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Fourth Edition

Financial ACCOUNTING

IFRS Principles

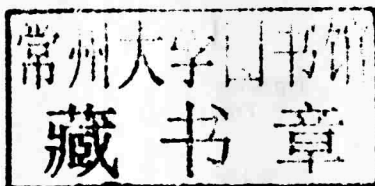
Ilse Lubbe | Goolam Modack | Alex Watson



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IFRS Principles

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OXFORD
UNIVERSITY PRESS
SOUTHERN AFRICA

Oxford University Press is a department of the University of Oxford.
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Oxford University Press in the UK and in certain other countries.

Published in South Africa by
Oxford University Press Southern Africa (Pty) Limited

Vasco Boulevard, Goodwood, N1 City, Cape Town, South Africa, 7460
P O Box 12119, N1 City, Cape Town, South Africa, 7463

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First published 2011
Fourth edition published 2014

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Financial Accounting: IFRS Principles 4e

ISBN 978 0 19 904923 3

Third impression 2015

Typeset in Minion Pro Regular 9.5pt on 11.5pt
Printed on 70 gsm woodfree paper

Acknowledgements

Publishing Manager: Alida Terblanche

Publisher: Marisa Montemaranano

Project Manager: Kelly Williams

Editor: Louise Banks

Indexer: Adrienne Pretorius

Designer: Judith Cross, Oswald Kurten

Typesetter: Baseline Publishing Services

Cover design: Judith Cross

Cover image: iStock

Printed and bound by ABC Press, Cape Town

122992

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PREFACE

It remains a challenge to accountants to prepare and present financial information for an entity in a way that is informative and useful to its users. Much has been written and debated in recent years on the way in which an entity presents and communicates its financial position and financial performance to its stakeholders. These issues emphasised the need for financial information to represent the resources, claims and changes in the resources and claims of the reporting entity faithfully. The Conceptual Framework for Financial Reporting identifies the information needs of the capital providers of an entity as the main objective of financial reporting, and emphasises the importance of providing financial information that investors and creditors understand and can use to inform their decisions. This framework is based on the application of principles rather than rules. The principles applied when financial statements are prepared and presented are included in a set of accounting standards issued by the International Accounting Standards Board (IASB), collectively referred to as the International Financial Reporting Standards ('IFRS').

Global capital and financial markets highlighted the need for a single, global set of financial reporting standards. There are currently two main sets of accounting standards worldwide: those developed and approved by the International Accounting Standards Board (IASB), referred to as **International Financial Reporting Standards** (IFRS), and those developed and approved by the United States of America's (US) Financial Accounting Standards Board (FASB), referred to as US GAAP. In this textbook, we focus only on the principles included in IFRS. **Small and medium-sized entities** without public accountability are allowed to apply IFRS for SMEs when preparing financial statements. Where applicable, references are included for the application of IFRS for SMEs.

This publication applies a framework-based approach in the education of financial accounting principles. It assumes a basic knowledge of financial accounting, including the ability to prepare simple financial statements. From that starting point, you will be introduced to the application of the IFRSs, with the emphasis being placed on the concepts underpinning these standards. Once you have a strong understanding of the Conceptual Framework, you will realise that individual standards apply the principles of the framework, and that at different times, practical considerations and cost/benefit trade-offs may give rise to different applications of those principles.

The fourth edition of this publication has been updated with new publications and developments in IFRS, and more specifically those resulting from the new *Group Accounting Standards* (IFRS10, IFRS11 and IFRS12), *Fair Value Measurement* (IFRS13) and *Revenue from Contracts with Customers* (IFRS15). The chapters dealing with group accounting (included in Part 4 of this publication) have been revised extensively. Lecturers and students are referred to another new publication, *Financial Accounting: Groups* (Lubbe, Modack, Herbert & Hyland, 2014), which extends the discussion relating to group accounting and includes case studies with more detailed explanations.

This textbook has been updated for all changes in IFRS that are considered relevant and had been issued as standards by the IASB up to August 2014.

