INTERNATIONAL ACCOUNTING

Objectives of the course

- The objective of this course is to illustrate how IFRS accounting standards and the judgment used within the IFRS accounting framework affect financial statements.
- As a user, ask the right questions when analysing the financial statements of a company
- Be critical when comparing financial statements of different companies

Key learning outcomes

- Improved understanding of IFRS accounting standards
- Be able to demonstrate how accounting standards (IFRS) influence the accounting fundamentals and the financial statements
- Be able to show how the level of judgment used within an accounting framework influence the main accounting fundamentals (earnings and equity).
- Prerequisite: basic knowledge of accounting concepts

Course materials – primary materials

- Book MELVILLE ALAN: 'International Financial Reporting, A Practical Guide, Pearson'
- Hand-outs (slides): summary of the key aspects of the handbook

Teaching format

- Lectures (presumably all plenary sessions) : Standard format / topic
    - IFRS standard and the judgment needed
    - Exercises/examples to get familiar with the topic
- E-learnings of the IFRS/IAS standards

Assessment method

- Open book exam
- All materials can be brought to the exam (handbook, slides, other)
- Typical structure of the exam:
    - Multiple choice 3/4
    - Exercises/Open questions 1/4

TABLE DES MATIERES

INTRODUCTION

USEFULNESS OF ACCOUNTING

- A firm's financial statements support the decision making of different stakeholders as the primary objective of financial statements.
  - Acquisitions or mergers
  - Buying/selling shares
  - Getting a loan
- Stakeholders: owners, employees, suppliers, banks, …

FINANCIAL ANALYSIS

- Benchmarking useful and necessary:
  - Cross-sectional (comparing different companies)
  - Time series analysis (one company over a longer period) : trends
- Ratio analysis is a common tool to provide useful information for decision making

FINANCIAL RATIOS

- Profitability ratios (reasonable profit level)
  - Is a company successful at generating profits over a time period?
  - A reasonable profit margin for long term survival
    - Profit vs. sales
    - Profit vs investment

- Liquidity (short-term ability to pay debt)
  - Does a company have the short-term ability to pay its maturing obligations?
  - Essential for short-term survival

- Leverage (appropriate long-term debt level)
  - A protection for long-term creditors and investors
  - A firm should have an appropriate level of borrowing
    - Equity vs. total balance sheet
    - Debt vs. total balance sheet

Financial ratios: some examples

- Return on equity = profit/equity => profitability
- Return on assets = EBIT (=operating profit) / total assets
- Current ratio = current assets / current liabilities => liquidity
- Debt / equity ratio => Solvency
- Price / earnings ratio
- Earnings per share
- Only thing that is important for investors is debt/equity ratio for investments

Specific example: beer industry

	AB InBev (group)	AB inBev (statutory)	Heineken (group)	Heineken (statutory)	Malson Coors
ROE	20%	15%	24%	25%	6%
Debt/Equity ratio	1,70	0,40	1,82	0,95	1,03
Current ratio	1,01	0,60	0,71	0,03	0,67

! What care is the group! Investors look at the consolidate picture!

Remark

- In comparing the different financial ratios of those firms some crucial fundamentals are ignored
- What are the underlying fundamentals used in preparing the financial statements?
  - First question: consolidated or individual company accounts?
  - Second question: accounting standards used?
  - Third question: level of judgment used given certain accounting standards?
- Notes to the financial statements important!
    - Als de kosten bijvoorbeeld stijgen maar de prijs stijgt ook kan het zijn dat er geen negatief efect.

<u>Second question</u>: accounting standards used?

- What are the accounting standards used to prepare the financial statements?
    - IFRS: IFRS (International Financial Reporting Standards) are set by the IASB (International Accounting Standards Board)
        - AB + HEINEKEN => IFRS statement (EU based)
    - US GAAP: US GAAP are set by the FASB (Financial Accounting Standards Board)
    - Local GAAP
        - AB Inbev: belgium GAP (because IFRS is not allowed in Belgium)

Difference between accounting standards

IFRS

- **Principle based** accounting standards
  - Contains broad principles to account for transaction across industries with limited specific guidance and stated exceptions to the general guidance.
- Not develop for a specific jurisdiction: Global use not for a specific jurisdiction
- More professional judgment is needed with possible negative effects on comparability

US GAAP

- **Rule based** accounting standards
  - Significant guidance for transactions, industries, exceptions and specific recognition and measurement guidance
- Developed for a specific jurisdiction

	IFRS	US GAAP
Conceptual framework	More	Less
Professional judgement of the preparer	More	Less
Level of detailed procedure	Less	More
Amount of industry-specific guidance	Little	Extensive

Third question: level of judgment used given certain accounting standards?

- How does the level of judgment used within an accounting framework determine the level of earnings and equity within a firm?

One example: judgment question: Are development expenditures meeting the capitalisation criteria of IAS 38? They should be recognised under IFRS if, and only if, the entity can demonstrate all of the following:

- The technical feasibility of completing the intangible asset so that it will be available for use or sale
- Its intention to complete the intangible asset and use or sell it
- Its ability to use or sell the intangible asset
- How the intangible asset will generate future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of an intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset

Development expenditures = 1.000 EUR

	100% meets the criteria	50% meets the criteria
Assets	Company A IFRS	Company A IFRS
Non-current assets	3,000	2,500
Current assets	7,000	7,000
Equity	5,000	4,500
Liabilities	5,000	5,000
Net income total	1,000	500
ROE	0,20	0,11

Conclusion

- Be cautious in comparing financial ratios between firms
- Highly important to ask the following questions before analysing the financial statements:
  - Individual company or group accounts?
  - IFRS, US GAAP or local GAAP?
  - Level of judgment used within an accounting framework?

CHAPTER 1: THE REGULATORY FRAMEWORK

IFRS: how to account

Stock exchange: time to publish

The need for regulation

- Companies are owned by shareholders but managed by directors
- Most shareholders of larger companies have no day-to-day involvement with the company
- Shareholders rely upon financial reports for information to help them make important decisions
- Creditors and other user groups may rely heavily on financial reports for information
- Regulations try to ensure that financial reports provide a faithful representation

Sources of regulation

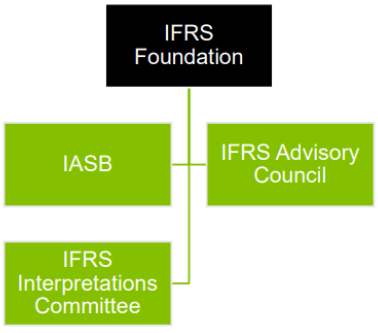
- Legislation (varies from country to country)
  - Broad rules
  - Company code
- Accounting standards:
  - National standards
  - International standards
- Stock exchange regulation
  - E.g. requirement to publish quarterly figures

Generally accepted accounting practice (GAAP)

- GAAP is the complete set of accounting regulations (from all sources) and accounting conventions that apply in a certain jurisdiction
  - E.g. UK GAAP, US GAAP, IFRS, BE GAAP etc.
- The IASB is developing a set of standards that may form the basis of "international GAAP"

IASB's regulatory structur

- IFRS Foundation: appoint the members of IASB
- IASB: they discuss standards, take decision
- IFRS Advisory Council: provides advise to the IASB
- IFRS Interpretations Committee: Committee help interpreting existing conceptual frameworks and standards.



The International Accounting Standards Board (IASB)

- Develops and amends international standards

- 16 members
- Responsible to the IFRS Foundation, which aims to develop global standards and promote their use
- The IFRS Advisory Council advises the IASB on its agenda and priorities
- The IFRS Interpretations Committee interprets international standards and provides guidance on matters not covered by standards

The standard-setting process :

- Identification of the topic area
- Application of the conceptual framework
    - Conceptual Framework = backbone of IFRS
- Consultation with national standard-setters, the IFRS Foundation and IFRS Advisory Council
- Publication of exposure draft and consideration of comments
    - Draft of a new standard which is being exposed to the public => exposure draft
- Publication standard

Structure of an international standard:

- Introduction
- Objectives and scope
- Definitions
- Body of the standard
- Effective date and transitional provisions
    - Transitional provisions =
- Formal approval by IASB and any dissenting opinions
    - Dissenting opinions: if the members are not unanimously accepted the new proposal
- Basis for conclusions
- Application/implementation guidance and/or illustrative examples

Purpose of accounting standards :

- Standards reduce variation in accounting practice and introduce a degree of uniformity into financial reporting
- Standards make it more likely that financial statements will provide a faithful representation of an entity's financial performance and financial position
- Meaningful comparisons may be drawn over time and between entities
- IASB conceptual framework stresses the importance of faithful representation and comparability

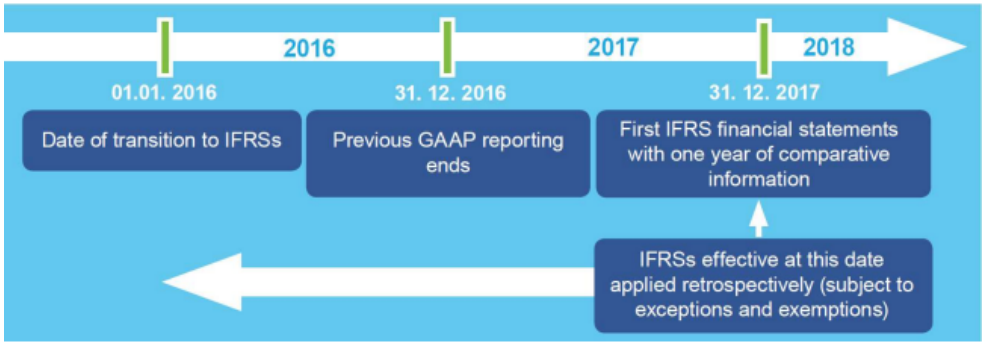
→ Self-explanatory = ensure consistency in practice

IFRS 1 First-time Adaption of IFRS

- The "first IFRS reporting period" is the period covered by the first IFRS financial statements
- The "date of transition" is the date at the start of the earliest period for which comparatives are provided in the first IFRS financial statements
- Need to prepare an opening IFRS statement of financial position as at the date of transition
- Must use the same accounting policies in the opening IFRS statement of financial position and in all periods presented in the first IFRS financial statement; these policies must comply with all international standards in force at the end of the first IFRS reporting period
- Certain reconciliations are required

Page 13 TB: exercise

Transition schedule:



CHAPTER 2: A CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

Definition Framework :

- A constitution
- A coherent system of interrelated objectives and fundamentals
- That can lead to consistent standards
- And that prescribes
  - The nature
  - The function
  - And the limits of financial accounting and financial standards
    - ⇨ The starting point for new IFRS rules

Purpose of the IASB Conceptual Framework:

- To assist in development of IFRS/IAS
- To provide a basis for reducing alternatives
- To assist national standard-setters in developing national standards
- To assist preparers of financial statements in applying international standards
- To assist auditors in forming an opinion as to whether international standards have been complied with
- To assist users in interpreting financial statements

Scope of the IASB conceptual Framework:

The IASB Conceptual Framework

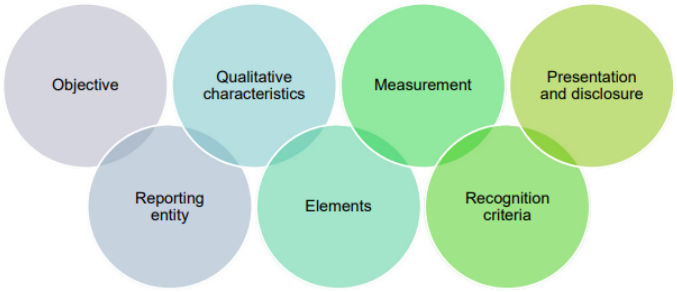
- Identifies the concepts
- That are the basis for general purpose
  - Available for each and everyone
- Financial statement prepared and presented
- For the benefit of external users

→General purpose = for general use, for everyone/ public

→ Specific purpose = for specific use, as agreed between parties (private)

7 underlying concepts:

Conceptual framework for financial reporting:



OBJECTIVE OF GENERAL PURPOSE FINANCIAL REPORTING

Provide information to the users of financial statements about the entity's taking into account a few basic underlying assumptions:

- Financial position (=balance sheet)
- Financial performance (accrual basis) (= income statement)
- Cash flows
- Changes in financial position which are not caused by financial performance (e.g. share issues) (=equity)

Details of economic resources and claims	Statement of financial position (SOFP)
Changes in economic resource and claims that relate to the financial performance	Statement of comprehensive income (I/C)
Changes in cash flows	Statement of cash flows (CFS)
Changes in economic resource – not relating to the economic performance	Statement of changes in equity (SOCIE)

Users of general purpose financial reports

Primary users:

- Existing/potential investors
- Existing/potential lenders and other creditors

Others (not listed in conceptual framework):

- Employees
- Customers
- Governments and their agencies
- The public

Underlying assumptions : important !

- Financial statements are normally prepared on **the "going concern basis"**
  - If the going concern doesn't take place than the firm needs to argument why?
- It is assumed that the entity will continue in operation for the foreseeable future and has neither the intention nor the need to close down or to materially reduce the scale of its operations
    - Sufficient means? Cash? In a year from now
- Financial statements are normally also prepared based on the "**accruals**" basis of accounting (except for sash flow statements)
  - Record entries when they occur but not when you effectively pay your supplier.

QUALITATIVE CHARACTERISTICS OF FINANCIAL INFORMATION

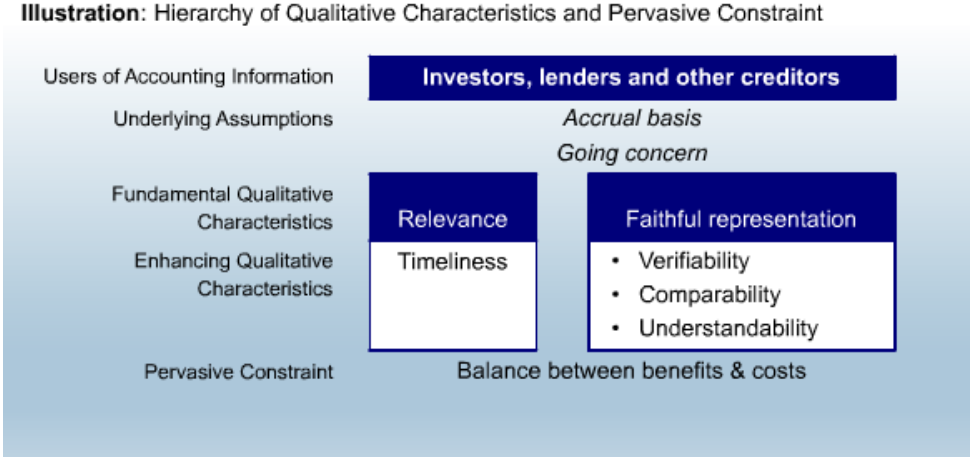
Two fundamental characteristics:

- Relevance (predictive or confirmatory value)
- Faithful representation (complete, neutral, error-free)

Four enhancing characteristics:

- Comparability (consistent accounting treatments)
- Verifiability (direct or indirect)
- Timeliness (in time to influence decisions)
- Understandability (clear and concise presentation)

Illustration: Hierarchy of Qualitative Characteristics and Pervasive Constraint



ELEMENTS: FINANCIAL POSITION

Asset

= A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity

Liability

= A present obligation of the entity arising from past events the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits

Equity

= The residual interest in the assets of the entity after deducting all its liabilities

Income

- Increases in economic benefits during an accounting period
- That result in an increase in equity
- Other than those that arise from contributions from equity holders
    - Revenue = in the course of ordinary activities
    - Gains = not arise in the course of ordinary activities

Expenses

- Decreases in economic benefits during an accounting period
- Other than those relating to distributions to equity holders
    - Expenses = in the course f ordinary activities
    - Losses = may or may not arise in the course of ordinary activities

RECOGNITION OF THE ELEMENTS OF FINANCIAL STATEMENTS

Recognition

- The inclusion of an element (asset, liability, equity or expense) in the income statement or the statement of financial position
- An item meeting the definition of an element should be recognized if
    - It is probable that any future economic benefits will flow to or from the entity
    - And the item has a cost or value that can be measured reliably
        - ⇨ At which point in the time do you need to recognize an asset or liability ?

MEASUREMENT BASES

- Historical cost
- Current value
    - Fair value
    - Value in use
    - Current cost
- The measurement basis most commonly used is historical cost

Measurement of the elements of financial statements

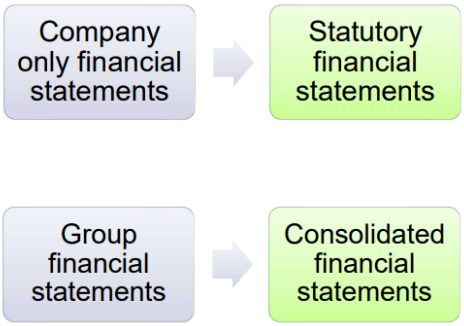
Historical cost

- Asset
    - At the amount paid at the time that they were acquired
- Liabilities
    - At the amount of proceeds received in return for taking on the obligation
    - Or in some case (e.g. income taxes) at the amount expected to be paid to clear the liability
- Current cost : Takes into account information obtained after initial acquisition (of an asset) or existence (of a debt).

Examples are:

- Fair value
  - Defined as “the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date”.
  - Fair value is with reference to prices in an active market or fair value can be estimated by using valuation techniques.
  - A transaction between 2 independent parties and both have basic information over the transaction where participants are not forced to do the transaction
  - Stock prices reflect the value of the company
  - Look to valuation, ebitda,… Apply multiple ratio’s
- Value in Use
  - The present value of net cash flows that an entity expects to derive from use of an asset and its disposal
- Current cost
  - The current cost of an asset is the amount that would have to be paid to acquire an equivalent asset (= replacement cost). The current cost of a liability is the amount that would have to be received for taking on an equivalent liability.

REPORTING ENTITY



CHAPTER 3 PRESENTATION OF FINANCIAL STATEMENTS (IAS1)

Presentation of financial statements

- Objective of financial statements
  - Provide information about the financial position and financial performance and cash flow of an entity or a group of entities
  - That is useful for making economic decisions
  - To a wide range of users
- IAS1: overaal framework on
  - Presentation of financial statements
  - Guidelinges for their structure
  - Minimum requirement for their content

Frequency of reporting

Financial statements should normally be presented at least annually. An entity which presents financial statements for a period which is longer or shorter than one year should disclose:

- The reason for using a period that is longer or shorter than one year
- The fact that the comparative amounts given for the previous period are not directly comparable with those given for the current period

Identification of the financial statements

- Name of the reporting entity
- Whether a single entity or a group
- Date at the end of the reporting period or the period covered
- Presentation currency used
- Level of rounding (e.g. € 000 or € m)

STATEMENT OF FINANCIAL POSITION

- Formerly referred to in the standards as the "balance sheet"
- The current/non-current distinction
- Information that must be presented in the statement f financial position
- Information that may be presented in the statement of financial position or in the notes

Current and non-current assets

An asset is a current asset if it satisfies any of the following criteria:

a) It is expected to be realised within the entity's normal operating cycle
b) It is held for the purpose of being traded
c) It is expected to be realised within 12 months after the reporting period
d) It is cash or a cash equivalent as defined by IAS7: withdrawal within 3 months → cash equivalent

All other assets are non-current assets

Current/non-current liabilities

A liability is a current liability if it satisfies any of the following criteria:

a) It is expected to be settled within the entity's normal operating cycle
b) It is held for the purpose of being traded
c) It is due to be settled within 12 months after the reporting period
d) The entity does not have the right to defer settlement for at least 12 months after the reporting period

All other liabilities are non-current liabilities

Information to be presented in the statement of financial position

- property, plant and equipment
- investment property
- intangible assets
- financial assets
- inventories
- trade receivables

- cash and cash equivalents
- trade payables
- provisions
- financial liabilities
- tax assets and liabilities
- equity capital and reserves

To be presented in the statement of financial position or in the notes

- sub-classification of line items as appropriate to the entity's operations and/or as required by other international standards
- analysis of equity capital and reserves

STATEMENT OF COMPREHENSIVE INCOME

All items of income and expense recognised in an accounting period must be presented in either:

- a single statement of comprehensive income, or
- two separate statements, comprising:
  - a statement showing the components of profit or loss, and
  - a second statement beginning with the profit or loss for the period and showing the entity's "other comprehensive income".

