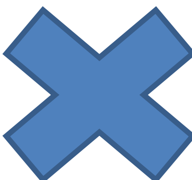
PV of contractual cash flows (discounted at original EIR)

=

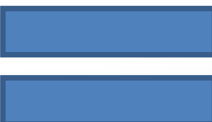
Credit losses

Measurement of Expected Credit Losses

Credit losses



Probability of default event taking place in the next 12 months



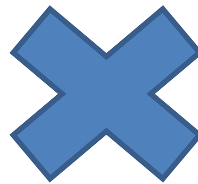
12-month expected credit losses

When are 12-month ECL recognised?

- The ECL allowance will reflect 12-month ECL :
  - On initial recognition; or
  - When the credit risk presented by the financial instrument is ‘low’; **or**
  - When the credit risk presented by the financial instrument has not significantly increased since initial recognition / previous reporting date.

Measurement of Expected Credit Losses

Credit losses



Probability of default event taking place in lifetime of the instrument

Lifetime expected credit losses

CHARTERED ACCOUNTANTS ACADEMY

When are lifetime ECL recognised?

- The ECL allowance will reflect lifetime ECL when:
  - The credit risk presented by the financial instrument is no longer ‘low’; **or**
  - The credit risk presented by the financial instrument has significantly increased since initial recognition / previous reporting date.

Exceptions to the general approach

- Trade receivables, contract assets and lease receivables; and

IFRS 9 5.5.15

- Purchased / Originated Credit-impaired Financial Assets

IFRS 9 5.5.13

RISK

What could go wrong?

How can it be addressed?

Derecognition of a financial asset

- An entity derecognises a financial asset (or part thereof) when, and only when, it loses control of the contractual rights that comprise the financial asset.
- An entity loses such control if:
  - it realises the rights to benefits specified in the contract
  - the rights expire
  - the entity surrenders those rights.
- A transfer of a financial asset to another entity without loss of control = collateralised borrowing.

Derecognition of a financial liability

- An entity derecognises a financial liability when, and only when, it is extinguished.
- This condition is met when either the debtor:
  - discharges the liability by paying the creditor, or
  - is legally released from primary responsibility for the liability (or part thereof).
- Gain/loss included in profit or loss is the difference between:
  - the carrying amount extinguished or transferred (including related unamortised costs), and
  - the amount paid for it.

RISK

What could go wrong?

How can it be addressed?

Effective date

- Effective 1 Jan 2018
- Earlier application is permitted

Transition

- Retrospective application, with exceptions
- Initial date of application

Other Issues

- ED 2015/11- Application of IFRS 9 with IFRS 4
- A proposed amendment to IFRS 4
- Difference timing for applying IFRS9 and the new IFRS 4
- Possible accounting mismatches and misunderstandings
- Overlay approach + temporary exemption

RISK

What could go wrong?

How can it be addressed?

Practice Statement

Management Commentary

How is management commenting in Annual Reports in Zimbabwe?

Review a ZSE listed Co.

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How is management commenting in Annual Reports in Globally?

Review a Welltec.

What is a Management Commentary (MC)?

- a narrative report that **provides a context** within which to interpret the AFS.
- provides management with an **opportunity to explain its objectives and its strategies** for achieving those objectives
- management commentary help users to evaluate an entity’s prospects and its general risks as well as successes
- Communication tool

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Objective of Management Commentary

- to **assist management** in presenting useful management commentary that relates to financial statements that have been prepared in accordance with IFRS

About MC

- Practice Statement is not an IFRS
- Not Prescriptive
- non-compliance with MC will not stop AFSs to comply with IFRSs
- Only applied by entities using IFRS (scope)

Identification of MC

- AFS should be made available with an MC or an MC should identify the AFS it relates to
- Identify MC clearly and separately in AFS
- Compliance: explain extent of compliance with MC in AFS other it complies in its entirety

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Users of MC

- MC considers needs of the primary users of financial reports.
- Those users are existing and potential investors, lenders and other creditors.

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Framework

- provide users with integrated information regarding:
  - context for the related financial statements,
  - the entity's resources and the claims against the entity and its resources, and
  - the transactions and other events that change them.

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Framework

- Management commentary should be consistent with the following **principles**:
  - Provide management's view of the entity's performance, position and progress (including forward looking information)
  - Supplement and complement information presented in the AFS (and possess the qualitative characteristics described in the *Conceptual Framework for Financial Reporting*)

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Presentation

- MC should be clear and straightforward, and
- focus on the most important information in a manner intended to address the principles, specifically:
  - being consistent with its related AFS
  - avoiding duplicating disclosures made in AFS where practicable
  - avoiding generic and immaterial disclosures.

ELEMENT	USER NEEDS
The nature of the business	The knowledge of the business in which an entity is engaged and the external environment in which it operates
Management's objectives and its strategies for meeting those objectives	To assess the strategies adopted by the entity and the likelihood that those strategies will be successful in meeting management's stated objectives
The entity's most significant resources, risks and relationships	A basis for determining the resources available to the entity as well as obligations to transfer resources to others; the ability of the entity to generate long-term, sustainable net inflows of resources; and the risks to which those resource-generating activities are exposed, both in the near term and in the long term

Elements of MC

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ELEMENT	USER NEEDS
The results of operations and prospects	The ability to understand whether an entity has delivered results in line with expectations and, implicitly, how well management has understood the entity's market, executed its strategy and managed the entity's resources, risks and relationships
The critical performance measures and indicators that management uses to evaluate the entity's performance against stated objectives	The ability to focus on the critical performance measures and indicators that management uses to assess and manage the entity's performance against stated objectives and strategies

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Have you been served?