Acknowledgements

Our colleagues and the students in the College of Accounting at the University of Cape Town provided valuable input on the previous two editions. Thank you for your comments and contributions. We would also like to thank our families for their support, patience and encouragement.

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August 2014

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PEDAGOGY

How to use this book

This is the fourth edition of the popular textbook *Financial Accounting: IFRS Principles*. It adopts a concepts-based approach in terms of the structure of the content, which is supported by discussions of contemporary issues, South African case studies and accounting challenges that are unique to the South African environment.

The book contains a number of features in each chapter to help the reader, whether he or she is a student, a tutorial group leader or a lecturer.

Parts

There are five parts to the book. You will see that each has its own introduction, which talks about the major aims of the chapters included in that part, and gives an indication of how the chapters in each part relate to each other and to the study of financial accounting as a whole. An example of a part is found on pages 1 and 2.

IFRS references

At the beginning of each chapter, you will find a list of IFRS and IFRS for SMEs references.

IFRS references

IFRS15: Revenue from Contracts with Customers

IFRS for SMEs references

Section 23: Revenue (including Construction Contracts)

Learning objectives

At the beginning of each chapter, you will find a bullet-point list of skills-orientated learning objectives. After studying the chapter, you should have enough information at your disposal to be able to express an informed opinion on the objective in question and to demonstrate a related skill if this is relevant. Here is an example:

- By the end of this chapter, you should be able to apply the requirements of the various sections of the Companies Act dealing with the disclosure of financial statements of companies.

Examples

Practical examples illustrating concepts and principles feature in every chapter, and provide a valuable study and revision tool.

Features

The study of the content of this book is made more interesting by the inclusion of boxes called 'Something to think about', which contain interesting research facts, debates and anomalies, or provide clarity on the specific detail of an accounting principle or standard.

Something to think about

Production costs can be divided into fixed and variable costs. Do you think depreciation is a fixed or a variable cost? Where depreciation is allocated on the basis of time, it would be a fixed cost. Where depreciation is allocated on the basis of the number of units produced, it would be a variable cost because it would vary in line with the number of units produced.

A feature called 'Something to do' also appears periodically. These either check what you have learnt or suggest an activity that will help you relate the theory being discussed to real life. Here is an example:

These features can also be used by tutorial leaders and lecturers as the point of discussion in a classroom situation.

Attention is drawn throughout to the new IFRS for SMEs standards in order to emphasise the key differences between these standards and the IFRS standards applied to larger entities.

Another useful feature is the highlighting of IFRS principles.

In Chapter 2, you will find a feature emphasising principles relating to the new Conceptual Framework.

At the end of every chapter, there is a reminder to go back over the learning objectives to ensure that all of the outcomes for a specific chapter have been achieved.

Something to do

Identify the information needs of the primary users of financial information that you would include in an integrated report. Think about how you would gather and report that information to ensure that it is useful, relevant, understandable and timely.

IFRS for SMEs update

The use of the revaluation model for subsequent measurement of property, plant and equipment is not an option in Section 17. This means that only the cost model is used for the subsequent measurement of property, plant and equipment for small and medium-sized entities.

IFRS principle: Accrual basis of accounting

The accrual basis of accounting requires a transaction to be recorded on the date it occurred, not when payment was made.

Conceptual Framework principle

For financial information to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable (refer to paragraph QC4 of the *Conceptual Framework*).

Test your knowledge

At the beginning of this chapter, there is a list of learning objectives. Go back to this list and check whether you have achieved these outcomes. If not, reread the appropriate section.

References to IFRS and IFRS for SMEs standards

You will see that the relevant IFRS and IFRS for SMEs accounting standards are carefully referenced throughout the text. They also appear in a useful list at the beginning of the book, on pages xxii to xxvi.

Exercises

Each chapter includes worked examples. As a student accountant, you will know that the best way to promote your complete understanding of the principles and applications involved is to practise using various exercises or examples. Additional questions and answers have been made available to lecturers using this textbook. These can be used as the basis of tutorials, further classroom discussion or assignments.