Information to be presented in the statement of comprehensive income

1. revenue
2. finance costs
3. tax expense
4. profit or loss from discontinued operations
5. profit or loss for the period
6. each class of other comprehensive income
7. total comprehensive income for the period

The first five items on this list may be presented in a separate statement of profit or loss.

To be presented in the statement of comprehensive income or in the notes

- further items of income and expense should be disclosed separately, if material
- an analysis of expenses should be resented using a classification based on either:
  - the nature of the expenses
    - f.e: payroll, dept cost for the whole company
  - the function of the expenses within the entity (e.g. cost f sales, distributions costs, administrative expenses)
    - You have here elements of the payroll, dept cost… you don't know how much of nature

STATEMENT OF CHANGE IN EQUITY

Shows how each component of equity has changed during an accounting period

- items presented include:
  - total comprehensive income for the period

- effects of any changes in accounting policies
- share issues; and
- dividends paid

Provides a reconciliation of the opening and closing balance on each component of equity

Notes to the financial statement:

- measurement bases and other accounting policies
- further information required by international standards
- additional information relevant to an understanding of the financial statement

Cross-referenced to the statement of financial position, the statement of comprehensive income, the statement of cash flows and the statement of changes in equity

CHAPTER 4 ACCOUNTING POLICIES, ACCOUNTING ESTIMATES AND ERRORS (IAS8)

ACCOUNTING **POLICIES**

IAS 8 defines accounting policies as the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements

> F.e., one of an entity's accounting policies might be to measure property, plant and equipment at a current valuation rather than at historical cost.

Selection of accounting policies:

An accounting policy should be selected so as to comply with applicable international standards. Otherwise, the entity should refer to:

1. International standards which deal with similar and related issues
2. The IASB conceptual framework
3. The pronouncements of other standard-setting bodies
4. Accounting literature and accepted industry practices

→ You begin with the first. If the standard is not clear, you can go to the second point and use the framework. If it is not enough to 3 and then to 4.

Changes in accounting policies!! (Important)

An accounting policy may be changed only if:

- The change is required by an international standard, or
- The change results in more reliable and more relevant information
- F.e. implementing ERP that allows you t be more performant

Accounting for a change in accounting policy:

- If a change in policy results from the application of international standard, the change is accounted for in accordance with the **transitional provisions** provided in that standard
- Otherwise, the change is accounted for retrospectively i.e. comparative figures are adjusted and are presented as if the new policy had always been applied
- Change an accounting policy => retrospectively
- Change an accounting estimate => prospectively
    - F.e: depreciation policies : how many years ? obsolete percentage ?
    - f.e. customers

Disclosure of a change in accounting policy:

- For changes caused by the initial application of an international standard:
    - The titles of the standard and a description of any transitional provisions in that standard
- For voluntary changes in accounting policies:
    - The reasons for making the change
- For all changes in accounting policies
    - The nature of the change
    - Adjustments made in the current period and in each prior period presented

ACCOUNTING **ESTIMATES**

IAS 8 states the following:

- Many items in financial statements cannot be measured with precision but can only be estimated
- The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability

Changes in accounting estimates should be accounted for prospectively. Comparative figures for prior periods should not be restated.

> F.e. depreciation policy, policy when to write off customers. You only change estimates for the future.

Accounting Estimates ⇔ Change in accounting policy

Examples:

- Change in the way how the provision for bad debt is calculated resulting in a more sophisticated/accurate prediction of future loss. => Policy, way to come with better informatin
- Change in the way how inventories are valued better reflecting the absorption of overhead costs. => Policy
- New valuation rules as a result of a change in the accounting standards. => Policy
- Revision of a provision for litigation based on new information. => Estimate: update because you receive new information
- Subsequent events indicate that a customer for which a provision for bad debt of 50% was recorded went bankrupt soon after year-end but before our prior year financials were approved for issuance. => Estimate

PRIOR PERIOD **ERRORS** :

IAS 8 defines prior period errors as "omission from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- Was available when financial statement for those periods were authorised for issue; and
- Could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements

Correction of a prior period error:

Material prior period errors must be corrected retrospectively. This involves:

- Restating comparative figures for the prior period(s) in which the error occurred, or
- If the error occurred before the earliest prior period for which comparatives are presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Disclosure of prior period errors :

- The nature of the prior period error
- For each prior period presented, the amount of the correction to each affected line item in the financial statements
- The amount of the correction at the beginning of the earliest prior period presented
- If retrospective restatement is impracticable for a particular prior period, a description of the circumstances that have led to this condition and a description of how (and from when) the error has been corrected

Management of ABC LTD, while preparing financial statements of the company for the period ended 31st December 20X2, noticed that they had failed to account for depreciation in last year's accounts in respect of an office building acquired in the preceding year.

Following are extracts of ABC LTD's most recent financial statements before the application of FIFO method.

Statement of Financial Position as at 31 December 20X2		
	20X2 $M	20X1 $M
Non Current Assets:		
Cost	50	50
Accumulated Depreciation	10	8
	40	42

Income Statement for the year ended 31 December 20X2		
	20X2 $M	20X1 $M
Administration Expenses:		
Depreciation	2	1

Statement of Changes in Equity for the year ended 31 December 20X2		
	20X2 $M	20X1 $M
Retained Earnings:		
Opening Reserves	40	30
Net Profit	30	20
Dividend	(10)	(10)
Closing Reserve	60	40

The omission of depreciation of office building in the previous year's financial statements represents a **prior period accounting error** which must be accounted for **retrospectively** in the financial statements. Consequently, ABC LTD shall adjust all comparative amounts presented in the current period's financial statements affected by the accounting error.

Management estimates that depreciation charge for the year 20X1 was under booked by $1 million.

Financial statement extracts of ABC LTD would appear as follows after the retrospective correction of the prior period accounting error.

Statement of Financial Position as at 31 December 20X2		
	20X2 $M	20X1 $M
Non Current Assets:		
Cost	50	50
Accumulated Depreciation	11	9
	39	41

Income Statement for the year ended 31 December 20X2		
	20X2 $M	20X1 $M
Administration Expenses:		
Depreciation	2	2

Statement of Changes in Equity for the year ended 31 December 20X2		
	20X2 $M	20X1 $M
Retained Earnings:		
Opening Reserves	39	30
Net Profit	30	19
Dividend	(10)	(10)
Closing Reserve	59	39

CHAPTER 5 PROPERTY, PLANT AND EQUIPMENT (IAS 16, IAS23, IAS20, IAS40)

PROPERTY, PLANT AND EQUIPMENT

Definition of property, plant and equipment

IAS 16 defines property, plant and equipment as:

"tangible items that:

- Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- Are expected to be used during more than one period."

Initial **recognition** of property, plant and equipment

An item of property, plant and equipment should be recognised as an asset if and only if:

- It is probable that **future economic benefits** associated with the item will flow to the entity concerned, and
- The **cost** of the item can be measured reliably

On initial recognition, property, plant and equipment should be measured at cost.

Cost includes :

- Purchase price, including import duties and non-refundable purchase taxes, less trade discounts
- Costs that are directly attributable to bringing the item to the location and condition necessary for it to be operated as intended, including:

  - Labour costs arising directly from the construction or acquisition of the item.
  - Site preparation costs;
  - Initial delivery and handling costs.
  - Installation, assembly and testing costs.
  - Professional fees
- The estimated costs of dismantling and removing the item and restoring the site on which the item is located, as long as the obligation to meet these costs is incurred when the item is acquired

In general, administrative costs and other general overhead expenses are not part of the cost of an item property, plant and equipment

Subsequent costs:

Routing servicing, repair and maintenance costs are not capital expenditure (not on balance sheet). The cost of major replacements should be treated as capital expenditure and recognised as an addition to the carrying amount of the asset concerned.

> → component accounting: : The newly installed equipment will be depreciated over its useful life and the outside body of the plane over its own useful life. The plane will be split up in groups of assets and each groups depreciated over its own useful life. This is called the 'Component accounting'.

Subsequent measurement of property, plant and equipment

After initial recognition, items of property, plant and equipment may be measured using either:

- **The cost model**: items are carried at cost less any accumulated depreciation and less any accumulated impairment losses.
- **The revaluation**: items are carried at fair value at the date of revaluation, less ay subsequent accumulated depreciation and less any subsequent accumulated impairment losses.

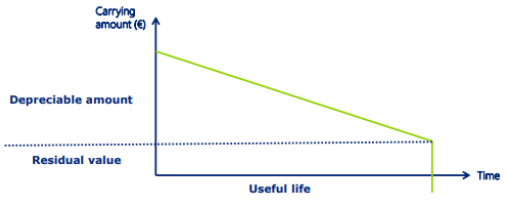
If the revaluation model is used it must be applied to entire classes of property, plant and equipment.

> You can not use for one building the revaluation and for the rest the cost model.

Revaluations should be made with sufficient regularity.

Depreciation of property, plant & equipment

IAS 16 defines depreciation as "the systematic allocation of the depreciable amount of an asset over its useful life".



- **Depreciable amount** is "the cost of an asset, or other amount substituted for cost, less its residual value
- **Residual value** is "the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal
- **Useful life** is "the period over which an asset is expected to be available for use by an entity

Purpose of depreciation:

The sole purpose of charging depreciation is to allocate an expense between accounting periods. In particular:

- The depreciation process makes no attempt to show assets at their current values
- Charging depreciation des not guarantee that there will be funds available to replace assets when they come to the end of their useful lives (no cash impact)

Review of residual values and useful lives:

- The residual value and useful life of property, plant and equipment should be reviewed at least at the end of **each financial year**.
- If expectation differ from previous estimates, these should be accounted for as a **change in an accounting estimate** in accordance with IAS 8
- The asset's depreciable amount is revised to reflect any change in residual value and then this amount is allocated as depreciation **over the remainder of the asset's expected useful life**.

Depreciation methods:

The depreciation method chosen in relation to an item of property, plant and equipment should match the usage pattern of that item.

Available depreciation methods include:

- the straight-line method (Bv. Afschrijven op 5 jaar)
- the diminishing balance method: frontloading of depreciation. (Elk jaar hetzelfde percentage)
- the units of production method: in function of how much it can produce => underline production

The depreciation method applied to an item of property, plant and equipment should be reviewed at least at the end of each financial year. If the usage pattern of the asset has changed, the depreciation method should be changed accordingly. A change in depreciation method is accounted for as a change in an accounting estimate in accordance with the requirements of IAS 8.

Main **disclosure** of IAS 16

For each class of property, plant and equipment:

- the measurement bases used;
- the depreciation methods used;
- the gross carrying amount and accumulated depreciation at the beginning and end of the accounting period;
- a reconciliation of the carrying amount at the beginning and end of the period, showing additions, disposals, revaluation increases and decreases, depreciation, impairment losses and any other movements

Example: Disclosure PP&E – Umicore

2.2 INFLATION ACCOUNTING

For the reported period, there is one subsidiary in the Umicore Group having a functional currency belonging to a hyperinflationary economy in Argentina. However, in view of significance to the Group, this is not material for IAS 29 to be applied.

2.3 FOREIGN CURRENCY TRANSLATION

Functional currency: items included in the financial statements of each entity in the Group are measured using the currency that best reflects the economic substance of the underlying events and circumstances relevant to that entity. The consolidated financial statements are presented in EUR which is the functional currency of the parent. To consolidate the Group and each of its subsidiaries, the financial statements are translated as follows:

- Assets and liabilities at the year-end rate as published by the European Central Bank
- Income statements at the average exchange rate for the year
- The components of shareholders' equity at the historical exchange rate

Exchange differences arising from the translation of the net investment in foreign subsidiaries, joint ventures and associated entities at the period-end exchange rate are recorded as part of the shareholders' equity under "currency translation differences".

When a foreign operation is partially disposed of or sold, exchange differences that were recorded in equity are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as local currency assets and liabilities of the foreign entity and are translated at the closing rate.

2.4 FOREIGN CURRENCY TRANSACTIONS

Foreign currency transactions are recognised during the period in the functional currency of each entity at exchange rates prevailing at the date of transaction. The date of a transaction is the date at which the transaction first qualifies for recognition. For practical reasons a rate that approximates the actual rate at the date of the transaction is used at some operations, for example, an average rate for the week or the month in which the transactions occur.

Subsequently, monetary assets and liabilities denominated in foreign currencies are translated at the closing rate at the end of the reporting period.

Gains and losses resulting from the settlement of foreign currency transactions, and from the translation of monetary assets and liabilities denominated in foreign currencies, are recognised in the income statement as a financial result.

In order to hedge its exposure to certain foreign exchange risks, the Company has entered into certain forward contracts (see Chapter 2.21, Financial instruments).

2.5 PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is recorded at historical cost, less accumulated depreciation and impairment losses. Cost includes all direct costs and appropriate allocation of indirect costs incurred to bring the asset to working condition for its intended use.

Borrowing costs that are directly attributable to investments are capitalised together with the costs of the assets in accordance with IAS 23. All borrowing costs that cannot be linked directly to an investment are recognised as expenses in the period when incurred.

The straight-line depreciation method is applied through the estimated useful life of the assets. Useful life is the period of time over which an asset is expected to be used by the Company.

Repair and maintenance costs are expensed in the period in which they are incurred, if they do not increase the future economic benefits of the asset. Otherwise they are classified as separate components of items of property, plant and equipment. Those major components of items of property, plant and equipment that are replaced at regular intervals are accounted for as separate assets as they have useful lives different from those items of property, plant and equipment to which they relate. Umicore's PPE, being complex and highly customised industrial assets, typically do not have an individual resale value if put outside the overall context of the operations. Therefore, no residual value is taken into account when determining the depreciable value.

The typical useful life per main type of property, plant and equipment are as follows:

- For material newly acquired or constructed assets, the useful life is separately assessed at the moment of the investment request and can deviate from the above standards.
- Management determines the estimated useful lives and related depreciation charges for property, plant and equipment. Management uses standard estimates based on a combination of physical durability and projected product life or industry life cycles. These useful lives could change significantly as a result of technical innovations, market developments or competitor actions. Management will increase the depreciation charge where useful lives are shorter than previously estimated, or it will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold.

2.5 PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is recorded at historical cost, less accumulated depreciation and impairment losses. Cost includes all direct costs and appropriate allocation of indirect costs incurred to bring the asset to working condition for its intended use.

Measurement basis

Borrowing costs that are directly attributable to investments are capitalised together with the costs of the assets in accordance with IAS 23. All borrowing costs that cannot be linked directly to an investment are recognised as expenses in the period when incurred.

Borrowing costs

The straight-line depreciation method is applied through the estimated useful life of the assets. Useful life is the period of time over which an asset is expected to be used by the Company.

Depreciation method

Repair and maintenance costs are expensed in the period in which they are incurred, if they do not increase the future economic benefits of the asset. Otherwise they are classified as separate components of items of property, plant and equipment. Those major components of items of property, plant and equipment that are replaced at regular intervals are accounted for as separate assets as they have useful lives different from those items of property, plant and equipment to which they relate. Umicore's PPE, being complex and highly customised industrial assets, typically do not have an individual resale value if put outside the overall context of the operations. Therefore, no residual value is taken into account when determining the depreciable value.

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Useful life

Land use rights are part of the Property, Plant and Equipment and are typically amortised over the contractual period.

	YEARS
Land	Non-depreciable
Buildings	
Industrial buildings	20
Improvements to buildings	10
Other buildings such as offices and laboratories	40
Investment properties	40
Plant, machinery and equipment	10
Furnaces	7
Small equipment	5
Furniture and vehicles	
Vehicles	5
Mobile handling equipment	7
Computer equipment	3-5
Furniture and office equipment	5-10

Useful life

BORROWING COSTS

IAS23 defines borrowing costs as "interest and other costs that an entity incurs in connection with the borrowing of funds."

Borrowing costs that are directly attributable to the acquisition, construction or production of a "qualifying asset" must be capitalised as part of the cost of that asset. Other borrowing costs are recognised as an expense in the period in which they are incurred.

Qualifying assets:

Qualifying assets are those which take a substantial periof of time to get ready for use or sale.

The capitalisation of borrowing costs should begin when:

- expenditure is bein incurred on the asset
- borrowing costs are being incurred, and
- activities are in progress that are necessary so as to prepare the asset for its intended use or sal.

Capitalisation ends when substantially all of the activities necessary to prepare the asset for its intended use or sale are complete.

GOVERNMENTS GRANTS

Government grants (IAS 20)

Government grants should be recognised in profit or loss "over the period in which the entity recognises as expenses the related costs which the grants are intended to compensate."

Therefore a grant for the acquisition of an asset should be recognised when calculating profit or loss for the periods in which depreciation is charged on that asset

- the grant may be credited to a deferred income account and then systematically transferred to the statement of comprehensive income over the useful life of the asset, or
- the grant may be deducted from the carrying amount of the asset. This will result in reduced depreciation charges over the asset's useful life.
    - ⇨ Depreciation will be lower because you take grant into account

INVESTMENT PROPERTY

Investment property (IAS 40):

Investment property is property (land and buildings) which is "held to earn rentals or for capital appreciation or both, rather than:

- for use in the production or supply of goods or services.
- for administrative purposes
- for sale in the ordinary course of business."

Measurement of investment property:

Initial measurement is at cost. Subsequently, investment property may be measured using either:

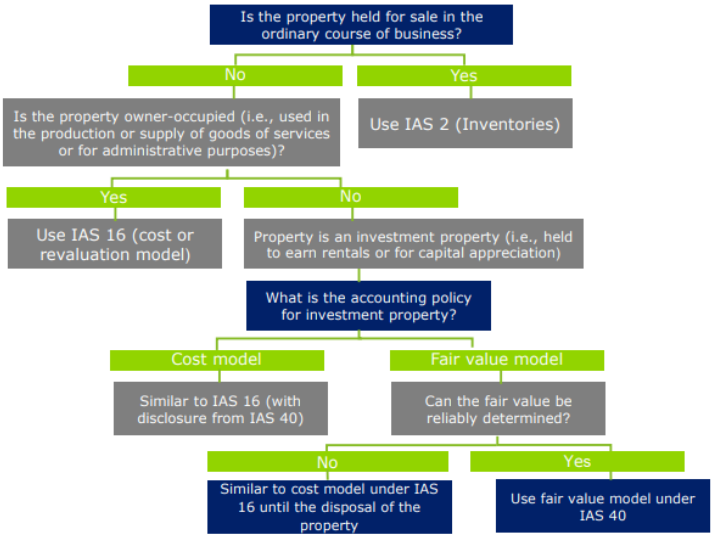
- **the fair value model:**

- the property is carried at fair value; gains and losses on adjusting faire value are recognised in the calculation of profit or loss

- **the cost model:**
  - the property is carried at cost less any accumulated depreciation and less any accumulated impairment losses.

