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Fourth Edition

Financial ACCOUNTING

IFRS Principles

Ilse Lubbe | Goolam Modack | Alex Watson

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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:

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.

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.

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.

Another useful feature is the highlighting of IFRS principles.

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.

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

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*).

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.

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 SMES[1]

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	**Financial instruments** are measured at fair value or amortised cost. Fair value gains and losses are recognised in profit and loss. For investments in equity instruments: may designate fair value gains and losses through **other comprehensive income**.	S11/S12	**Financial instruments** are measured at either of the following: • Fair value through profit and loss • Amortised cost. There are fewer disclosure requirements. **However: Fallback option to IAS39 (IFRS9).**
9	Impairment	IAS36	**Goodwill** must be **assessed** for impairment **annually**.	S27	**Goodwill** is only tested for impairment **if indicators exist**.
11	Leases	IAS17	**Leased assets** are not required to be **tested** for impairment unless there is an **indication of impairment**.	S20	**Leased assets** are required to be **tested for impairment annually**.
		IAS17	**Straight-lining** of operating leases with a fixed escalation clause is required.	S20	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	Disclosure: Requires **tax rate reconciliation**.	S29[2]	No **tax rate reconciliation** is required. However, an explanation of significant reconciling amounts is required.
13	Borrowing costs	IAS23	**Borrowing costs** on qualifying assets are **capitalised**.	S25	All **borrowing costs are expensed**.
17	Revenue	IFRS15	Revenue arises from **contracts with customers**.	S23	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	The effects of a **change in accounting policy** on **earnings per share** must be presented.	S10	The effects of a **change in accounting policy** on **earnings per share** are **not** required to be presented.
22	Business combinations	IFRS3	**Non-controlling interest** may be accounted for at **fair value** at acquisition.	S9/S19	**Non-controlling interest** must be accounted for **at their share** of the fair value of net assets at acquisition.
		IAS27	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**.	S9	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	**Full goodwill** may be recognised at acquisition of a subsidiary, which includes the fair value of the goodwill attributable to non-controlling interest.	S19	The **goodwill** recognised is **limited** to the goodwill purchased by the parent company.
		IAS36	**Goodwill** is **not amortised**, but is rather tested for impairment annually.	S19	**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').

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