Free CD!

A CD containing a series of graded questions, including additional questions at an advanced level, together with selected solutions and helpful comments, is supplied free with every textbook purchased.

Ancillary material

An Instructor's Manual to accompany this fourth edition of *Financial Accounting: IFRS Principles* will be made available by Oxford University Press Southern Africa to lecturers prescribing this textbook.

The Instructor's Manual contains the following:

- 1 Solutions to all questions in the textbook and on the student CD
- 2 A teaching plan
- 3 A set of PowerPoint® slides.

The Instructor's Manual is available on CD with the ISBN 978 0 19 040248 8, and can be obtained from Oxford University Press SA through the Higher Education sales administrator.

Further contact

Should you have any comments about this textbook, the publisher and authors would be pleased to receive them. Contact the Commissioning Editor, Higher Education Division, Oxford University Press Southern Africa or contact Oxford University Press Southern Africa through the website at www.oxford.co.za.

INTERNATIONAL FINANCIAL REPORTING STANDARDS AND INTERPRETATIONS

International Financial Reporting Standards (IFRS)			
IFRS/IAS	IFRS for SMEs (Section/s)	Title	Chapter/s
IFRS1	–	First-time Adoption of International Financial Reporting Standards	–
IFRS2	26	Share-based Payment	21
IFRS3	19	Business Combinations	22, 6
IFRS4	–	Insurance Contracts	–
IFRS5	–	Non-current Assets Held for Sale and Discontinued Operations	15
IFRS6	–	Exploration for and Evaluation of Mineral Resources	–
IFRS7	11, 12	Financial Instruments: Disclosures	8
IFRS8	–	Operating Segments	3
IFRS9	11, 12, 22	Financial Instruments	8
IFRS10	9	Consolidated Financial Statements	23
IFRS11	–	Joint Arrangements	25
IFRS12	–	Disclosure of Interests in Other Entities	26
IFRS13	–	Fair Value Measurement	3
IFRS15	23	Revenue from Contracts with Customers	17
IAS1	3, 4, 5, 6, 7, 8	Presentation of Financial Statements	3, 16, 19
IAS2	13	Inventories	7
IAS7	7	Statement of Cash Flows	27
IAS8	10	Accounting Policies, Changes in Accounting Estimates and Errors	18
IAS10	32	Events after the Reporting Period	14
IAS12	29	Income Taxes	12
IAS16	17	Property, Plant and Equipment	4
IAS17	20	Leases	11
IAS19	28	Employee Benefits	19
IAS20	24	Accounting for Government Grants and Disclosure of Government Assistance	–
IAS21	30	The Effects of Changes in Foreign Exchange Rates	20, 24
IAS23	25	Borrowing Costs	13
IAS24	33	Related Party Disclosures	3
IAS26	–	Accounting and Reporting by Retirement Benefit Plans	–
IAS27	9	Separate Financial Statements	23
IAS28	14, 15	Investments in Associates and Joint Ventures	25
IAS29	31	Financial Reporting in Hyperinflationary Economies	–
IAS32	11, 12, 22	Financial Instruments: Presentation	8, 16
IAS33	–	Earnings per Share	28
IAS34	–	Interim Financial Reporting	3
IAS36	27	Impairment of Assets	9, 6
IAS37	21	Provisions, Contingent Liabilities and Contingent Assets	10
IAS38	18	Intangible Assets	6
IAS39	11, 12, 22	Financial Instruments: Recognition and Measurement	8
IAS40	16	Investment Property	5
IAS41	34	Agriculture	–