→ It is a choice: the one is not better than another

Decision tree-IAS 40



EXERCISES PROPERTY, PLANT AND EQUIPMENT & INVESTMENT PROPERTY

Exercise 1

On 1 July 2018, TRACER LTD replaced an elevator in one of its factory buildings. The cost of a new elevator was €250.000 and the carrying amount of the old elevator was € 56.000. The old elevator had a zero disposal value and the cost of decommissioning the new elevator (in future) was estimated at €20.000.

Explain how each of these transactions should be accounted (including journal entries) in accordance with the requirements of IAS 16.

Solution - Explain

In accordance with IAS 16 the costs of the replacement elevator are included in property, plant and equipment. The estimate of the costs of decommissioning the new elevator should also be included in the asset's cost. The gain or loss arising from the derecognition of the old elevator is included in the income statement.

	Dt (-000)	Cr (-000)
Property, plant and equipment	250	
@ Trade suppliers		250
Property, plant and equipment	20	
@ Provisions		20
Loss on derecognition of old lift (P&L)	56	
@ Property, plant and equipment		56

Decommissioning of 20 000 should be capital
20 000 + 250 000 => 270 000
56 000 => will go to P&L

Exercise 2

During 2018, MACY LTD decided to construct a portable sales kiosk for the promotion and marketing of the company's products. The following costs were incurred:

	€
Purchase of materials (before deducting trade discount of 5 %)	30.000
Labour costs incurred to construct	25.000
Correction of a design error	2.000
Marketing costs associated with promotion of products	2.700
Safety checks	1.300
Interest cost incurred during construction	3.000
Present value cost at 31.12.2018 of dismantling sale kiosk in future	1.000
Value added tax on materials (at 20 %)	13.000
Total	78.000

You have to take the 5% of the 30 000

Solution – Explain

The following should be capitalised as part of the construction cost of the sales kiosk.

	€
Materials (net of trade discount)	28.500
Labour costs	25.000
Safety checks	1.300
Estimated dismantling costs	1.000
Total	55.800

The cost of correcting design errors is not capitalised as this is considered an abnormal cost that is not adding the potential towards future economic benefits.

Marketing costs are not capitalised as they are not necessary to bring the sales kiosk into working conditions

Financing costs are not capitalised, as the kiosk does not meet the definition of qualifying asset under IAS 23 Borrowing costs.

	Dt	Cr
Property, Plant & Equipment	55.800	
VAT receivable	13.000	
Marketing expenses (P&L)	2.700	
Other expenses – correction of design error (P&L)	2.000	
Finance expense	3.000	
@ Trade payables		75.500
Provision for dismantling costs		1.000

Cost of correcting desing errors => in the design fase
Marketing costs => P&L
Financing costs => does not qualify

Exercise 3

BRIGHT LTD purchased machinery on 1 January 2018. The purchase cost was €20.000, and this was payable on 1 January 2019. Normal credit terms are three months, and the normal cash price would have been € 19.500.

Solution – explain

Cost is the normal cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the total payment and the cash price equivalent must be recognised as interest over the credit period.

	Dt	Cr
Property, plant & equipment	19.500	
@ Trade payables		19.500
Interest charges (P&L)	500	
@ Trade payables		500

The difference are interest costs in order to have a longer credit time.
=> 500 ! = P&L is NOT borrowing costs

Exercise 4

Major Limited purchased a building in January 2017 for €1.5M. Eight floors of the building are let on an operating lease to Merchant Bank Limited, with the remaining two floors being occupied by Tom Limited, which is a subsidiary of Major Limited.

Financial statements of Major Limited
The building is investment property, and should be accounted for as follows:

	Dr €'000	Cr €'000
Investment property	1,500	
Bank		1,500

Consolidated financial statements of the Major Group
The portion that is occupied by Tom Limited is not investment property as far as the Group is concerned. On the assumption that each floor of the building has equal value, the following treatment is appropriate:

	Dr €'000	Cr €'000
Investment property	1,200	
Buildings	300	
Bank		1,500
(Being separate treatment of property, as permitted by IAS 40)		

Investment because is not for own use ! It is rented

2 Floors => own use

3 Floors => rented

300 -> own use

CHAPTER 6 INTANGIBLE ASSETS (IAS 38 AND IFRS 3)

INTANGIBLE ASSETS

Definition of intangible asset

IAS 38 defines an intangible asset as "an identifiable, non-monetary asset without physical substance".

- An asset is **identifiable** when it arises from legal rights or when it is "separable".
- The requirement to be "identifiable" creates a distinction between intangible assets (in scope of IAS 38) and goodwill (outside of the scope of IAS 38)
- An asset is **separable** if it "is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged."
- **Monetary** assets are defined as "money held and assets to be received in fixed or determinable amounts of money.

Initial **recognition and measurement** of intangible assets

An item is recognised as an intangible asset only if it meets the definition of an intangible asset and:

- It is probable that the **future economic benefits** attributable to the item will flow the entity, and
- The **cost** of the item can be measured reliably.

Intangible assets should be measured initially at their cost. The cost of an intangible asset is the cost incurred to acquire it or internally generate it.

Internally generated intangible assets

Internal generation of an intangible asset is split into a research phase and a development phase.

- **Research** is defined as "original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding".

- **Development** is defined as "the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start commercial production or use".

IAS 38 treatment of research and development costs:

All research expenditure must be written off as an expense when it is incurred (It is not on balance sheet). An intangible asset which arises from the development phase of an internal project must be recognised if all of the following criteria are satisfied:

- Technical feasibility of completion
- Availability fo resources to complete
- Intention to complete and ability to use/sell the asset
- Probability of future economic benefits
- Ability to measure expenditure reliably

Expenditure on internally generated brands, mastheads, publishing titles, customer lists and similar items must always be written off.

Subsequent measurement of intangible assets:

After initial recognition, intangible assets may be measured using either:

- The cost model: items are carried at cost less any accumulated amortisation and less any accumulated impairment losses
- The revaluation model: items are carried at fair value at the date of revaluation, less any subsequent accumulated amortisation and less any subsequent accumulated impairment losses.

The revaluation model cannot be used unless there is an active market for he intangible asset concerned.

Amortisation:

IAS38 requires that the depreciable amount of an intangible asset with a finite useful life should be amortised over that useful life.

Depreciable amount is "the cost of the asset, or other amount substituted for cost, less its residual value."

The residual value of an intangible assets with a finite useful life is assumed to be zero, unless a third party is committed to buy the asset at the end of its useful life, or there is an active market for the asset and its residual value can be determined by reference to that market.

Amortisation methods:

The amortisation method chosen in relation to an intangible asset should match the usage pattern of that asset. Available amortisation methods include:

- The straight-line method: linear method
- The diminishing balance method : constant amortization rate

If the asset's usage pattern cannot be estimated reliably, the straight-line method should be used

Review of residual value, useful life and amortisation method:

The residual value and **useful life** of an intangible asset should be **reviewed** at leas at the end of each financial year. If expectation differ from previous estimates, these should be accounted for as a **change in an accounting estimate** in accordance with IAS8. Similarly, the **amortisation** method used in relation to an intangible asset should be reviewed at least at the end of each financial year. Any change in method should be accounted for as a change in an accounting estimate in accordance with IAS8.

Intangible assets with indefinite useful lives:

Intangible assets with indefinite useful lives are not amortised, but the useful life of such an asset should be reviewed in every accounting period.

If circumstances now indicate that the asset's useful life has become finite, it should be amortised over the remainder of that life. This change is accounted for as a change in an accounting estimate in accordance with the requirements of IAS8.

IAS 38 disclosure requirements:

For each class of intangible asset, distinguishing between internally generated assets and others:

- whether the useful lives are indefinite or finite
- if finite, the useful lives or amortisation rates used
- the amortisation methods used
- gross carrying amount and accumulated amortisation at the beginning and end of the accounting period
- the line item in the statement of comprehensive income in which amortisation is included
- a reconciliation of the carrying amount at the beginning and end of the period, showing additions, disposals, revaluation increases and decreases, amortisation, impairment losses and any other movements.

Example disclosure intangible assets: AB-InBev

(G) INTANGIBLE ASSETS

Research and development
Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognized in the income statement as an expense as incurred.

Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalized if the product or process is technically and commercially feasible, future economic benefits are probable and the company has sufficient resources to complete development. The expenditure capitalized includes the cost of materials, direct labor and an appropriate proportion of overheads. Other development expenditure is recognized in the income statement as an expense as incurred. Capitalized development expenditure is stated at cost less accumulated amortization (see below) and impairment losses (refer to accounting policy O).

Amortization related to research and development intangible assets is included within the cost of sales if production related and in sales and marketing if related to commercial activities.

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets are capitalized as part of the cost of such assets.

Supply and distribution rights
A supply right is the right for AB InBev to supply a customer and the commitment by the customer to purchase from AB InBev. A distribution right is the right to sell specified products in a certain territory. Acquired distribution rights are measured initially at cost or fair value when obtained through a business combination. Amortization related to supply and distribution rights is included within sales and marketing expenses.

Brands
If part of the consideration paid in a business combination relates to trademarks, trade names, formulas, recipes or technological expertise these intangible assets are considered as a group of complementary assets that is referred to as a brand for which one fair value is determined. Expenditure on internally generated brands is expensed as incurred.

Software
Purchased software is measured at cost less accumulated amortization. Expenditure on internally developed software is capitalized when the expenditure qualifies as development activities; otherwise, it is recognized in the income statement when incurred. Amortization related to software is included in cost of sales, distribution expenses, sales and marketing expenses or administrative expenses based on the activity the software supports.

Other intangible assets

Other intangible assets, acquired by the company, are recognized at cost less accumulated amortization and impairment losses. Other intangible assets also include multi-year sponsorship rights acquired by the company. These are initially recognized at the present value of the future payments and subsequently measured at cost less accumulated amortization and impairment losses.

Subsequent expenditure

Subsequent expenditure on capitalized intangible assets is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditures are expensed as incurred.

Amortization

Intangible assets with a finite life are amortized using the straight-line method over their estimated useful lives. Licenses, brewing, supply and distribution rights are amortized over the period in which the rights exist. Brands are considered to have an indefinite life unless plans exist to discontinue the brand. Discontinuance of a brand can be either through sale or termination of marketing support. When AB InBev purchases distribution rights for its own products the life of these rights is considered indefinite, unless the company has a plan to discontinue the related brand or distribution. Software and capitalized development costs related to technology are amortized over 3 to 5 years.

Brands are deemed intangible assets with indefinite useful lives and, therefore, are not amortized but tested for impairment on an annual basis (refer to accounting policy O).

Gains and losses on sale

Net gains on sale of intangible assets are presented in the income statement as other operating income. Net losses on sale are included as other operating expenses. Net gains and losses are recognized in the income statement when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs can be estimated reliably, and there is no continuing managerial involvement with the intangible assets.

15. Intangible assets

	31 December 2018					31 December 2017
Million US dollar	Brands	Commercial intangibles	Software	Other	Total	Total
Acquisition cost						
Balance at end of previous year	**43 402**	**2 904**	**2 177**	**388**	**48 871**	**47 191**
Effect of movements in foreign exchange	(1 482)	(105)	(137)	(41)	(1 765)	1 286
Acquisitions through business combinations	-	22	-	2	24	417
Acquisitions and expenditures	2	367	73	226	668	312
Disposals	(25)	(55)	-	(16)	(96)	(191)
Disposals through the sale of subsidiaries	(14)	-	(29)	(4)	(47)	-
Transfer (to)/from other asset categories and	250	(184)	608	136	810	(144)
Balance at end of period	**42 133**	**2 949**	**2 692**	**691**	**48 465**	**48 871**
Amortization and impairment losses						
Balance at end of previous year	**(32)**	**(1 379)**	**(1 472)**	**(114)**	**(2 997)**	**(2 401)**
Effect of movements in foreign exchange	-	73	84	7	164	(139)
Amortization	-	(163)	(251)	(31)	(445)	(498)
Disposals	-	45	(39)	8	14	89
Disposals through the sale of subsidiaries	-	-	28	2	30	-
Transfer to/(from) other asset categories and	-	(55)	(352)	7	(400)	(48)
Balance at end of period	**(32)**	**(1 479)**	**(2 002)**	**(121)**	**(3 634)**	**(2 997)**
Carrying value						
at 31 December 2017	**43 370**	**1 525**	**705**	**274**	**45 874**	**45 874**
at 31 December 2018	**42 101**	**1 470**	**690**	**570**	**44 831**	**-**

On 2 May 2018, AB InBev recovered the Budweiser distribution rights in Argentina from CCU. The transaction involved the transfer of the Isenbeck, Iguana, Diosa, Norte and Baltica brands, along with a cash payment of 306m US dollar and other commitments, to CCU Argentina. The Budweiser distribution rights have been assigned an indefinite useful life.

AB InBev is the owner of some of the world's most valuable brands in the beer industry. As a result, brands and certain distribution rights are expected to generate positive cash flows for as long as the company owns the brands and distribution rights. Given AB InBev's more than 600-year history, brands and certain distribution rights have been assigned indefinite lives.

Acquisitions and expenditures of commercial intangibles mainly represent supply and distribution rights, exclusive multi-year sponsorship rights and other commercial intangibles.

Intangible assets with indefinite useful lives are comprised primarily of brands and certain distribution rights that AB InBev purchases for its own products, and are tested for impairment during the fourth quarter of the year or whenever a triggering event has occurred.

As of 31 December 2018, the carrying amount of the intangible assets amounted to 44 831m US dollar (31 December 2017: 45 874m US dollar) of which 42 435m US dollar was assigned an indefinite useful life (31 December 2017: 43 595m US dollar) and 2 396m US dollar a finite life (31 December 2017: 2 279m US dollar).

The carrying amount of intangible assets with indefinite useful lives was allocated to the different countries as follows:

Million US dollar Country	2018	2017
United States	22 037	21 960
Colombia	3 516	3 820
South Africa	3 325	3 899
Mexico	3 068	3 058
Peru	2 720	2 825
Australia	2 422	2 773
South Korea	1 013	1 058
Ecuador	595	595
China	381	403
Dominican Republic	339	353
Rest of Africa	1 274	1 353
Other countries	1 745	1 498
Total carrying amount of intangible assets with indefinite useful lives	**42 435**	**43 595**

Intangible assets with indefinite useful lives have been tested for impairment using the same methodology and assumptions as disclosed in Note 14 *Goodwill*. Based on the assumptions described in that note, AB InBev concluded that no impairment charge is warranted. While a change in the estimates used could have a material impact on the calculation of the fair values and trigger an impairment charge, the company is not aware of any reasonably possible change in a key assumption used that would cause a cash-generating unit's carrying amount to exceed its recoverable amount.

- **goodwill** arises from factors such as an entity's food reputation, its brand and strong customer relationships.
- IAS38 forbids **internally generated goodwill** to be recognised as an asset
- Goodwill which is purchased in a business combination is dealt with by **IFRS 3 Business combinations** A business combination occurs when an entity acquires control of another business.

IFRS 3 Business Combinations:

Goodwill is defined as "an asset representing the future economic benefits arising from … assets acquired in a business combination that are not individually identified and separately recognised".

Goodwill acquired in a business combination is recognised as an asset and measured initially at cost.

The cost of the goodwill is equal to the excess of the cost of the business combination over the net fair value of the identifiable assets and liabilities which have been acquired.

The exercise of allocating the consideration paid to the fair value of the identifiable assets and liabilities is called "acquisition accounting" or "purchase price allocation".

Negative goodwill:

Negative goodwill would seem to arise if the cost of a business combination is less than the net fair value of the identifiable assets and liabilities acquired. This (exceptional) situation could arise for two main reasons:

- errors in determining the cost of the business combination or determining the fair values of the identifiable assets and liabilities acquired
- a "bargain purchase" has occurred. Negative goodwill should be treated as income and included in the acquirer's profit or loss.

Subsequent measurement of goodwill:

Goodwill acquired in a business combination should not be amortised. Instead, such goodwill should be measured at its cost less any accumulated impairment losses. Broadly, impairment occurs when an asset's value falls below its carrying amount (see IAS 36). Goodwill should be tested for impairment annually.

Main disclosure requirements of IFRS 3

The main disclosure requirements of IFRS 3 in relation to goodwill are:

- a reconciliation of the carrying amount of the carrying amount of goodwill at the beginning and end of the period showing additions, disposals, impairment losses and any other movements.
- the amount of any negative goodwill which has been included in profit or loss and the line item in the statement of comprehensive income in which this is included

Example disclosure Business Combinations – AB Inbev

6. Acquisitions and disposals of subsidiaries

The table below summarizes the impact of acquisitions and disposals on the statement of financial position and cash flows of AB InBev for 31 December 2018 and 31 December 2017:

Million US dollar	2018 Acquisitions	2017 Acquisitions	2018 Disposals	2017 Disposals
Non-current assets				
Property, plant and equipment	2	169	(310)	-
Intangible assets	24	417	(17)	-
Deferred tax assets	23	-	-	-
Trade and other receivables	-	1	(86)	-
Current assets				
Inventories	17	9	(84)	-
Income tax receivables	-	-	(2)	-
Trade and other receivables	2	20	(79)	-
Cash and cash equivalents	8	5	(6)	-
Assets held for sale	-	27	(27)	-
Non-current liabilities				
Interest-bearing loans and borrowings	(3)	(1)	-	-
Deferred tax liabilities	-	(74)	4	-
Current liabilities				
Trade and other payables	(19)	(24)	406	-
Net identifiable assets and liabilities	**54**	**549**	**(201)**	**-**
Non-controlling interest	**-**	**(114)**	1	**-**
Goodwill on acquisitions and goodwill disposed of	107	398	(652)	-
Loss/(gain) on disposal	-	-	(15)	(42)
Consideration to be (paid)/received	(112)	(375)	47	-
Net cash paid on prior years acquisitions	68	136	-	-
Recycling of cumulative translation adjustment in respect of net assets	-	-	(584)	-
Contribution in kind	-	-	1 150	-
Consideration paid/(received)	**117**	**594**	**(254)**	**(42)**
Cash (acquired)/ disposed of	(5)	(5)	(3)	-
Net cash outflow / (inflow)	**112**	**589**	**(257)**	**(42)**

On 30 March 2018, AB InBev completed the 50:50 merger of AB InBev's and Anadolu Efes' existing Russia and Ukraine businesses. Following the closing of the transaction, the operations of AB InBev and Anadolu Efes in Russia and Ukraine are combined under AB InBev Efes. The combined business is fully consolidated in the Anadolu Efes financial accounts. As a result of the transaction, AB InBev stopped consolidating its Russia and Ukraine businesses and accounts for its investment in AB InBev Efes under the equity method as of that date. See also Note 16 *Investments in associates*.

The transaction described above involved the contribution by AB InBev of its existing Russia and Ukraine businesses to AB InBev Efes in exchange for a 50% ownership in AB InBev Efes. In line with IFRS, the contribution by AB InBev of its existing Russia and Ukraine businesses to AB InBev Efes, with AB InBev losing control, is accounted for as a deemed disposal and the 50% non-controlling interest AB InBev received in AB InBev Efes in exchange for such contribution is accounted for as a deemed acquisition of an investment in associate, with both acquisition and disposal measured at their fair value estimated at 1.15 billion US dollar representing the estimated value of the 50 % investment AB InBev will hold in AB InBev Efes after adjustment for net debt.