Interpretations		
IFRIC/SIC	Title	Chapter/s
IFRIC1	Changes in Existing Decommissioning, Restoration and Similar Liabilities	4, 10
IFRIC2	Members' Shares in Co-operative Entities and Similar Instruments	–
IFRIC4	Determining whether an Arrangement Contains a Lease	11
IFRIC5	Rights to Interests Arising From Decommissioning, Restoration and Environmental Rehabilitation Funds	4, 10
IFRIC6	Liabilities Arising From Participating in a Specific Market – Waste Electrical and Electronic Equipment	–
IFRIC7	Applying the Restatement Approach under IAS29 Financial Reporting in Hyperinflationary Economies	–
IFRIC10	Interim Financial Reporting and Impairment	–
IFRIC12	Service Concession Arrangements	–
IFRIC14	IAS19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and Their Interaction	–
IFRIC16	Hedges of a Net Investment in a Foreign Operation	–
IFRIC17	Distributions of Non-cash Assets to Owners	16
IFRIC18	Transfer of Assets from Customers	–
IFRIC19	Extinguishing Financial Liabilities with Equity Instruments	–
IFRIC20	Stripping Costs In the Production Phase of a Surface Mine	–
SIC7	Introduction of the Euro	–
SIC10	Government Assistance – No Specific Relation to Operating Activities	–
SIC15	Operating Leases – Incentives	11
SIC25	Income Taxes – Changes in the Tax Status of an Entity or its Shareholders	–
SIC27	Evaluating the Substance of Transactions Involving the Legal Form of a Lease	11
SIC29	Service Concession Arrangements: Disclosures	–
SIC32	Intangible Assets – Web Site Costs	6

South African Financial Reporting Guides (FRG)		
FRG	Title	Chapter/s
FRG1	Substantively Enacted Tax Rates and Tax Laws	12
FRG2	Accounting for Black Economic Empowerment (BEE) Transactions	21
FRG3	The Limit on a Defined Benefit Asset, Minimum Funding Requirements and Their Interaction in the South African Pension Fund Environment	

Circulars issued by the South African Institute of Chartered Accountants (only those covered in this textbook are listed here)		
Circular	Title	Chapter/s
CC 09/06	Transactions Giving Rise to Adjustments to Revenue/purchases	17
CC 12/06	Operating Leases	11
CC 02/13	Headline Earnings	28

KEY DIFFERENCES BETWEEN IFRS AND IFRS FOR SMES¹

Chapter	Topic	Full IFRS		IFRS for SMEs	
3	Presentation of financial statements	IAS1	A statement of profit or loss and other comprehensive income must be presented, although it can be prepared as a combined statement, or split into a statement of profit or loss and a statement of profit or loss and other comprehensive income .	S3	In addition to the options in IAS1, if a company has no other comprehensive income , it may present a statement of income and retained earnings .
4	Property, plant and equipment	IAS16	Replacement parts are considered for capitalisation in terms of the normal asset recognition criteria .	S17	Replacement parts must provide incremental future benefits in order to be capitalised.
		IAS16	The component approach is applied to each significant part of PPE.	S17	The component approach is only applied where a component has significantly different depreciation patterns .
		IAS16	Borrowing costs must be capitalised to PPE .	S17	Borrowing costs may not be capitalised to PPE .
		IAS16	The cost or revaluation models may be used.	S17	Only the cost model may be used for PPE.
		IAS16	The residual value, depreciation method and useful life must be reassessed annually .	S17	The residual value, depreciation method and useful life must be reassessed only when there are indications of change .
5	Investment properties	IAS40	Companies have a policy choice between measuring investment property at cost or fair value.	S16	If the fair value of investment property can be determined, it must be measured using the fair value method . Otherwise it is accounted for as property, plant and equipment using depreciated cost .
		IAS40	If the residual value of investment property cannot be measured reliably, it is deemed to be zero .	S16	The residual value must be estimated if it cannot be measured reliably.
6	Intangible assets	IAS38	The residual value, depreciation method and useful life must be reassessed annually .	S18	The residual value, depreciation method and useful life must only be reassessed when there are indications of change.
		IAS38	Development costs may be capitalised once certain criteria have been met.	S18	Development costs must be expensed .
		IAS38	Intangible assets may have an indefinite useful life and only be subject to an annual impairment test.	S18	Intangible assets are amortised over their useful lives. If the company cannot estimate the useful life, it is presumed to be ten years.
		IAS38	The cost or revaluation models may be used.	S18	Only the cost model may be used for intangible assets.
7	Inventories	IAS2	Borrowing costs must be capitalised to inventory .	S13	Borrowing costs may not be capitalised to inventory .