When a parent loses control of a subsidiary, IFRS 10 requires all assets and liabilities of the former subsidiary to be derecognized and any gain or loss associated with the deemed disposal interest to be recognized in the consolidated income statement. IFRS also requires that any amounts previously recognized in the consolidated statement of other comprehensive income, including historical translation adjustments, be recycled to the consolidated income statement, at the date when control is lost.

AB InBev has derecognized 573m US dollar net assets related to its former Russia and Ukraine businesses and has recycled 584m US dollar from other comprehensive income to the consolidated income statement, resulting in a net non-recurring, non-cash loss of 7m US dollar (see also Note 8 *Non-recurring items*).

In the first quarter of 2017, AB InBev and Keurig Green Mountain, Inc. established a joint venture for conducting research and development of an in-home alcohol drink system, focusing on the US and Canadian markets. The transaction included the contribution of intellectual property and manufacturing assets from Keurig Green Mountain, Inc. Pursuant to the terms of the joint venture agreement, AB InBev owns 70% of the voting and economic interest in the joint venture. Under IFRS, this transaction was accounted for as a business combination as AB InBev was deemed as the accounting acquirer as per IFRS rules.

The company undertook a series of additional acquisitions and disposals during 2017 and 2018, with no significant impact in the company's consolidated financial statements.

CHAPTER 7 IMPAIRMENT (WAARDEVERMINDERING) OF ASSETS (IAS 36)

DEFINITION OF AN IMPAIRMENT LOSS

IAS 36 defines an impairment loss as "the amount by which the carrying amount of an asset or cash-generating unit exceeds its recoverable amount.

Broadly, the recoverable amount of an asset is the amount that can be obtained by either using it or selling it.

→ If recoverable amount > book value : there is no impairment loss

EXTERNAL AND INTERNAL INDICATION OF IMPAIRMENT

External:

- decline in the market value of the asset
- adverse technological, market, economic or legal changes
- increase in the discount rate used when computing value in use
- carrying amount of the entity's net assets exceeds market capitalisation.

Internal:

- evidence of obsolescence or physical damage to the asset
- the asset has become idle
- plans to discontinue the operation in which the asset is used
- plans to dispose of the asset
- useful life of the asset reassessed as finite
- evidence that the asset's economic performance will be worse than expected.

Example – impairment indicators:

Treasury Island Group has a well established retail outlet at each of its two tourist resorts. To date these retail outlets have been tremendously profitable.

During the current period, a large, well-established competitor, opens a store within 5km of each resort, selling similar products at lower prices. Does this represent an impairment indicator?

YES. A competitor entering the market in the same area as Impairment Island's existing retail outlet represents an impairment indicator.

What type of impairment indicator is it? External

Example – impairment indicators

Books4All Inc operates a chain of bookstores.

Under local tax regulations, customers have historically been charged a 2% sales tax on book purchases. However, during the current period, sales tax has increased from 2% to 10%, resulting in an increase in the amount customers must pay for books. Customers are very sensitive to price changes.

What impact will this have on Books4All Inc's impairment assessment?

a) Increasing tax rates do not represent an impairment indicator, since they reflect a charge that is paid by customers, with no impact on the recoverable amount of Books4All.

b) Increasing tax rates will likely represent an impairment indicator since they will increase the amount customers must pay for books – affecting book demand.

c) Increasing tax rates do not represent an impairment indicator, as the sales price of the books has not decreased.

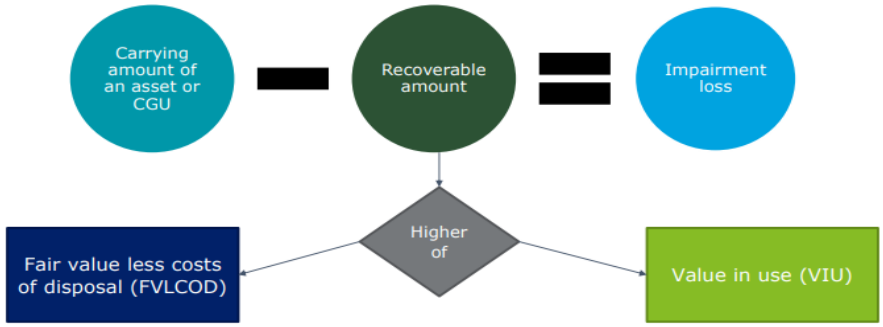
d) It is unknown whether increasing tax rates represents an impairment indicator, and more evidence is required.

=> Answer: B : Revised cashflow forecasts should be prepared by management, based on the best information available, so as to determine the value in use of the assets.

→ It will revise effect demand : sales will change

RECOVERABLE AMOUNT

IAS 36 defines the recoverable amount of an asset as *"the HIGHER of its fair value less costs of disposal and its value in use".*

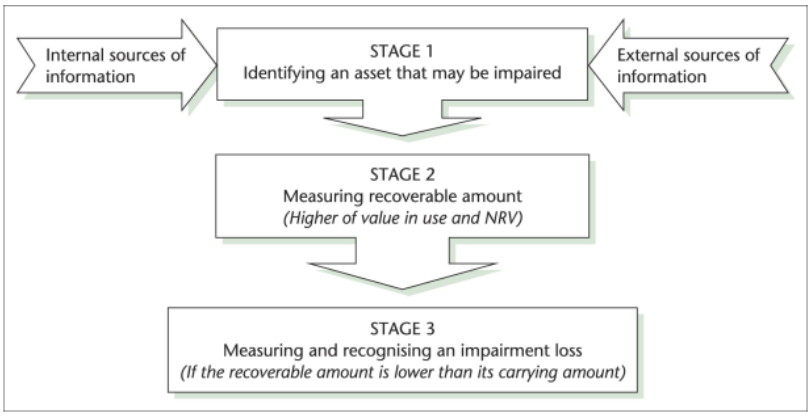


*Fair value is the **price** that would be received to sell an asset or paid to transfer a liability in an **orderly transaction** between market participants at the measurement date.*

*VIU is the **present value of future cash flows** (inflows and outflows) expected to be derived from the use of the asset or CGU.*

You don't have to compare to both amount. If 1 is higher you can stop, and you don't have to compare to other amount.

Stages of an impairment test



RECOGNITION AND MEASUREMENT OF AN IMPAIRMENT LOSS

If the recoverable amount of an asset is less than its carrying amount, the asset's carrying amount should be reduced to its recoverable amount. The amount of this reduction is an **impairment loss**. In general, an impairment loss is recognised as an **expense**.

(But for revalued assets:

- an impairment loss is first debited to revaluation reserve to the extent of any credit balance previously existing in that reserve in respect of the same asset (and is shown as a negative figure in other comprehensive income);

- any excess is then recognised as an expense)

Example value in use:

Value in use:
Entity C estimates that an asset is expected to generate the following **cash flows** over its useful life of four years:

	Inflows €000	*Outflows €000*
Year 1	150	12
Year 2	200	14
Year 3	180	14
Year 4	120	12

- All cash flows will occur at the end of the year concerned.
- At the end of the four year period, the asset is expected to be sold for €100,000.
- Assuming a discount rate of 12% and working to the nearest €000, calculate the asset's value in use.

	Inflows €000	*Outflows €000*	*Net cash flow €000*	*Discount factor*	*Present value €000*
Year 1	150	12	138	0.893	124
Year 2	200	14	186	0.797	148
Year 3	180	14	166	0.712	118
Year 4	120	12	208	0.636	132
Value in use					522

Notes:
(i) The cash inflow for year 4 includes €100,000 disposal proceeds for the asset.
(ii) The discount factor for the first year is $1 \div 1.12 = 0.893$. The discount factor for the second year is $1 \div (1.12)^2$ and so forth.
(iii) The asset's value in use is €522,000.

If car > value in use you have to book an impairment for the difference

	2011	2012	2013	2014	2015
Revenue	3,500	3,710	3,933	4,169	4,419
Revenue growth per approved budget	*6%*	*6%*	*6%*	*6%*	*6%*
EBITDA	1,050	1,113	1,180	1,251	1,326
EBITDA margin per approved budget	*30%*	*30%*	*30%*	*30%*	*30%*
Add: Change in net working capital	(12)	(11)	(11)	(12)	(13)
Less: Replacement capital expenditure	(175)	(195)	(270)	(325)	(250)
Pre-tax Free cash flow	863	907	899	914	1,063
Discount rate (pre-tax rate based on WACC)	12.5%				
Discount period (mid-year convention)	0.5	1.5	2.5	3.5	4.5
Discount factor	0.943	0.838	0.745	0.662	0.589
Present value of free cash flow	814	760	670	605	626
Present value of free cash flow (FY11 to FY15)	3,475				
Present value of terminal value*	5,557				
Value in use	**9,032**				

EBITDA can been used as a substitute in the projection of income and expense related cash flows. However, adjustments must be made to account for other cash flows not captured within EBITDA, including working capital movements and capital expenditure.

**As required by IAS 36, cash flow projections for periods beyond the most recent budgets/forecasts are determined by extrapolation using a steady or declining growth rate, unless an increasing growth rate can be justified. The resulting figure is called the terminal value. It is then discounted to present value.

To calculate the present value of the terminal value in this example, we

- Calculated the normalised future long-term cash flow of CU 1,074 – determined by using the 2015 pre-tax cash flow of CU 1,063 (per the above table) and adjusting it for a lower change in working capital due to a lower long-term growth rate.
- Applied the long-term annual growth rate of 1% to the normalised future cash flows to determine the terminal value.
- Discounted the terminal value using the assumed pre-tax discount rate of 12.5% and the discount factor used in 2015 of 0.589 (per the above table) . Discount factor is = 1/((1+12,5%)^4,5)

That is, CU 5,557 = (1,074*1.01)/(12.5%-1%)*0.589.

Terminal value = (FCF*1+perpetual growth rate)/(Discount rate – perpetual growth rate)

Example recoverable amount:

Recoverable amount:
An entity has determined the VIU and FVLCOD for its assets, as follows:

	Carrying amount €	*Fair value less costs to sell* €	*Value in use* €
Asset A	20,000	24,000	36,000
Asset B	22,000	18,000	26,000
Asset C	14,000	23,000	n/d
Asset D	17,000	13,000	14,000
Asset E	25,500	n/d	37,600
Asset F	20,000	28,000	24,000
Asset G	42,000	30,000	20,000

Note: n/d = not determined.

- Determine for each asset the impairment loss, if any

If one of the 2 is greater than carrying amount -> impairment loss = 0

	Carrying amount €	*Recoverable amount* €	*Impairment loss* €
Asset A	20,000	36,000	0
Asset B	22,000	26,000	0
Asset C	14,000	23,000 (at least)	0
Asset D	17,000	14,000	3,000
Asset E	25,500	37,600 (at least)	0
Asset F	20,000	28,000	0
Asset G	42,000	30,000	12,000

Notes:
(i) In each case, the recoverable amount is the higher of fair value less costs to sell and value in use. For assets C and E, one of these figures has not been determined, so the recoverable amount is assumed to be the figure avilable. Such recoverable amount is higher than the carrying amount, so there is no impairment loss.
(ii) For most of the assets, the carrying amount is less than the recoverable amount, so there is no impairment loss. However, assets D and G are impaired.
(iii) Although value in use has not been determined for asset C and fair value less costs to sell has not been determined for asset E, yet it is clear that these assets are not impaired. Therefore, it is not necessary to expend further effort to determine the missing figures.

If both are bigger then you take the biggest difference →12 000

CASH-GENERATING UNITS (CGUS)

IAS 36 defines a CGU as "the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets".

Where an impairment review of a CGU is required, it should cover all its tangible assets, intangible assets and attributable goodwill.

Cash-generating units (CGUs) – example

A national wireless communication provider owns a number of sets of antennae, radio transmitters and receivers (collectively referred to as 'antennae sets') installed on cell towers which together provide the infrastructure for its telecommunications network.

If a specific antennae set is damaged or otherwise is not capable of operating, its output can be delivered from a similar antennae set on another cell tower so that services are virtually uninterrupted, and all cash flow streams will remain intact. This interchangeability is a feature deliberately built into the integrated logistical design of the network. ! NOT INDEPENDENT!

Should the individual antennae be identified as separate CGU's?

- No!
- Each individual antennae set is not 'largely independent'. Each antennae set is part of a group of assets that make up the entity's network of towers and antennae.
- It is not appropriate to attribute specific cash flows to individual antennae sets because the sets are almost instantaneously interchangeable and, as a result, whether an individual antennae set is capable of operating does not affect cash inflows.
- Because the wireless communication provider operates using a national network, the national network infrastructure asset group would be the smallest identifiable asset group that generates cash inflows that are largely independent; therefore, the national network infrastructure asset group is a cash-generating unit and it is at that level that the network should be assessed for impairment.

ALLOCATION OF AN IMPAIRMENT LOSS FOR A CGU

An impairment loss for a CGU is recognised by **reducing the carrying amount of the CGU's assets**. The loss is allocated between assets as follows:

- **first, to any goodwill** which has been allocated to the CGU
- then, to the other assets of the CGU, in proportion to their carrying amounts

Example – allocation of impairment loss to a CGU

Allocation of impairment loss of a CGU:

A CGU has the following net assets (in €m)

Goodwill	20
Property	40
Plant and equipment	60
Total	**120**

The recoverable amount has been determined at €90m.

We show how to allocate the impairment loss to the net assets of the CGU.

The impairment loss is €30m (€120m – €90m).

Of this loss, €20m is used to eliminate the goodwill.

The remaining €10m is split between the other two assets in the ratio 40:60.
Property is reduced by €4m and plant and equipment by €6m.

	Goodwill €m	*Property* €m	*Plant* €m	*Total* €m
Carrying value	20	40	60	120
Impairment loss	(20)	(4)	(6)	30
Carrying value after impairment	0	36	54	90

20 - 4 - 6

20 - 10

30

Reversal of an impairment loss:

- Entities must assess whether there are any indications that previous impairment losses have decreased or no longer exist.
- These indications are generally **the opposite** of the indications of impairment.
- If any of these indications exist, the recoverable amount of the asset or CGU must be determined again, with a view to reversing all or part of the previously recognised impairment loss.
- **Impairment losses previously recognized on goodwill are never reversed.**

IAS 36 DISCLOSURE REQUIREMENTS

For each class of assets, the entity should disclose:

- the amount of impairment losses (or reversals) recognised as expenses (or income) during the period and the line items in which these are included;
- the amount of impairment losses (or reversals) recognised in other comprehensive income during the period. For each material impairment loss or reversal recognised in the period, the entity should make various disclosures with regard to the nature, amount and circumstances of the loss or the reversal.

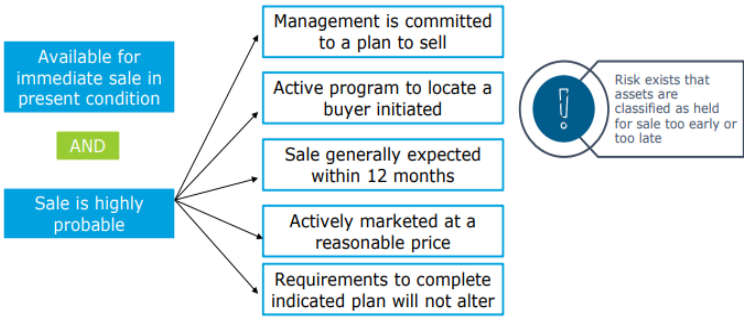
CHAPTER 8 NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

NON-CURRENT ASSETS HELD FOR SALE:

CLASSIFICATION OF A NON-CURRENT ASSET AS HELD FOR SALE

IFRS 5 states **that a non-current asset** should be classified as held for sale if its carrying amount "will be recovered principally through a sale transaction rather than through continuing use".

For this to be the case, the asset must be available for immediate sale in its **present condition** and the sale must be **highly probable ! (2 conditions)**



A **disposal group** is a group of assets (possibly with some associated liabilities) which are to be disposed of in a single transaction.

Example – available for immediate sale:

An entity is committed to a plan to sell its headquarters building and has initiated actions to locate a buyer:

- situation1: the entity intends to transfer the building to a buyer after it vacates the building. The time necessary to vacate the building is usual and customary for sales of such assets. The criterion would be met at the plan commitment date.
- Situation 2: the entity will continue to use the building until construction of a new headquarters building is completed. The entity does not intend to transfer the existing building to a buyer until after construction of the new building is completed (and it vacates the existing building). The delay in the timing of the transfer of the existing building imposed by the entity (seller) demonstrates that the building is not available for immediate sale. The criterion would not be met until construction of the new building is completed, even if a firm purchase commitment for the future transfer of the existing building is obtained earlier.

MEASUREMENT OF NON-CURRENT ASSETS HELD FOR SALE

A non-current asset or a disposal group which is held for sale should be measured at the **lower of its carrying amount** when it was initially classified as held for sale and its **"fair value less costs to sell".**

- Fair value is "the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date"
- Costs to sell are "... costs directly attributable to the disposal of an asset (or disposal group), excluding finance costs and income tax expense"

Depreciation should not be charged with regard to non-current assets or disposal groups which are held for sale.

Example – measurement of non-current assets held for sale:

A freehold property was originally acquired for CU400,000. Some years later, after cumulative depreciation of CU110,000 has been recognised, the property is classified as held for sale.

At the time of classification as held for sale:

- carrying amount is CU290,000; and
- fair value less costs to sell is assessed at CU300,000

Accordingly

- no write-down on classification as held for sale and the property is carried at CU290,000 (being the lower of the carrying amount and the FVLCOD)

SCOPE OF THE MEASUREMENT REQUIREMENTS OF IFRS5

The measurement requirements of IFRS5 apply **only to non-current assets** and do not apply at all to certain assets (e.g. investment properties) whether these are to be sold individually or as part of a disposal group.

An asset which is beyond the scope of the measurement requirements of IFRS 5 should continue to be measured in accordance with the applicable standard.

If such an asset forms part of a disposal group, its carrying amount should be remeasured in accordance with the applicable standard each time that the carrying amount of the disposal group is compared with its fair value less costs to sell.

ACCOUNTING FOR IMPAIRMENT LOSSES

When an asset or disposal group is initially classified as held for sale, an impairment loss is recognised if fair value less costs to sell is lower than carrying amount.

A further impairment loss is recognised if there is a decrease in fair value less costs to sell and a gain is recognised if there is an increase in fair value less costs to sell. But gains which exceed the cumulative impairment losses that have already been recognised in relation to the asset or group are not recognised.

For a disposal group, impairment losses and any subsequent gains are generally allocated between the non-current assets in the group in the order set out in IAS 36.

ASSETS NO LONGER CLASSIFIED AS HELD FOR SALE

A non-current asset that ceases to be classified as held for sale should be measured at **the lower of**:

- its **carrying amount** before being classified as held for sale, less any depreciation that would have been charged in the meantime if it had not been held for sale, and
- its **recoverable amount** at the date of the decision not to sell, where recoverable amount is the higher of the asset's fair value less costs to sell and its value in use.

PRESENTATION OF NON-CURRENT ASSETS HELD FOR SALE

Non-current assets held for sale and the assets of a disposal group held for sale should be presented separately from other assets in the statement of financial position.