1 The IFRS for SMEs was first published by the IASB in July 2009. This standard is currently under review. At the time of publication, the IASB has issued an Exposure Draft (ED/2013/9), *Proposed Amendments to the International Financial Reporting Standard for Small and Medium-sized Entities*.

Chapter	Topic	Full IFRS	IFRS for SMEs
8	Financial instruments	IFRS9 (IAS39) IFRS7 IAS32	S11/S12 Financial instruments are measured at either of the following: <ul style="list-style-type: none"> Fair value through profit and loss Amortised cost. There are fewer disclosure requirements. However: Fallback option to IAS39 (IFRS9).
9	Impairment	IAS36	S27 Goodwill must be assessed for impairment annually . Goodwill is only tested for impairment if indicators exist .
11	Leases	IAS17	S20 Leased assets are not required to be tested for impairment unless there is an indication of impairment . Leased assets are required to be tested for impairment annually .
		IAS17	S20 Straight-lining of operating leases with a fixed escalation clause is required. Operating leases are not required to be accounted for on a straight-line basis if the escalation is in line with expected general inflation.
12	Deferred tax	IAS12	S29 ² Disclosure: Requires tax rate reconciliation . No tax rate reconciliation is required. However, an explanation of significant reconciling amounts is required.
13	Borrowing costs	IAS23	S25 Borrowing costs on qualifying assets are capitalised . All borrowing costs are expensed .
17	Revenue	IFRS15	S23 Revenue arises from contracts with customers . Revenue arises from transactions and events including the sale of goods , the rendering of services , construction contracts and the use by others of the entity assets yielding interest , royalties or dividends .
18	Change in accounting policies	IAS8	S10 The effects of a change in accounting policy on earnings per share must be presented. The effects of a change in accounting policy on earnings per share are not required to be presented.
22	Business combinations	IFRS3	S9/S19 Non-controlling interest must be accounted for at fair value at acquisition. Non-controlling interest must be accounted for at their share of the fair value of net assets at acquisition.
		IAS27	S9 When the shareholding in a subsidiary decreases and control is lost as a result, the fair value of the remaining investment is deemed to be the cost of the retained interest . When the shareholding in a subsidiary decreases and control is lost as a result, the carrying amount of the remaining investment is deemed to be the cost of the retained interest . In the parent's separate financial statements, this cost will be the original cost, while in the consolidated financial statements, this will include the group share of post-acquisition earnings.
		IFRS3	S19 Full goodwill may be recognised at acquisition of a subsidiary, which includes the fair value of the goodwill attributable to non-controlling interest. The goodwill recognised is limited to the goodwill purchased by the parent company.
		IAS36	S19 Goodwill is not amortised , but is rather tested for impairment annually. Goodwill is amortised over its useful life. If the company cannot estimate the useful life, it is presumed to be ten years.

2 Initially, Section 23 of IFRS for SMEs was based on the IASB's exposure draft *Income Tax* (published in March 2009). However, the additional training material published by the IASB clarifies the alignment with full IFRS. The IFRS for SMEs training material is available on the IFRS website (www.ifrs.org).

Chapter	Topic	Full IFRS		IFRS for SMEs	
		IFRS3	Acquisition costs must be expensed in the period in which they are incurred.	S19	Acquisition costs are included in the cost of the business combination and are therefore effectively included in goodwill.
25	Investments in associates and joint ventures	IAS28	Investments in associates and joint ventures must be measured using the equity accounting method , except for limited circumstances when fair value may be used.	S14, S15	Investments in associates and joint ventures may be measured at cost , at fair value or by using the equity accounting method .
		IAS28	There are no specific requirements regarding the treatment of transaction costs.	S14	Transaction costs are included in the cost of the investment.
		IAS28	Goodwill is included in the investment in associate and is not amortised .	S14	When using the equity method, goodwill is recognised separately and amortised .