- The liabilities of a disposal group should be presented separately from other liabilities.
- These assets and liabilities must not be offset.

The notes to the financial statements should provide further information with regard to non-current assets held for sale, including a description of the asset, an explanation of the circumstances and the amounts of any impairment losses.

Prior periods are not reclassified!

Example presentation non-current assets held for sale – **AB InBev**

Consolidated statement of financial position

As at Million US dollar	Notes	31 December 2018	31 December 2017
ASSETS			
Non-current assets			
Property, plant and equipment	13	25 910	27 184
Goodwill	14	133 311	140 940
Intangible assets	15	44 831	45 874
Investments in associates and joint ventures	16	6 136	5 263
Investment securities	17	108	100
Deferred tax assets	18	1 457	1 216
Employee benefits	25	16	22
Income tax receivables		992	708
Derivatives	29	291	25
Trade and other receivables	20	769	834
Total non-current assets		213 822	222 166
Current assets			
Investment securities	17	87	1 304
Inventories	19	4 234	4 119
Income tax receivables		457	908
Derivatives	29	16	458
Trade and other receivables	20	6 375	6 566
Cash and cash equivalents	21	7 074	10 472
Assets classified as held for sale	22	39	133
Total current assets		**18 281**	**23 960**
Total assets		**232 103**	**246 126**

22. Assets classified as held for sale, liabilities associated with assets held for sale and discontinued operations

ASSETS CLASSIFIED AS HELD FOR SALE

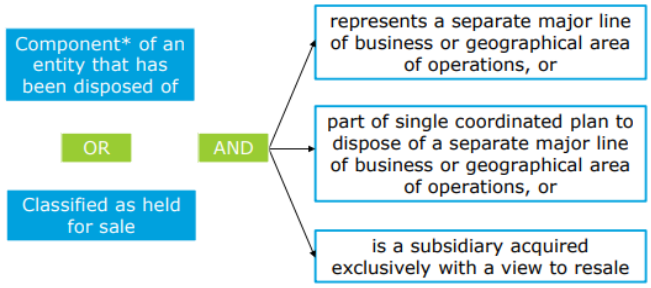
Million US dollar	31 December 2018	31 December 2017
Balance at the end of previous year	133	16 458
Disposals from SAB transaction-related divestitures	-	(15 514)
Reclassified to assets held for sale in the period	35	91
Disposals	(128)	(26)
Effect of movements in foreign exchange	(1)	132
Other movements	-	(1 008)
Balance at the end of year	**39**	**133**

LIABILITIES ASSOCIATED WITH ASSETS HELD FOR SALE

Million US dollar	31 December 2018	31 December 2017
Balance at the end of previous year	**-**	**2 174**
Disposals from SAB transaction-related divestitures	-	(1 166)
Other movements	-	(1 008)
Balance at the end of year	**-**	**-**

DISCONTINUED OPERATIONS

IFRS5 defines a discontinued operation as "***a component of an entity that either has been disposed of or is classified as held for sale ...***".



* A component of an entity comprises operations & cash flows that can be clearly distinguished operationally and for financial reporting purposes from rest of entity

IFRS5 requires that entities should present and disclose information that enables users of the financial statements to evaluate the effects of discontinued operations.

PRESENTATION AND DISCLOSURE OF DISCOUNTED OPERATIONS

With regard to discontinued operations, the entity should disclose:

- a single amount in the statement of comprehensive income, comprising the total of:
  - the post-tax profit or loss of discontinued operations, and
  - the post-tax gain or loss on the measurement to fair value (less costs to sell) or the disposal of assets which constitute discontinued operations.
- an analysis of this single amount, either in the statement of comprehensive income or in the notes to the financial statements.

Comparative period is restated.

Example presentation discontinued operations – AB InBev

Consolidated income statement

For the year ended 31 December Million US dollar, except earnings per shares in US dollar	Notes	2018	2017
Revenue		**54 619**	**56 444**
Cost of sales		(20 359)	(21 386)
Gross profit		**34 259**	**35 058**
Distribution expenses		(5 770)	(5 876)
Sales and marketing expenses		(7 883)	(8 382)
Administrative expenses		(3 465)	(3 841)
Other operating income/(expenses)	7	680	854
Profit from operations before non-recurring items		**17 821**	**17 814**
Restructuring	8	(385)	(468)
Acquisition costs business combinations	8	(74)	(155)
Business and asset disposal	8	(26)	(39)
Provision for EU investigation	8	(230)	-
Profit from operations		**17 106**	**17 152**
Finance cost	11	(7 186)	(6 192)
Finance income	11	440	378
Non-recurring net finance income/(cost)	11	(1 982)	(693)
Net finance income/(cost)		**(8 729)**	**(6 507)**
Share of result of associates and joint ventures	16	153	430
Profit before tax		**8 530**	**11 076**
Income tax expense	12	(2 839)	(1 920)
Profit from continuing operations		**5 691**	**9 155**
Profit from discontinued operations		-	28
Profit of the period		**5 691**	**9 183**

CHAPTER 10: INVENTORIES (IAS 2)

DEFINITION

Inventories are assets:

- held for sale in the ordinary course of business (finished goods or margin labs);
- in the process of production for such sale; or
- in the form of materials or supplies to be consumed in the production process or in the rendering of services. (raw material or direct supplies)

Definition covers Raw Materials and Supplies, Work in Process, Finished Goods and Merchandise.

⇨ So merchandise, finished goods, goods/work in process, direct materials and supplies

MEASUREMENT OF INVENTORIES

Inventories are measured "*at the lower of cost AND net realisable value*" (IAS 2) whereby:

- Cost comprises "*all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition*".
- Net realisable value is "*the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale*".
    - F.e: covid a lot of hops didn't sell their clothes. Will people but it next year? If no what is the least price, I can put on those clothes. This discount can be so big that the net realizable value is lower than the cost value. (They must book an impairment)

Conversion costs:

= Costs directly related to **production** (such as direct materials, direct labour) plus a systematic allocation of fixed and variable production overheads.

- **Fixed production** overheads are indirect costs of production which remain fairly constant (e.g. depreciation of factory buildings, costs of factory management).
- **Variable production** overheads are indirect costs of production which vary with volume of production (e.g. indirect materials and labour).

    Examples of indirect materials are: Cleaning supplies; Disposable safety equipment; Disposable tools; Fittings and fasteners; Glue; Tape; Oil.

    Examples of indirect labor positions are: Production supervisor; Purchasing staff; Materials handling staff; Materials management staff; Quality ...

Fixed production overheads

- Allocation of fixed production overheads to units of production is based on normal activity. Why?
- If actual activity is less than normal, unallocated fixed overheads are recognised as an expense, not as part of cost of goods produced.
- If actual activity is greater than normal, the amount of fixed overhead allocated to each unit of production is decreased.

Costs excluded from the cost of inventories

- Abnormal amounts of wasted materials, labour or other production costs.
- Storage costs, unless necessary in the production process before a further production stage.
    - Assume you have a production process who takes place at 2 locations you start working on a product in location x and at the end of that production process you have an intermediate. The cost of storing the intermediate is absolutely part of the overall inventory value because after it moves to another location where the production continues until you have finished goods. All storage cost continued to be capitalized until we are at the end of the production. One the good is produced, the further cost of storage in the warehouse is not part of the inventories.
- Administrative overheads not incurred to bring inventories to their present location or condition.
    - Overhead that you are inquiring that has nothing to do with producing the inventory f.e: the administrative cost for the person who is managing the warehouse with the finished goods.
- Selling costs.
    - Are related to the sales process!

Cost measurement techniques

- Based on cost price or acquisition cost if acquired from third parties.
- Techniques such as standard costing or the retail method may be used if the results provide a reasonable approximation to cost.

The standard cost approximates the value of one unit of production based on the different cost components:

E.G. standard cost of a pair of shoes

Standard Cost Card			
	Cost/Rate (£)	Quantity	Total (£)
Materials - leather (metres)	16.00	0.5	8.00
Materials - sole (unit)	0.75	2	1.50
Direct labour (hours)	9.50	0.5	4.75
Variable overheads	5.00	1	5.00
Total marginal cost			19.25

Standard costs should be regularly reviewed and, if necessary, revised. Why?

The retail method determines the cost of inventory by reducing sales value by the appropriate gross margin.

	A	B	C	D
1		At Cost (75% of Retail)		At Retail
2	Beginning inventory	$200,000	÷ 0.75 →	$266,667
3	Purchases	300,000	÷ 0.75 →	400,000
4	Cost of goods available for sale	$500,000		$666,667
5	Sales	345,000	← 0.75 ×	460,000
6	Ending inventory	$155,000		$206,667
7				

- B2: You have your beginning inventory
- D2: The value of the inventory is transformed in the retail value. (You multiply by the selling price)
- B3: The number of purchases since the day of stock out.
- D3: B3 transformed in sales prices

At the end you want your ending inventory !

COST FORMULAS TO BE UTILIZED

- The cost of inventories that are <u>not</u> inter-changeable should be ascertained "*by using specific identification of their individual costs*".
- For interchangeable items, costs are ascertained using either of the following cost formulas:
  - First-In, First-Out (FIFO);
  - Weighted average cost.
- Last-In, First-Out (LIFO) is not allowed under IFRS (contrary to US GAAP).

Weighted average cost

- The weighted average cost formula assigns a value to each item of inventory based on the weighted average of items in inventories at the beginning of the period and the weighted average of items of inventories purchased or produced during the period.
- Depending on the inventory system of the reporting entity, the weighted average cost is calculated either on a periodic basis or on a perpetual basis as the inventories are received.

FIFO

- The FIFO cost formula assumes that the items of inventory that were purchased or produced first are sold first.

- Therefore, at the end of the period, the items in inventory are valued using the prices for the most recent purchases.

Cost formulae – WAC

An entity had opening inventories of 15,000 units at a weighted average cost of CU4 per unit, and made the following purchases during the year.

Date of purchases	Number of units	Cost per unit CU	Total cost CU
1 January	15,000	4.20	63,000
1 April	20,000	4.50	90,000
1 May	25,000	4.10	102,500
1 July	10,000	4.40	44,000
1 October	5,000	4.50	22,500
Total	75,000		322,000

Closing inventories are 20,000 units.

Under the weighted average formula, the number of units in closing inventories is multiplied by the weighted average cost per unit for the year.

	Number of units	Cost per unit CU	Total cost CU
Opening inventories	15,000	4.00	60,000
Date of purchase:			
1 January	15,000	4.20	63,000
1 April	20,000	4.50	90,000
1 May	25,000	4.10	102,500
1 July	10,000	4.40	44,000
1 October	5,000	4.50	22,500
Total	90,000		382,000

The weighted average cost per unit for the year is calculated as follows:

CU382,000 / 90,000 = CU4.24

The value of closing inventories is CU4.24 × 20,000 = CU84,800.

Cost formulae – FIFO

Under the FIFO formula, the first units held are the first units sold. Therefore, closing inventories are valued at the cost per unit of the latest purchases.

If 20,000 units are on hand at year end, the value of closing inventories is calculated as follows.

Date of purchases	Number of units	Cost per unit CU	Total cost CU
October	5,000	4.50	22,500
July	10,000	4.40	44,000
May	5,000	4.10	20,500
Total	20,000		87,000

Thus, closing inventories are valued at CU87,000.

Measurement of inventories - Net realisable value (NRV)

Net realisable value is "the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale".

- The costs and NRV of inventories should normally be compared "item by item" (IAS2).
- However, similar or related items may be grouped if this is appropriate.
    - f.e: socks, underwear…

When the net realisable value of an item of inventory is less than its cost, the excess is written off immediately in profit or loss.

Net realisable value estimates are made at the end of each reporting period

When estimating the net realisable value of inventories, management should consider all of the facts relating to the inventories and the operating environment at the time the estimates are made.

Estimates are based on the most reliable evidence available at that time as to the amount that the inventories are likely to realize.

These estimates take into consideration fluctuations in price or cost directly relating to events occurring after the reporting period to the extent that such events confirm conditions existing at the end of the reporting period.

What does this concept mean in different industries?
What does this concept mean in different economic circumstances?

- To fashion retailers if they don't have an E-commerce at times when the public is not allowed to shop?
- To fashion retailers that make strategical errors in their assortment and bought too much inventories of clothes people don't like?
- To a car seller at times when the economy suffers and the public suddenly purchases less cars?

- To businesses that sell items that become quickly technically obsolete due to technological advancements?
- To food retailers selling fresh fruit and vegetables on the day(s) before they expire?
- ….

NVR Example

Sales after the reporting period

An item of inventory which cost CU100 is sold after the reporting period for CU80. A sale after the reporting period at a lower price generally provides evidence of the net realisable value of the inventories at the end of the reporting period and the closing inventories should therefore be carried at CU80 less any costs to sell.

However, this will not always be the case. If, for example, further investigation shows that the decrease in sales price arose because of damage to the inventories that occurred after the reporting period, this would indicate that the CU80 sales price did not reflect conditions existing at the end of the reporting period and that the loss in value should not be accounted for until the next period. In these circumstances, it would be necessary to assess whether the item could have been sold undamaged for an amount at or in excess of its cost (CU100) plus any costs to sell. If so, no write-down would be required at the end of the reporting period.

→ When the net realisable value of an item of inventory is less than its cost, the excess is written off immediately in profit or loss.

- F.e: it has costed a 100 currency per unit, and it has been sold after period for 80. Does this 80 say something about the end value? Was it already 80? If yes, you should utilize the information you learned for the sales at 80 in finalizing and closing the books at year 2020.
  →If it was caused by a damage in 2021 (January) you cannot say that that goods should be valued at 80.

Measurement of inventories – Reversal of NRV write-offs

- When subsequent evaluations show that the circumstances that previously caused inventories to be written down below cost no longer exist, or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, write-downs of inventories previously recognised are required to be reversed.
- The amount of the write-down should be reversed through profit or loss so that the new carrying amount is the lower of the cost and the revised net realisable value. Therefore, the amount of the reversal is limited to the amount of the original write-down.

→ This occurs, for example, when an item of inventory that is carried at net realisable value because its selling price had declined is still on hand in a subsequent period and its selling price has increased (though it would still be necessary, if the item had been on hand for a long time, to consider whether there might be obsolescence issues).

DISCLOSURES

- Accounting policies adopted, including any cost formula used
- Total carrying amount of inventories and analysis of carrying amount into appropriate classifications
    - Total amount on balance sheet and if you have subcategories : raw materials, direct supplies… => Appropriate classifications
- Amount of inventories recognised as an expense in the period
- Amount of any write-down to NRV or any reversal of previous write-down.

Example - Costs of conversion (not exercises like that on exam but good for understanding)

- Manufact BVBA purchased 10.000 units of raw material Z at €8 per unit (excl. of VAT and trade discounts) during the year ended 31 December 2018.
- In producing 5.000 units of finished products 'O' the 10.000 units raw materials were utilised.
- In addition 20.000 direct labour hours were required for conversion at a rate of €5 per hour.
- Fixed production overheads for the year of €90.000 were incurred and paid in full.
- Variable production overheads of €7 per unit of finished product 'O' were also incurred and paid in full.
- The level of production of 5.000 units was less than Manufact's normal level of activity of 6.000 units.
- During 2018, 4.000 units of finished product 'O' were sold.

Question: What is the value on the balance sheet of the remaining 1.000 units?

Solution:

The inventory of 1.000 finished goods 'O' is valued as follows on 31 December 2018:

Raw materials: 10.000 units @ €8 per unit	80.000
Direct wages: 20.000 hours @ €5 per unit	100.000
Fixed production overheads (90.000€/6 X 5)	75.000
Variable production overheads	
(5.000 units @ €7 per unit)	35.000
	290.000

290.000 / 5.000 units = 58 €/unit

1.000 remaining inventory units * 58 € = 58.000 €

Alternative Solution

The inventory of 1.000 finished goods 'O' is valued as follows on 31 December 2018:

Raw materials: 2.000 units @ €8 per unit	16.000
Direct wages: 4.000 hours @ €5 per unit	20.000
Fixed production overheads (18.000€/6 X 5)	15.000

Variable production overheads	
(1.000 units @ €7 per unit)	7.000
	58.000

CHAPTER 23: EARNINGS PER SHARE

INTRODUCTION – SIGNIFICANCE OF EPS

⇨ EPS is widely used as a means of assessing a company's financial performance

- EPS feeds into the Price/Earnings ratio, which is an important indicator of investment potential
- Important that EPS should be calculated on a consistent basis so that comparisons can be made between accounting periods and between companies
- As with all ratios, the EPS figure is affected by the company's accounting policies
- EPS is the only ratio which is defined by an international accounting standard (IAS33)

SCOPE OF IAS33

- IAS33 applies only to companies whose shares are publicly traded.
- The consolidated financial statements of a group of companies disclose EPS for the group as a whole (why?).
    - It doesn't make a lot of sense to look at individual companies within a group. You must look at the group because groups ratios can be fundamentally different when you look at a group or a company. And what is relevant is the group consolidate financial statements.

CALCULATION OF BASIC EPS

Basic EPS for an accounting period is calculated by dividing the amount of the profit (or loss) for that period which is attributable to the ordinary shareholders by the weighted average number of ordinary shares outstanding during the period.

- Profit attributable to the ordinary shareholders is the profit after tax and preference dividends.
- Shares are outstanding from the date on which they are issued.

Basic EPS must be disclosed for the previous accounting period as well as for the current accounting period.

CALCULATION OF THE WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING DURING AN ACCOUNTING PERIOD

The weighted average number of ordinary shares for an accounting period is calculated by *adding*:

a) the number of ordinary shares outstanding at the beginning of the period, and

b) the number of ordinary shares issued during the period, multiplied by a time weighting factor

and then *subtracting* the number of ordinary shares bought back by the company during the period (if any) multiplied by a time weighting factor.

Calculation of Diluted EPS

Diluted EPS is the EPS figure that would arise if all *dilutive potential ordinary shares* were issued.

- Potential ordinary shares generally occur in connection with convertible loan stocks and share options.
- Shares are regarded as dilutive if the effect of their issue would be to reduce basic EPS.

Diluted EPS must be disclosed for the previous accounting period as well as for the current accounting period.

> Diluted (NL: verwaterd) means that you could have a profit per share that is in fact a lower amount if you take into account a few situations that could exits.

Why dilutive effect?

- Convertible loan: If the debt is converted, the company would have to issue additional shares.
    - F.e: a company has a convertible loan (= you issue a loan and you get money in return but rather then reimbursing the debt at the end of the period you give the option to the debtholder that he don't need to reimburse you but you want the dept converted in equity) As investor you need to take into account that at any time you investment per share could have been lower in case the convertible loan would be exercised because at that moment the company creates new equity and therefore issues new shares and so the denominated increases and therefore the profit per share will decrease.
- Stock options:
    - Stock options that are *in the money* (exercise price < market price of stock) ➔ holders of the stock option can convert their options into stock for a profit at any point and time.
    - Stock options that are out of the money (exercise price > market price of stock) ➔ holders of the stock option would not convert their options, because it would be cheaper to purchase the stock on the open market.