The following topics have been omitted from IFRS for SMEs:

- Earnings per share
- Interim financial reporting
- Segment reporting
- Insurance
- Assets held for sale (however, Section 4:14 requires the separate disclosure of assets [and facts] relating to a ‘binding sale agreement for a major disposal of assets’).

ABRIDGED TABLE OF CONTENTS

Part 1	Financial reporting	1
Chapter 1	The financial reporting environment	3
Chapter 2	Review of the Conceptual Framework	19
Chapter 3	Presentation of financial statements	45
Part 2	The statement of financial position	91
Chapter 4	Property, plant and equipment	93
Chapter 5	Investment properties	131
Chapter 6	Intangible assets	147
Chapter 7	Inventories	163
Chapter 8	Financial instruments	203
Chapter 9	Impairment of assets	249
Chapter 10	Provisions, contingent liabilities and contingent assets	263
Chapter 11	Leases	289
Chapter 12	Income taxes	313
Chapter 13	Borrowing costs	359
Chapter 14	Events after the reporting period	371
Chapter 15	Non-current assets held for sale and discontinued operations	379
Chapter 16	Owners' equity	391
Part 3	The statement of profit or loss and other comprehensive income	429
Chapter 17	Revenue	431
Chapter 18	Accounting policies, changes in accounting estimates and errors	467
Chapter 19	Expenses, gains and losses	495
Chapter 20	Foreign exchange transactions	527
Chapter 21	Share-based payments	545
Part 4	Accounting for groups	555
Chapter 22	Business combinations	559
Chapter 23	Separate financial statements	577
Chapter 24	Consolidated financial statements	593
Chapter 25	Investments in associates and joint ventures	655
Chapter 26	Joint arrangements	675
Part 5	Other reporting	681
Chapter 27	Statements of cash flows	683
Chapter 28	Earnings per share and headline earnings per share	727
Chapter 29	Analysis and evaluation of financial statements	745

CONTENTS

Preface	xvii
Authors and contributors	xviii
Pedagogy	xix
International financial reporting standards and interpretations	xxii
Key differences between IFRS and IFRS for SMEs	xxiv

Part 1 FINANCIAL REPORTING 1

CHAPTER 1 The financial reporting environment 3

1 Introduction to financial reporting	4
1.1 What is accounting and how did it develop?	4
1.2 What are accounting standards and reporting frameworks?	5
2 International Financial Reporting Standards (IFRS)	6
2.1 The standard-setting structure of IFRS	7
2.2 Compliance with IFRS	8
2.3 The current status of IFRS	8
3 Interpreting an entity's financial statements in the light of the limitations of IFRS	9
4 New developments in financial reporting	9
4.1 IFRS for small and medium-sized entities	10
4.2 Corporate governance	11
4.3 Integrated reporting	12
4.4 XBRL-reporting	14
5 Practical implementation of IFRS in South Africa	15
5.1 The South African financial reporting system	15
5.2 Legal requirements for compliance with IFRS in South Africa	15

CHAPTER 2 Review of the Conceptual Framework 19

1 Introduction	20
1.1 What is the status of the updates?	21
2 The purpose of the Conceptual Framework	22
3 General purpose financial reporting	22
3.1 What is the objective of general purpose financial reporting?	23
3.2 Who are the users of the financial statements?	25

3.3 Who is responsible for the preparation and presentation of financial statements?	26
4 The reporting entity	27
4.1 The entity as a going concern	28
5 Characteristics of useful financial information	28
5.1 Faithful representation	29
5.2 Relevance and materiality	30
5.3 Enhancing qualitative characteristics	31
5.4 Balancing the cost of information with its benefits	34
6 Elements of financial statements	34
6.1 Assets	35
6.2 Liabilities	36
6.3 Equity	36
6.4 Discussion paper update	37
6.5 Performance	38
7 Recognition and measurement of the elements	39
7.1 Recognising assets and liabilities	39
7.2 Measurement	39
7.3 Which measurement basis to use	40
8 Concepts of capital	41