Example EPS in the income statement

For the year ended 31 December			
In millions of €	Note	2020	2019
Revenue	6.1	**23,770**	28,521
Excise tax expense	6.1	(4,055)	(4,552)
Net revenue	6.1	**19,715**	23,969
Other income	6.2	**56**	95
Raw materials, consumables and services	6.3	(12,450)	(14,592)
Personnel expenses	6.4	(3,669)	(3,880)
Amortisation, depreciation and impairments	6.6/8.1	(2,874)	(1,959)
Total other expenses		**(18,993)**	(20,431)
Operating profit		**778**	3,633
Interest income	11.1	50	75
Interest expenses	11.1	(497)	(529)
Other net finance expenses	11.1	(143)	(59)
Net finance expenses		**(590)**	(513)
Share of profit/(loss) of associates and joint ventures	10.3	(31)	164
Profit before income tax		**157**	3,284
Income tax expense	12.1	(245)	(910)
Profit/(Loss)		**(88)**	2,374
Attributable to:			
Shareholders of the Company (net profit/(loss))		(204)	2,166
Non-controlling interests		116	208
Profit/(Loss)		**(88)**	2,374
Weighted average number of shares – basic	6.7	575,625,598	573,643,551
Weighted average number of shares – diluted	6.7	575,625,598	574,217,111
Basic earnings per share (€)	6.7	(0.36)	3.78
Diluted earnings per share (€)	6.7	(0.36)	3.77

Heineken

For the year ended 31 December Million US dollar, except earnings per shares in US dollar	Notes	2020	2019
Revenue		**46 881**	**52 329**
Cost of sales		(19 634)	(20 362)
Gross profit		**27 247**	**31 967**
Distribution expenses		(5 104)	(5 525)
Sales and marketing expenses		(6 861)	(7 348)
Administrative expenses		(3 404)	(3 548)
Other operating income/(expenses)	7	845	875
Profit from operations before non-recurring items		**12 723**	**16 421**
Impairment of goodwill	8	(2 500)	-
COVID-19 costs	8	(182)	-
Restructuring	8	(157)	(170)
Business and asset disposal (including impairment losses)	8	(239)	(50)
Acquisition costs business combinations	8	(25)	(23)
Brazil state tax regularization program	8	-	(74)
Cost related to public offering of minority stake in Budweiser APAC	8	-	(6)
Profit from operations		**9 620**	**16 098**
Finance cost	11	(6 601)	(4 873)
Finance income	11	642	518
Non-recurring net finance income/(cost)	11	(1 738)	882
Net finance income/(cost)		**(7 697)**	**(3 473)**
Share of result of associates and joint ventures	16	156	152
Profit before tax		**2 079**	**12 776**
Income tax expense	12	(1 932)	(2 786)
Profit from continuing operations		**147**	**9 990**
Profit from discontinued operations	22	2 055	424
Profit of the period		**2 202**	**10 414**
Profit from continuing operations attributable to:			
Equity holders of AB InBev		(650)	8 748
Non-controlling interest		797	1 243
Profit of the period attributable to:			
Equity holders of AB InBev		1 405	9 171
Non-controlling interest		797	1 243
Basic earnings per share	23	0.70	4.62
Diluted earnings per share	23	0.69	4.53
Basic earnings per share from continuing operations	23	(0.33)	4.41
Diluted earnings per share from continuing operations	23	(0.33)	4.32

AB InBev

If the earnings per share is different than the dilutes earnings per share it means that the company has stock options (or out of the money) or convertible loans.

BONUS ISSUES (NOT EXAM)

- A bonus issue is an issue of free extra shares to existing shareholders in proportion to their existing holdings. A bonus issue increases the number of issued shares but not the company's capacity to earn profits. This reduces EPS and distorts comparisons with previous periods.

- IAS33 requires that a bonus issue is treated as if it had occurred *at the beginning of the earliest period presented in the financial statements*. This is usually the previous accounting period (for which comparatives are given).
- The financial statements for a period in which there has been a bonus issue must restate EPS for the previous period, calculated as if the bonus shares had existed throughout that period.

RIGHTS ISSUES (NOT EXAM)

A rights issue is an issue of shares (for which a price is charged) to existing shareholders in proportion to their existing holdings. If a rights issue is not made at full market price it contains a "bonus element".

IAS33 requires that a rights issue that is not made at full market price is split into two components:

a) an issue of bonus shares

b) an issue of shares at full market price

Each of these components is then treated in the usual way.

- When a rights issue occurs, it is first necessary to calculate the theoretical market value per share after that issue.
- The bonus element of the issue is then equal to the size of bonus issue *that would have caused the same fall in the market price* of the company's shares as the fall caused by the rights issue.
- The remainder of the rights issue is treated as an issue of shares at full market price.

PRESENTATION AND DISCLOSURE REQUIREMENTS

- Basic EPS and diluted EPS must be presented in the statement of comprehensive income.
- EPS figures must be presented even if they are negative (i.e. if there is a loss per share).
- The earnings figures used in EPS calculations must be disclosed and reconciled to the profit or loss shown in the financial statements.
- The weighted average number of shares used in the calculation of basic EPS and diluted EPS must be disclosed and reconciled to each other

Example EPS further disclosures

EARNINGS PER SHARE

The calculation of basic earnings per share for 2020 is based on the profit attributable to equity holders of AB InBev of 1 405m US dollar (2019: 9 171m US dollar) and a weighted average number of ordinary and restricted shares outstanding (including deferred share instruments and stock lending) per end of the period, calculated as follows:

Million shares	2020	2019
Issued ordinary and restricted shares at 1 January, net of treasury shares	1 959	1 957
Effect of stock lending	30	25
Effect of delivery of treasury shares	9	2
Weighted average number of ordinary and restricted shares at 31 December	**1 998**	**1 984**

The calculation of diluted earnings per share for 2020 is based on the profit attributable to equity holders of AB InBev of 1 405m US dollar (2019: 9 171m US dollar) and a weighted average number of ordinary and restricted shares (diluted) outstanding (including deferred share instruments and stock lending) at the end of the period, calculated as follows:

Million shares	2020	2019
Weighted average number of ordinary and restricted shares at 31 December	1 998	1 984
Effect of share options, warrants and restricted stock units	39	42
Weighted average number of ordinary and restricted shares (diluted) at 31 December	**2 037**	**2 026**

The calculation of earnings per share before non-recurring items and discontinued operations is based on the profit from continuing operations attributable to equity holders of AB InBev. A reconciliation of the profit before non-recurring items and discontinued operations, attributable to equity holders of AB InBev to the profit attributable to equity holders of AB InBev is calculated as follows:

Million US dollar	2020	2019
Profit before non-recurring items and discontinued operations, attributable to equity holders of AB InBev	3 807	8 086
Non-recurring items, before taxes (refer to Note 8)	(3 103)	(323)
Non-recurring finance income/(cost), before taxes (refer to Note 11)	(1 738)	882
Non-recurring taxes (refer to Note 8)	155	(6)
Non-recurring non-controlling interest (refer to Note 8)	228	108
Profit from discontinued operations (refer to Note 22)	2 055	424
Profit attributable to equity holders of AB InBev	**1 405**	**9 171**

The calculation of the Underlying EPS is based on the profit before non-recurring items, discontinued operations, mark-to-market gains/losses and hyperinflation impacts attributable to equity holders of AB InBev. A reconciliation of the profit before non-recurring items, discontinued operations, mark-to-market gains/losses and hyperinflation impacts, attributable to equity holders of AB InBev to the profit before non-recurring items and discontinued operations, attributable to equity holders of AB InBev, is calculated as follows:

Million US dollar	2020	2019
Profit before non-recurring items, discontinued operations, mark-to-market gains/losses and hyperinflation impacts, attributable to equity holders of AB InBev	5 022	7 196
Mark-to-market (losses)/gains on certain derivatives related to the hedging of share-based payment programs (refer to Note 11)	(1 211)	898
Hyperinflation impacts	(4)	(7)
Profit before non-recurring items and discontinued operations, attributable to equity holders of AB InBev	**3 807**	**8 086**

The table below sets out the EPS calculation:

Million US dollar	2020	2019
Profit attributable to equity holders of AB InBev	1 405	9 171
Weighted average number of ordinary and restricted shares	1 998	1 984
Basic EPS from continuing and discontinued operations	**0.70**	**4.62**
Profit from continuing operations attributable to equity holders of AB InBev	(650)	8 748
Weighted average number of ordinary and restricted shares	1 998	1 984
Basic EPS from continuing operations	**(0.33)**	**4.41**
Profit from continuing operations before non-recurring items and discontinued operations, attributable to equity holders of AB InBev	3 807	8 086
Weighted average number of ordinary and restricted shares	1 998	1 984
Basic EPS from continuing operations before non-recurring items	**1.91**	**4.08**
Profit before non-recurring items, discontinued operations, mark-to-market gains/losses and hyperinflation impacts, attributable to equity holders of AB InBev	5 022	7 196
Weighted average number of ordinary and restricted shares	1 998	1 984
Underlying EPS	**2.51**	**3.63**
Profit attributable to equity holders of AB InBev	1 405	9 171
Weighted average number of ordinary and restricted shares (diluted)	2 037	2 026
Diluted EPS from continuing and discontinued operations	**0.69**	**4.53**
Profit from continuing operations attributable to equity holders of AB InBev	(650)	8 748
Weighted average number of ordinary and restricted shares (diluted)[1]	1 998	2 026
Diluted EPS from continuing operations	**(0.33)**	**4.32**
Profit from continuing operations before non-recurring items and discontinued operations, attributable to equity holders of AB InBev	3 807	8 086
Weighted average number of ordinary and restricted shares (diluted)	2 037	2 026
Diluted EPS from continuing operations before non-recurring items	**1.87**	**3.99**

The average market value of the company's shares for purposes of calculating the dilutive effect of share options and restricted stock units was based on quoted market prices for the period that the options and restricted stock units were outstanding. For the calculation of Diluted EPS from continuing operations before non-recurring items, 76m share options were anti-dilutive and not included in the calculation of the dilutive effect as at 31 December 2020 (31 December 2019: 59m share options[1]).

CHAPTER 11: FINANCIAL INSTRUMENTS (IAS32, IFRS7, IFRS9)

EXAMPLES OF FINANCIAL INSTRUMENTS

- Financial instruments include contracts relating to:
    - the issue of shares
    - the issue of loans
    - trade receivables and payables

- Financial instruments also include more complex arrangements such as:
    - convertible debt
    - interest rate swaps
    - forward rate agreements
    - etc…

DEFINITONS

- A **financial instrument** is "*any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity*"
- A **financial asset** is *any asset that is:*
    - *Cash*
    - *an equity instrument of another entity*
    - *a contractual right to receive cash*"
- A **financial liability** is *any liability that is a contractual obligation to deliver cash or another financial asset*
- An **equity instrument** is "*any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities*".

Example 1 – Financial instruments: tell why it is a financial instrument

1. A company issues a loan: there is a contractual agreement between 2 parties whereby 1 party exchange cash and the other party becomes creditholder and therefore has a financial receivable.
2. A company sells goods to a customer on credit
3. A company deposits money into a bank account
4. A company overdraws its bank account
5. A company issues ordinary shares
6. A company invests in newly issued ordinary shares of another company

Question:

Explain why each of these transactions listed above gives rise to a financial instrument as defined by IAS 32

Solution

Melville A, International Financial Reporting, A practical guide, Sixth edition, Chapter 11, p 176 and 177

Melville A, International Financial Reporting, A practical guide, Seventh edition, Chapter 11, p 174 and 175

Melville A, International Financial Reporting, A practical guide, Eight edition, Chapter 11, p 182 and 183

IFRS9

- This standard establish principles for recognising and measuring financial assets and financial liabilities.
- Recognition is concerned with determining when a financial asset or liability should be shown in the statement of financial position.
- Measurement is concerned with the amount at which financial assets and liabilities should be shown (initially and subsequently).

RECOGNITIONS AND INITIAL MEASUREMENTS

Financial assets and financial liabilities arising in consequence of a financial instrument should be recognised only when the entity "*becomes party to the contractual provisions of the instrument*".

Recognition occurs when the contractual arrangements become binding.

The initial measurement of financial instruments is at fair value

Types of financial asset (IFRS9) and measurement

IFRS9 classifies financial assets into only two categories:

- financial assets measured at amortised cost
- all other financial assets (which are measured at fair value).

After initial recognition, a financial asset is normally measured at amortised cost if the contractual terms of the asset give rise on specified dates to cash flows that are solely payments of principal and interest (e.g. a loan).

Types of financial asset (IFRS9) : Amortised Cost using the effective interest method:

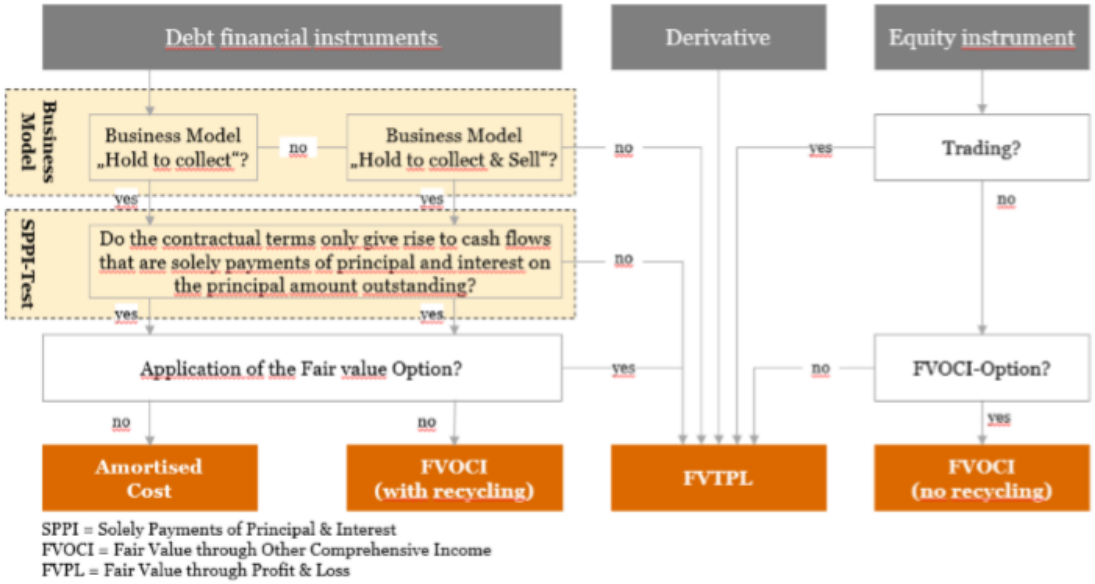
The "amortised cost" of a financial asset is equal to the amount at which the asset was initially recognised, plus the amount of interest earned to date, minus any repayments received to date.

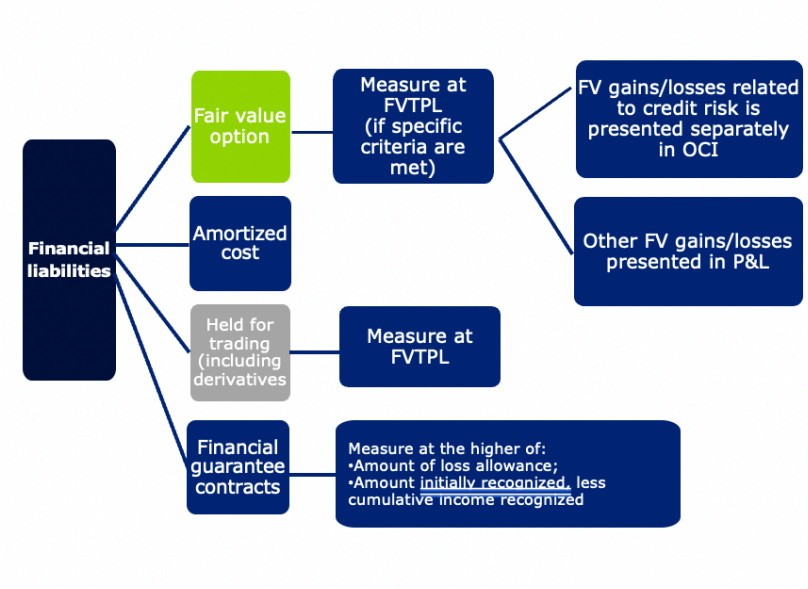
	Opening balance	Plus profit or loss finance charge @ 12% on the opening balance	Less the cash paid (6% x 20,000)	Closing balance, being the liability on the statement of financial position
Year 1	$17,000	$2,040	($1,200)	$17,840
Year 2	$17,840	$2,141	($1,200)	$18,781
Year 3	$18,781	$2,254	($1,200)	$19,835
Year 4	$19,835	$2,380	($1,200)	
			($21,015)	Nil
Total finance costs		$8,815		

SUBSEQUENT MEASUREMENTS

FINANCIAL ASSETS

⇨ How to value financial assets





THE EFFECTIVE INTEREST METHOD

The “The "amortised cost" of a financial asset is equal to the amount at which the asset was initially recognised, plus the amount of interest earned to date, minus any repayments received to date.

The “effective interest method” calculates the amount of interest earned to date using an interest rate that exactly discounts estimated future cash receipts to the initial carrying amount of the asset.

FINANCIAL LIABILITIES

Most financial liabilities are measured at amortised cost using the effective interest method.

But financial liabilities at fair value through profit or loss (i.e. financial liabilities held for trading) are measured at fair value. Gains or losses are usually recognised in the calculation of profit or loss for the period in which they arise.

COMPOUND FINANCIAL INSTRUMENTS

- Compound financial instruments are those which contain both a liability component and an equity component.
    - Convertible dept/ loan
- IAS32 requires that compound financial instruments should be separated into their two components and that each of these components should then be recognised separately, one as a financial liability and the other as equity.

DISCLOSURE REQUIREMENTS

- IFRS7 requires many detailed disclosures relating to financial instruments.
- The main purpose of these disclosures is to enable users to evaluate the significance of financial instruments for the entity's financial position and performance.
- Disclosures are also required which will enable users to evaluate the nature and extent of any risk related to financial instruments.

Exercise 6 – Compound financial instruments

- On 1 January 2010, Thorpe LTD issued €1 M 7% convertible bonds at par.
- The bonds will pay interest annually on 31 December, and they are due for redemption at par on 31 December 2012.
- Alternatively, the bondholders can opt to convert their bonds into 30 ordinary shares of €1 each for every €100 of convertible bonds on 31 December 2012.
- The market interest rate on a similar bond, with no conversion option, was 8 % on 1 January 2010.

Question:

Outline how Thorpe LTD should account for the issue of the convertible bonds.

Solution:

Fair value of liability component	Present value
- Interest on 31 December 2010 (70.000/1,08)	64.815
- Interest on 31 December 2011 (70.000/(1,08)^2	60.014
- Interest on 31 December 2012 (70.000/(1,08)^3	55.568
- Capital redemption on 31 December 2012 (1.000.000/(1,08)^3	793.833
Total Liability component	974.230
Equity component	25.770
Proceeds of the bond issue	1.000.000

Journal entry issue of the bond

	Dt	Cr
500 Cash and bank balance (SOFP - CA)	1.000.000	
@ 150 Borrowings - Convertible bond (SOFP – NCL)		974.230
110 Other reserves - Convertible bond (SOFP – E)		25.770

Journal entry 31 December 2010

	Dt	Cr
650 Finance expense (I/S)	77.938	
@ 500 Cash and bank balance (SOFP - CA)		70.000
150 Borrowings - Convertible bond (SOFP – NCL)		7.938

Effective intrest is charged to I/S

974.230 x 8 % = 77.938

Journal entry 31 December 2011

	Dt	Cr
650 Finance expense (I/S)	78.573	
@ 500 Cash and bank balance (SOFP - CA)		70.000
150 Convertible bond – fin cost (SOFP – liability)		8.573

Effective intrest is charged to I/S

(974.230 + 7.938) x 8 % = 78.573

Journal entry 31 December 2012

	Dt	Cr
650 Finance expense (I/S)	79.259	
@ 500 Cash and bank balance (SOFP - CA)		70.000
150 Borrowings - Convertible bond (SOFP – NCL)		9.259

Effective intrest is charged to I/S

(974.230 + 7.938 + 8.573) x 8 % = 79.259

Cumulative entries - 31 December 2012

	Dt	Cr
Inception: credit 110 Other reserves - Convertible bond (SOFP – E)		25.770
Inception: credit 150 Borrowings - Convertible bond (SOFP – NCL)		974.230
31.12.2010: 150 Borrowings - Convertible bond (SOFP – NCL)		7.938
31.12.2011: 150 Borrowings - Convertible bond (SOFP – NCL)		8.573
31.12.2012 150 Borrowings - Convertible bond (SOFP – NCL)		9.259
31.12.2012		1.000.000

Solution – Journal entry conversion 31 December 2012

	Dt	Cr
150 Borrowings - Convertible bond (SOFP - NCL)	1.000.000	
110 Other reserves - Convertible bond (SOFP – E)	25.770	
@ 100 Issued capital (SOFP - E) (*)		300.000
101 Share premium (SOFP – E		725.770

€1.000.000/100 x 30 = 300.000

Solution – Journal entry repayment 31 December 2012

	Dt	Cr
150 Borrowings - Convertible bond (SOFP - NCL)	1.000.000	
@ 500 Cash and bank balance (SOFP - CA)		1.000.000
110 Other reserves - Convertible bond (SOFP – E)	25.770	
@ 130 Retained earnings (SOFP – E)		25.770

IFRS 16 is applicable to all leases, including leases of right-of-use assets in a sublease, except for:

Leases to use **natural resources**

Leases of **biological assets** in the scope of IAS 41 – Agriculture

Service concession arrangements within the scope of IFRIC 12 – Service Concession

Licenses of intellectual property granted by a lessor within the scope of IFRS 15 – Revenue from contracts with customers

Right held by a lessee under licensing agreements within the scope of IAS 38 Intangible Assets for such items as motion picture films, video recording, plays, manuscript, patent and copyrights – lessees permitted but not required to apply IFRS 16 to leases of other intangible assets

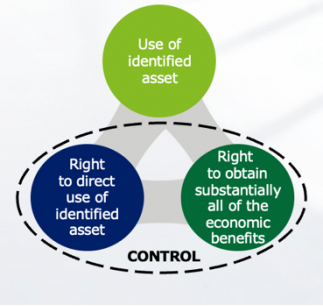
Recognition exemptions for short term leases and low value assets ! (< 12 months or < 5000 euro on the benchmark)

IDENTIFYING A LEASE

What is a Lease?

A lease is a contract, or part of a contract, that conveys the right to use an asset for a period of time in exchange for consideration. (Not necessarily in cash but in the most cases)

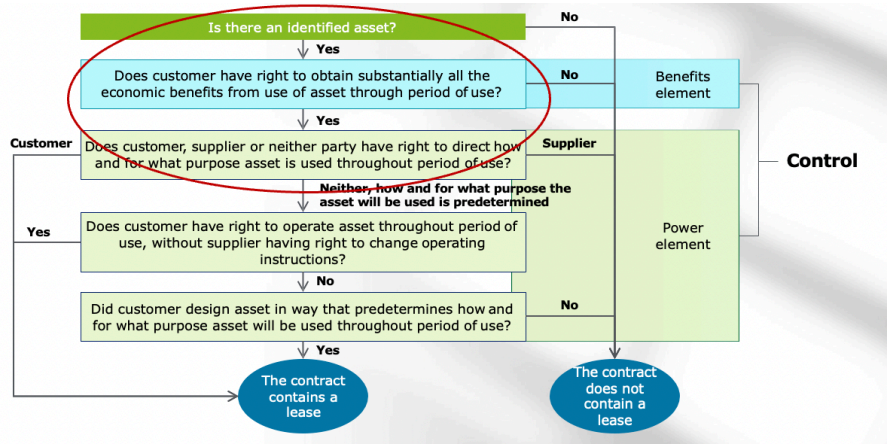
When Does a Contract Contain a Lease



A contract is a lease or contains a lease if it meets both criteria:

- Fulfilment of lease depends on use of an **identified asset** and
- Contract conveys right to **control** use of identified asset for a period of time in exchange for consideration. (you should be able to use the identified asset (lessee) and you can do whatever you want with it)

Lease definition: Decision tree + Benefits and Power Elements



1. **Is there an Identified Asset?**

= An asset is typically identified by being **explicitly specified** in a contract but can also be **implicitly specified** at time made available for use by customer

No identified asset if supplier has a **substantive right** to substitute one asset for another (f.e: if the contract says that you can use a car for 4 year → a car is not specific, he will give you which is available that day)

- The supplier has the practical ability to substitute alternative assets throughout the period of use **and**
- The supplier would benefit economically from the exercise of its right to substitute the asset

Is a capacity portion of an asset an identified asset?

- Capacity portion of asset is identified asset if it is physically distinct
- It is not identified asset if it is not physically distinct, unless it represents substantially all the capacity of the asset, so the customer obtains substantially all economic benefits from use of the asset.

F.e:

- *Supreme cable 50%*
- *Large gaspipe of energy → lease 25% of pipe*

  => You cannot make the difference between your part and the other part! So here it is not an identified asset!

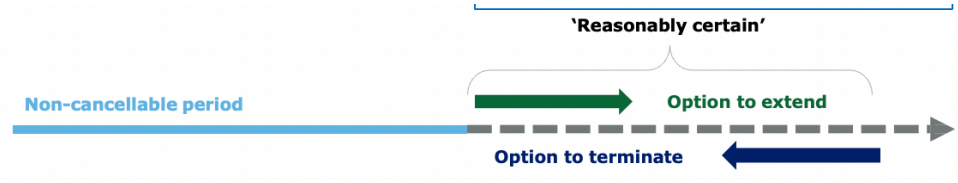
  But if you look at for example the leasing of the second floor of a building + 6 parking spots. It is well defined; you can distinguish the parts.

  ⇨ *If you lease 90% of all the asset it is an identified asset !*

DETERMINING THE LEASE TERM

Lease term

In evaluating options, also take into account enforceability for the lessee in the **contract** (see IFRS 16.BC127)



Consider all facts and circumstances that create an **economic incentive** (See IFRS 16.B37- B40), including expected changes: E.g.

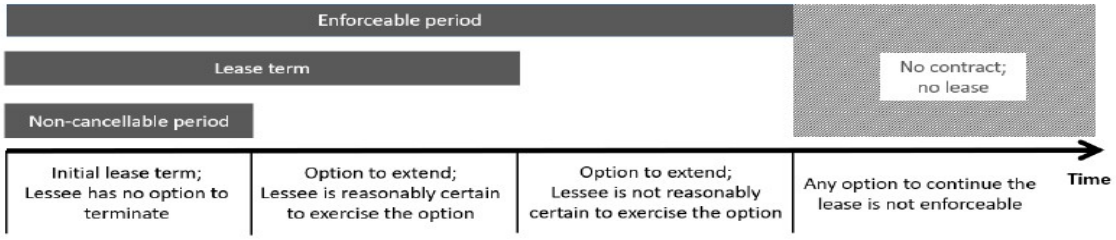
- Contractual terms for optional periods
- Significant leasehold improvements

- Costs of termination and return
- Importance to operations (specialized, location, alternatives)
- Past practice

Reassess significant event or change in circumstances that lessee controls and affects whether exercise 'reasonably certain'.

Revise: change in non-cancellable period.

Some key concept

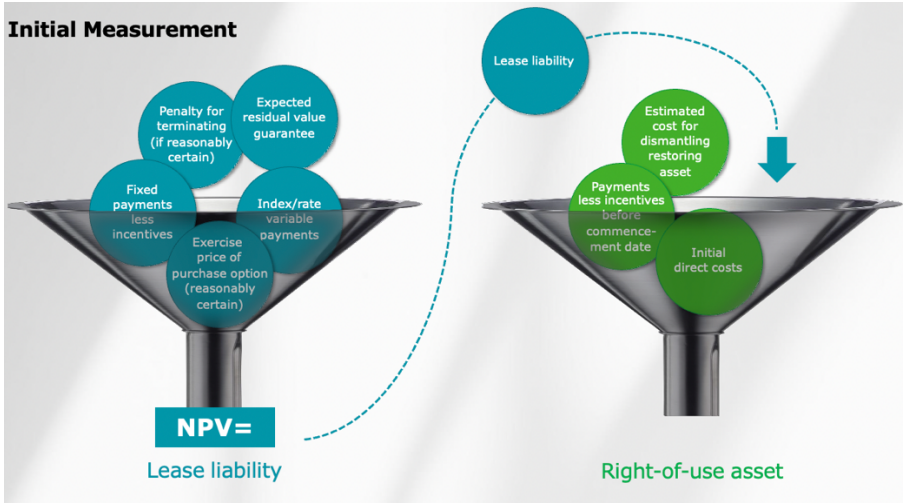


Non-cancellable period = any period during which the **lessee** cannot terminate the contract (IFRS 16.B35) ➔ = minimum lease term. (minimum 5 years)

Enforceable period = period for which enforceable rights and obligations exist between the lessee and the lessor (as described in IFRS 16.B34).

LEASE MEASUREMENT

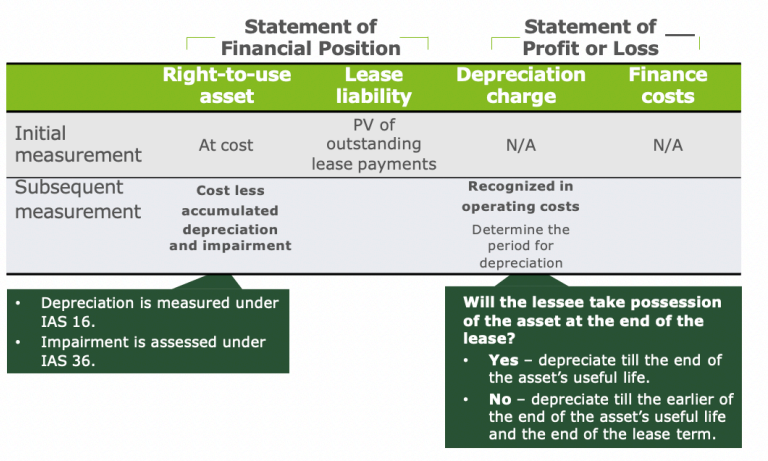
Initial measurement



Left side is part of the lease liability => you pay, and it come back to you

Subsequent measurements

How should the lease be subsequently measured?

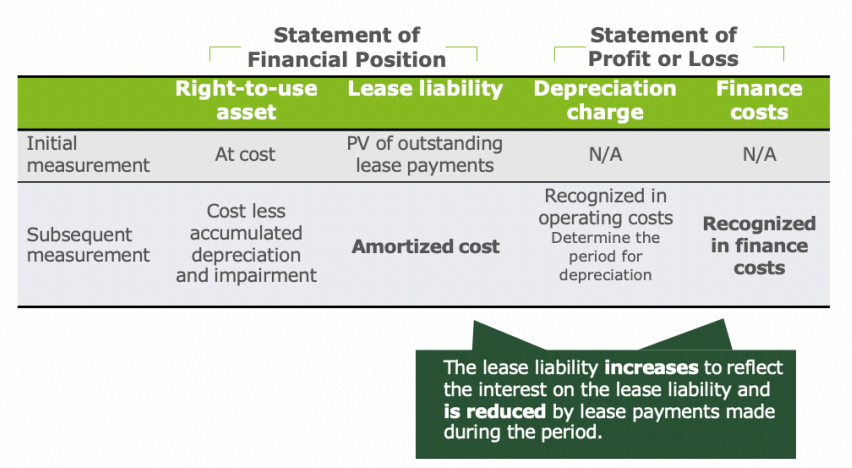


	Statement of Financial Position		Statement of Profit or Loss	
	Right-to-use asset	**Lease liability**	**Depreciation charge**	**Finance costs**
Initial measurement	At cost	PV of outstanding lease payments	N/A	N/A
Subsequent measurement	**Cost less accumulated depreciation and impairment**		**Recognized in operating costs** Determine the period for depreciation	

- Depreciation is measured under IAS 16.
- Impairment is assessed under IAS 36.

Will the lessee take possession of the asset at the end of the lease?
- **Yes** – depreciate till the end of the asset's useful life.
- **No** – depreciate till the earlier of the end of the asset's useful life and the end of the lease term.

Lease liability and interest costs

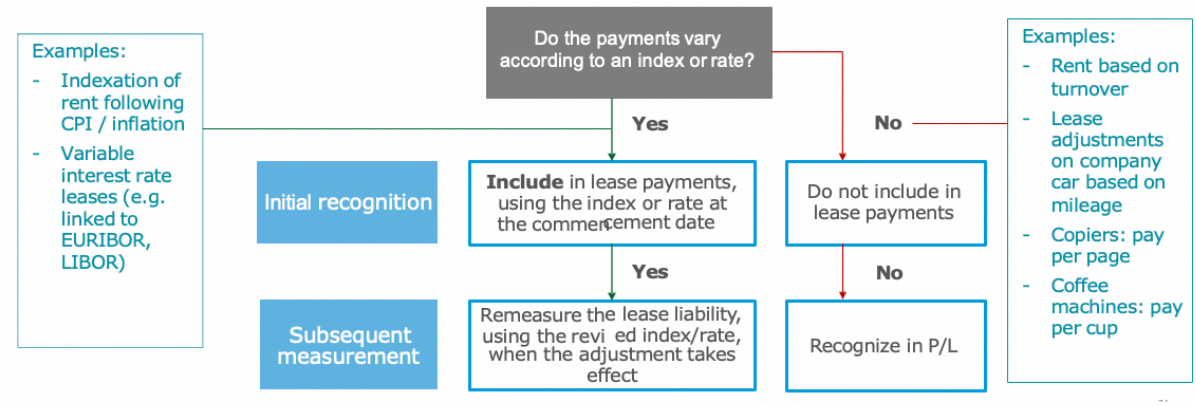


	Statement of Financial Position		Statement of Profit or Loss	
	Right-to-use asset	**Lease liability**	**Depreciation charge**	**Finance costs**
Initial measurement	At cost	PV of outstanding lease payments	N/A	N/A
Subsequent measurement	Cost less accumulated depreciation and impairment	**Amortized cost**	Recognized in operating costs Determine the period for depreciation	**Recognized in finance costs**

The lease liability **increases** to reflect the interest on the lease liability and **is reduced** by lease payments made during the period.

Variable lease payments

The portion of payments made by a lessee to a lessor for the right to use an underlying asset during the lease term **that varies** because of changes in facts or circumstances occurring after the commencement date, other than the passage of time. => Adjusted with inflation



→ Comparing just for information

IFRS 16 – Lease measurement

All lease payments dependent on future performance or use of the asset

Variable lease payments depending on the performance of the leased asset should not be included in the lease payments, even if it is virtually certain that you will have to pay these fees.

Example 1: retail store

Lease of retail store where lease payments are equal to 1% of revenue generated in the shop ➔ although it is very likely that there will be lease payments, these are fully variable and therefore do not need to be recorded as a lease liability at commencement of the lease

Example 2: solar farm

Purchase of all capacity of the output of a solar farm for 10 years, which is classified as a lease after analysis of the lease definition.

Lease payments = EUR 5 for each kWh of electricity generated by the solar farm.

➔ No lease liability, book cost in P/L at the moment the electricity is generated.

Lessee accounting (cont'd)

Exemptions for lessees

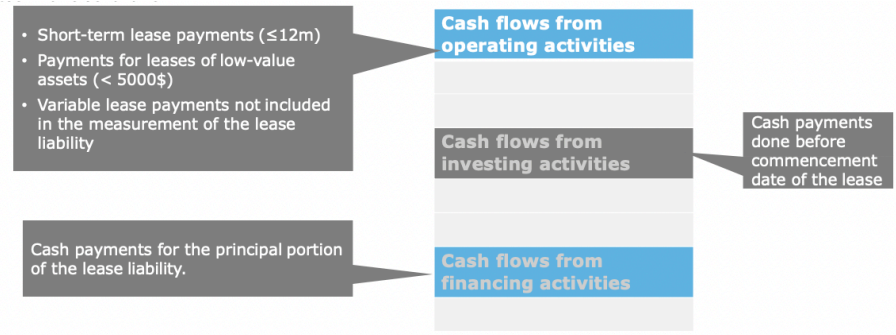
Recognition exemptions allowing short-term leases and low value assets to be accounted for by simply recognizing an expense, typically straight-line, over the lease term

Short-term leases	• Does not include a purchase option • Has a lease term at commencement date of 12 months or less • Must be applied consistently for each **class** of underlying leased asset
Leases of "Low value" asset	• Applies in absolute terms rather than by reference to the size of the reporting entity (new asset value < U.S.$ 5K) • Applies to leased assets that are not highly dependent on, or highly interrelated with, other assets • Applied on a **lease by lease** basis

- Examples expected to qualify include office furniture, phones, personal computers and tablets
- Vehicles not expected to qualify as "Low value"
- General materiality guidance still applies! (you cannot leave things)

Classification of cash flows

Cash repayments of the lease liability are classified between **principal** and **interest** portions. These are presented in the statement of cash flows as follows:



- Interest paid: classified as operating or financing
- IFRS 16 may impact calculation of certain Alternative Performance Measurements (APM), such as Free Cash Flow or Capex KPI

DETERMINING THE DISCOUNT RATE

NPV includes the discount rate

Discount Rate Imapcts

Higher discount rate =

- Lower lease liability
- Lower total depreciation

→ More pronounced front-loading of total lease expens

- Higher interest expense

Discount rate

Lease payments should be discounted using interest rate implicit in lease

⇨ Rate that causes present value of lease payments and unguaranteed residual value = sum of fair value of underlying asset and any initial direct costs of lessor

If implicit interest rate cannot be readily determined: Lessee's incremental borrowing rate (IBR)
(Expected that use of lessee's IBR as discount rate to be widespread in practice)

⇨ Rate lessee would have to pay to borrow funds necessary (over similar term with similar security) to obtain similar-value asset to right-of-use asset, in similar economic environment

PRACTICAL CASE – LESSEE ACCOUNTING

On 31/12/2019, an entity (lessee) enters in a lease with the following characteristics:

- Leased asset: machine
- Lease term: 5 years
- Rental payments (excl. taxes): €50.000 per year
- No purchase option

- The economic life-time of the machine is 5 years. The entity applies a straight-line depreciation method for other similar machines.
- The interest rate implicit in the lease is 4,25% (you will receive it !)

You are required to determine:

- The present value of the minimum lease payments at 31/12/2019.
- The journal entries to be posted in 2019 and 2020

Present value of the minimum lease payments

The value corresponds to the lease payments discounted at the interest rate implicit in the lease (4,25%).