CHAPTER 3 Presentation of financial statements 45

1 Introduction	47
2 Preparation and presentation of financial statements	48
2.1 General purpose financial statements	48
2.2 Supplementary reports and disclosures	49
2.3 Financial reporting developments	50
2.4 Integrated reporting	51
3 Overall considerations to be used when preparing financial statements	51
3.1 Qualitative characteristics of information contained in financial statements	51
3.2 Comparability	55
3.3 Assumptions underlying the preparation of financial statements	56
4 Structure of financial statements	58
4.1 Identification of the entity	58
4.2 Separate and group financial statements	58
4.3 Reporting period	59
4.4 Interim reports	60

5	Derecognition of intangible assets	160	2.2	Financial liabilities	207
6	Disclosure of intangible assets	160	2.3	Equity instruments	209
6.1	Accounting policy	160	2.4	Derivative instruments	210
6.2	Disclosure in the statement of financial position	160	2.5	Compound financial instruments	210
6.3	Disclosure in the statement of profit or loss and other comprehensive income	161	3	Basic financial assets	210
CHAPTER 7 Inventories	163		3.1	Initial recognition and measurement	211
1	Introduction	164	3.2	Subsequent measurement	213
2	Accounting for inventory	164	3.3	Reclassifications	226
2.1	Definition of inventory	164	3.4	Subsequent changes in financial assets not related to cash flows	226
2.2	Classification as a current asset	166	3.5	Impairments and uncollectable financial assets	229
2.3	Categorisation of inventory	166	3.6	Derecognising financial assets	229
3	The recording and reporting of inventory	167	4	Basic financial liabilities	229
3.1	Recording inventory	167	4.1	Raising capital	229
3.2	Reporting issues	171	4.2	Initial measurement at fair value	230
4	Measurement of inventory	171	4.3	Interest or dividends payable	233
4.1	How to determine cost	172	4.4	Subsequent measurement	235
4.2	Abnormal wastage	176	4.5	Foreign liabilities	241
4.3	Costs for a service provider	177	4.6	Derecognising financial liabilities	241
4.4	Costing formulae	178	5	Derivatives	241
4.5	Changes in the accounting policy for allocating costs	183	5.1	Embedded derivatives	242
4.6	Conversion costs	183	5.2	Share rights and options	242
4.7	By-products and joint products	189	6	Hedge accounting	243
4.8	Inventories held at branches	190	7	Presentation and disclosure of financial instruments	243
5	Net realisable value	195	7.1	Accounting policy note	244
5.1	Calculating net realisable value	195	7.2	Presentation of the statement of financial position and notes	244
5.2	Recording net realisable value adjustments	197	7.3	Presentation of the statement of profit or loss, and other comprehensive income and notes	245
5.3	Subsequent recovery of inventory previously recognised at net realisable value	197	CHAPTER 9 Impairment of assets	249	
5.4	Disclosure of write-downs to net realisable value and reversals of these in subsequent years	198	1	Introduction	250
6	Disclosure requirements for inventory	198	2	Descriptions of impairment	250
6.1	Accounting policy	199	3	Identifying an asset that may be impaired	251
6.2	Disclosure in the statement of financial position	199	3.1	When to undertake an impairment test	252
6.3	Disclosure in the statement of profit or loss and other comprehensive income	199	3.2	Collecting evidence	252
CHAPTER 8 Financial instruments	203		4	Measurement of the recoverable amount of an asset	252
1	Introduction	205	4.1	Calculating fair value less costs to sell	253
2	Description and classification of financial instruments	206	4.2	Calculating value in use	253
2.1	Financial assets	206	5	Recognising an impairment loss	254
			6	Reversal of an impairment loss	255
			6.1	Compensation for impairments	256
			7	Cash-generating units and goodwill	258
			7.1	Calculating recoverable amount and carrying amount of cash-generating units	258