50 000 +	50 000 +	50 000 +	50 000 +	50 000 +
(1,0425)	$(1{,}0425)^2$	$(1{,}0425)^3$	$(1{,}0425)^4$	$(1{,}0425)^5$
PV = 221 036 (STEP 1)				

Deprecation expense per year

= 221.036 / 5

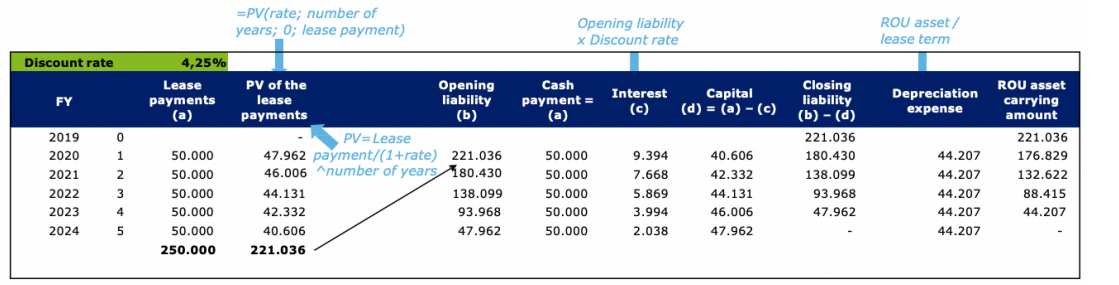
= 44.207

Interest expense in year 1 (2020)

= 221.036 * 4,25%

= 9.394

Practical Case



Discount rate 4,25%

FY		Lease payments (a)	PV of the lease payments	Opening liability (b)	Cash payment = (a)	Interest (c)	Capital (d) = (a) – (c)	Closing liability (b) – (d)	Depreciation expense	ROU asset carrying amount
2019	0		-					221.036		221.036
2020	1	50.000	47.962	221.036	50.000	9.394	40.606	180.430	44.207	176.829
2021	2	50.000	46.006	180.430	50.000	7.668	42.332	138.099	44.207	132.622
2022	3	50.000	44.131	138.099	50.000	5.869	44.131	93.968	44.207	88.415
2023	4	50.000	42.332	93.968	50.000	3.994	46.006	47.962	44.207	44.207
2024	5	50.000	40.606	47.962	50.000	2.038	47.962	-	44.207	-
		250.000	**221.036**							

2019	DR ROU asset	221.036		*Recognise the ROU asset and the lease liability at commencement of the lease*
	CR Lease liability		221.036	
2020	DR Lease liability	40.606		
	DR Interest expense	9.394		*Recognise the interest expense and the reduction in the lease liability when the cash payment is received*
	CR Cash		50.000	
	DR Depreciation expense	44.207		*Recognise depreciation on the ROU asset in accordance with the entity's accounting policy for such assets*
	CR Accumulated depreciation		44.207	

IFRS 16 – Lease measurements (NOT SEEN IN CLASS)

Remeasurement arising from a change in future lease payments resulting from a change in index

Example

1/1/20X1: start of lease for 8 years.

Lease payments:

- First 3 years: 100 per year
- 1/1/20X4 and 1/1/20X7: lease payments will be adjusted based on CPI for the preceding 3 years.
- Made at the end of the year

Initial measurement = 646 = 8 payments of 100 in arrears, discounted at the rate implicit in the lease (5%).

First adjustment to cash flows resulting from change in CPI will be in 20x4 ➔ recalculate lease liability and add same adjustment to the related right-of-use asset

⇨ This means that each time the cash flows of the lease change due to a change in index or rate (e.g. due to inflation), the lease liability amortization table and the depreciation table for the related asset will have to be adjusted ➔ very complex to follow up on this in Excel especially if there are many indexed leases.

Adjust lease when change in cash flows

Year	Opening lease liability	Adjustment	Interest	Repayment	Closing lease liability
	CU	CU	CU	CU	CU
20X1	646	—	32	(100)	578
20X2	578	—	29	(100)	507
20X3	507	—	25	(100)	432
20X4	432	35 (a)	22	(108)	381
20X5	381	—	19	(108)	292
20X6	292	—	16	(108)	200
20X7	200	9 (b)	11	(113)	107
20X8	107	—	6	(113)	—

(a) Difference between five remaining payments of CU100 discounted at 5 per cent and five remaining payments of CU108 discounted at 5 per cent.
(b) Difference between two remaining payments of CU108 discounted at 5 per cent and two remaining payments of CU113 discounted at 5 per cent.

LESSOR ACCOUNTING

For the owner of the building/ warehouse/…

Lease classifications

Finance lease

- A lease that transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred.
- In substance the lessee obtains control of the asset, because the lessee has the ability to direct the use of the asset, and obtain substantially all the remaining benefits of the asset.

Operating lease

- A lease other than a finance lease

Examples of situations normally indicating finance lease

Finance lease:

- Option to purchase at a price sufficiently lower than fair value.
- Transfer of ownership at end of lease term.
- Lease term is for a major part of the economic life.
- Present value of minimum lease payments is substantially all fair value.
- Leased assets are of a specialized nature.

Accounting treatment – lessor

Finance lease:

- Recognize a receivable equal to the net investment in the lease.
- Receipts of rental payments are allocated between finance income and repayments of principal

Operating lease:

- Leased assets are depreciated and classified according to their nature, with no difference from the treatment of assets which are not leased.
- Lease income is usually recognized on straight line basis over the lease term.

DISCLOSURES

Lessee disclosure

Statement of Financial Position

	Right-of-Use: Land	Right-of-Use: Buildings	Right-of-Use: IT equipment	Right-of-Use: Telecommuni-cations network and equipment	Right-of-Use: Motor vehicles	Right-of-Use: Other	Right-of-Use: Total
Cost							
As at January 1, 2017	132,530	1,174,013	82,525	74,056	25,767	718	1,489,609
Additions	39,143	217,493	-	5,980	-	27	262,643
Asset retirement obligation	-	10,145	-	-	-	-	10,145
Transfers and reclassifications	(7,513)	7,513	(17,236)	-	7,483	-	(9,753)
Disposals	(706)	(39,701)	(2,289)	(7,041)	(6,155)	-	(55,892)
As at December 31, 2017	**163,454**	**1,369,463**	**63,000**	**72,995**	**27,095**	**745**	**1,696,752**
Accumulated depreciation							
As at January 1, 2017	44,524	572,474	58,716	54,518	13,203	665	744,100
Charge	10,816	103,270	14,337	9,553	7,437	13	145,426
Charge from asset retirement obligation	-	2,602	-	-	-	-	2,602
Transfers and reclassifications	(377)	377	(17,345)	-	-	-	(17,345)
Disposals	(134)	(20,608)	(2,276)	(4,756)	(6,124)	-	(33,898)
As at December 31, 2017	**54,829**	**658,115**	**53,432**	**59,315**	**14,516**	**678**	**840,885**
Net book value as at December 31, 2017	**108,625**	**711,348**	**9,568**	**13,680**	**12,579**	**67**	**855,867**

Lease liabilities[b, c]

In thousands of euro	2019
Maturity analysis – contractual undiscounted cash flows	
Less than one year	7,644
One to five years	12,936
More than five years	2,092
Total undiscounted lease liabilities at 31 December	22,672
Lease liabilities included in the statement of financial position at 31 December	19,943
Current	6,506
Non-current	13,437

Amounts recognised in profit or loss

In thousands of euro	2019
Interest on lease liabilities	(1,369)
Variable lease payments not included in the measurement of lease liabilities	(1,700)
Income from sub-leasing right-of-use assets	950
Expenses relating to short-term leases	(1,470)
Expenses relating to leases of low-value assets, excluding short-term leases of low-value assets	(750)

Lessor disclosures

i. Operating lease

The Group leases out its investment property and some machinery. The Group has classified these leases as operating leases, because they do not transfer substantially all of the risks and rewards incidental to the ownership of the assets. Note 2 sets out information about the operating leases of investment property.

The following table sets out a maturity analysis of lease payments, showing the undiscounted lease payments to be received after the reporting date.[a]

In thousands of euro	2019
Less than one year	750
One to two years	350
Two to three years	150
Three to four years	150
Four to five years	150
More than five years	450
Total undiscounted lease payments	2,000

ii. Finance lease

The Group also sub-leases an office building that it leased in 2014. The Group has classified the sub lease as a finance lease, because the sub-lease is for the whole of the remaining term of the head lease.

The following table sets out a maturity analysis of lease receivables, showing the undiscounted lease payments to be received after the reporting date.[a]

In thousands of euro	2019
Less than one year	550
One to two years	550
Two to three years	550
Three to four years	550
Total undiscounted lease payments receivable	2,200
Unearned finance income	(272)
Net investment in the lease	1,928

CHAPTER 12: PROVISIONS (IAS 37)

DEFINITION OF A PROVISION

IAS37 defines a provision as "**a liability of uncertain timing or amount**" and states that a provision should be recognised when **all** of the following conditions are satisfied:

1. the entity has a **present obligation** (legal or constructive) as a result of a past event; (The event has to be in the past!)
2. it is **probable** that an outflow of resources embodying economic benefits will be required to settle the obligation; and
3. a **reliable estimate** can be made of the amount of the obligation. (If you cannot make a reliable estimation, you cannot book a provision)

⇨ If the amount will be certain, it's just a liability.

OBLIGATING EVENTS

A past event which leads to a present obligation is an "**obligating event**".

For a past event to be an obligating event, the entity must have no realistic alternative but to settle the obligation created by the event.

This will be the case if:

a) the obligation is legally enforceable, or

b) the event has given rise to a "***constructive obligation***", where the entity has created a valid expectation that it will discharge the obligation, even though this is not legally enforceable.

! Without an obligating event, there can be no provision.

! A provision is recognized only if the obligation in question exists independently of the entity's future actions

(no provision for future operating costs, as these could be avoided by changing the method of operation or ceasing the operations concerned)

→ You cannot set up a provision, 'in case of'

Legal obligation

- An entity in the oil industry causes contamination of land, but it cleans up only when required to do so under the laws of the country it operates in.
- One of the countries it operates in has, to date, had no legislation requiring cleaning up. The entity has been contaminating in land in the country of several years.
- At the end of the reporting period, new legislation was enacted requiring cleaning up of the contaminated land.

⇨ There is a present obligation as the result of a past **obligating event.**

The past obligating event is the contamination of the land, which has already occurred.
The present obligation arises because of the new legislation being enacted.
This will leave the entity **no realistic alternative** to cleaning up.

Constructive obligation

- An oil company operates in a country where there is no environmental legislation. It is causing contamination, but has no legal obligation to clean up.
- However, the entity has a widely published environmental policy in which it undertakes to clean up all of the contamination that it causes.
- This policy is an integral part of the entity's public profile, and in the past, the entity has always honoured it.

⇨ There is a present obligation as the result of a past **obligating event** – the contamination of the land.

This is a **constructive**, rather than a **legal** obligation, because although no legislation applies, the past conduct of the entity has created a valid expectation on the part of those affected by the contamination that the entity will clean up.

Obligating event: Example – OK Radios

Hi,

This is a debate we've been having - can you help?

OK Radios does not give warranties to customers purchasing our key product. However, over a number of years we have had a policy of repairing or replacing defective goods within three years of sale. Judging by their past record, there will probably be a certain proportion of goods returned.

John and Nicki believe that the obligation to repair or to replace the goods should be recognised when defective goods are returned by the customer, while Paul insists that the obligating event is the sale of the goods. Can you help?

Thanks

Mandy
Accounts Clerk, OK Radios

Which of the following events obligates OK Radios to repair the radio?

- ❑ The return of the goods by the customer
- ❑ The sale of the goods to the customer
- ❑ Neither – there is no obligating event

The **obligating event** for the **provision** is the sale of the goods – it is at this time that a valid **expectation** arises on the part of the customers that faulty goods will be repaired or replaced.

At this point the entity cannot realistically avoid the outflow of economic benefits
→ Constructive obligation

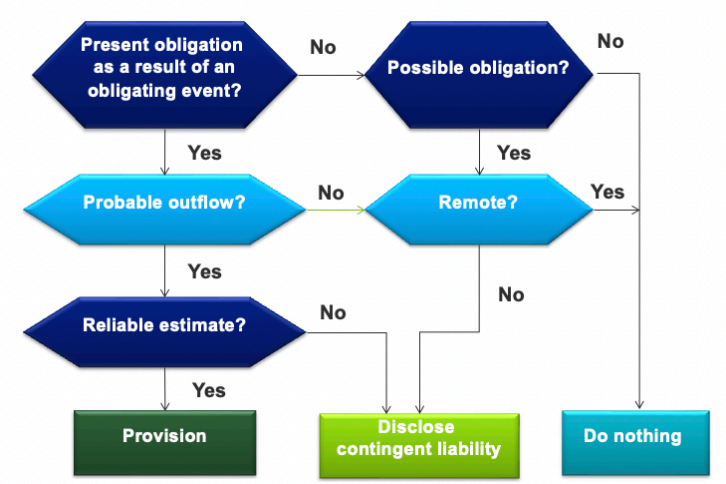
Key definitions

Provisions = A liability of uncertain timing or amount

Liability = A present obligation as a result of past events, the settlement of which is expected to result in an outflow of resources

Contingent liability = A possible obligation depending on the occurrence / non-occurrence of uncertain future events; or a present obligation but no probable outflow of economic benefits or amount cannot be reliably measured

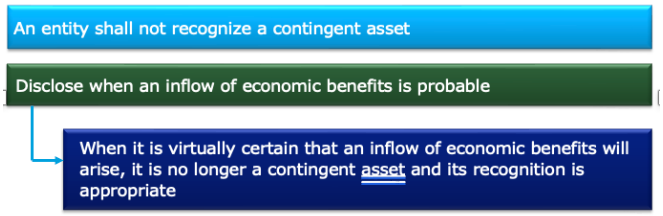
Key recognition principles



(Remote: verry low chance that it will occur)

Contingent assets

A contingent asset is **a possible asset** that arises from **past events** and whose existence will be **confirmed** only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity



MEASUREMENT OF A PROVISION

The **Best Estimate** Methodology

The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

- Amount the entity would **rationally pay** to settle obligation or transfer it to a third party

- Estimates of the outcome and financial effect are determined by the **judgement** of the management of the entity

- **Uncertainties** surrounding the amount to be recognised as a provision are dealt with by various means according to the circumstances

Expected value:

- Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities

- Varies based on probabilities given to each outcome

Most likely outcome:

- Where a single obligation is being measured,
  the individual most likely outcome may be the best estimate of the liability.

- Can vary if there is more than one likely outcome

Risks and Uncertainties

- The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision.

Present Value

- The amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.

Future Events

- Future events that may affect the amount required to settle an obligation shall be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.

Expected Disposal of Assets

- Gains from the expected disposal of assets shall not be taken into account in measuring a provision.

Reimbursements

- Reimbursements shall be recognised when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation

- The reimbursement shall be treated as a separate asset.

Measurement of a provision – Example OK Radios

Two of OK Radio's employees have resigned.

The reason given was a 15% reduction in their usual salaries – they had refused to work overtime as they had in previous months, because they wanted to spend more time with their families.

Subsequently, the employees have taken the employer to court, suing for constructive dismissal (creating unfavourable working conditions). The case is now in the final stages, and a ruling is expected within the week.

The entity's lawyers believe that the court will rule in favour of the employees.

They have brought to OK's attention a similar recent case in which the court awarded the employees two years' salary, ruling that they were constructively dismissed.

Hello,

According to our lawyers, we're probably looking at a payout on this court case. Their opinion about the probability is as follows:

- *a 70% chance of a payout of two years' salary (€ 100,000 per employee)*
- *a 20% chance of a payout of three years' salary (€ 150,000 per employee)*
- *a 10% chance of a payout of one year's salary (€ 50,000 per employee)*

Can you let me know if this is sufficient information to establish the probability of the outcome and if you want me to recognise a provision for this?

Give the best estimate of the liability regarding the case for constructive dismissal brought by OK Radios' former employees, based on the most likely outcome.

- ❑ € 110,000
- ❑ € 300,000
- ❑ € 200,000

    ⇨ 200K is the right answer (only option with more than 70% chance+ you have 2 employees)

SPECIFIC APPLICATIONS OF IAS37

IAS 37 – **Application**

Onerous Contracts

The Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

- If an entity has a contract that is onerous, the present obligation under the contract shall be recognised and measured as a provision.
- The amount therefore to be recognised is:
    - the least net cost of exiting from the contract, which is the lower of;
        - the cost of fulfilling it and any compensation or
        - penalties arising from failure to fulfil it.

→ A loss contract: outflow is higher than the inflow

Scenario 1 – Onerous Contract

A manufacturing entity enters into a three-year operating lease in respect of certain equipment. At the end of year one, the manufacturing entity decides to reorganize its production facilities. Under the reorganization plan, a decision to cancel the lease is made. The decision has not been communicated to the lessor.

The lease contract stipulates that a penalty of €1,000,000 is payable on early cancellation. If the lease is not canceled, the remaining lease payments will amount to €3,000,000.

The lease contract does allow the lessee to sublet equipment if they so wish. If the manufacturing entity were to sublet the equipment to its sister entity, the rental income will equal rental expense.

Question:

How should the entity account for the lease cancellation under IAS 37? (Assume that the lease cancellation is not part of a general restructuring)

- After the decision to cancel the lease contract is taken, the lease contract becomes an onerous contract (cfr definition).
- The entity has no more expected benefits from the use of the equipment, and will still incur significant expenditure
    - Lease contract will result in operating losses of EUR 3 000 000 if it continues
    - Penalty to exit the contract is EUR 1 000 000
- Therefore, it looks like we should recognise a provision
- However, the IAS says "least net cost"
    - And also no communication to the lessor, so not official ending of the contract.
- If we sublet – then the entity will break even.
- Therefore – no provision recognised.
    - ⇨ Restructuring - Based on the transaction description, the entity has a detailed formal plan. As the entity has not communicated its intention to restructure, requirement (b) is not satisfied. The entity, therefore, does not have an obligation to restructure. Now the entity needs to further assess if there are other ways within the Standard to recognize a provision for the lease cancellation.
    - ⇨ IAS 37.82 states the following: "Identifiable future operating losses up to the date of a restructuring are not included in a provision, unless they relate to an onerous contract as defined in paragraph 10."

Restructuring

- A provision for restructuring costs is recognised only when the general recognition criteria for provisions are met. This therefore requires a constructive obligation.
- A constructive obligation arises when:

- The entity has a **detailed formal plan** for the restructuring, **and**
- has raised **a valid expectation** in those affected that it will carry out the restructuring by starting to **implement** the plan.

- A restructuring provision shall include only the **direct expenditures** arising from the restructuring, which are those that are both:
  - Necessarily entailed by the restructuring, and
  - Not associated with the ongoing activities of the entity. This includes those costs associated with relocating and retraining continuing staff.

Scenario 2 - Restructuring

An entity called "Fellras" has announced a formal plan to move a manufacturing plant from its present location (called "plant USA") to a new location (called "plant Mexico"). Further, Fellras has entered into irrevocable contracts with relevant parties to affect the move in the following 18 months.

This plan will involve three actions:

- The transfer of the plant USA workforce to the plant Mexico location. This action will result in downsizing the number of employees by 10%. The redundancy costs are estimated to be €2,000,000.
- The dismantling of plant USA. The costs to dismantle plant USA is estimated to be €1,000,000. In the jurisdiction in which Fellras operates plant USA, there is no legal obligation for dismantling plants when abandoned. Fellras is not particularly known for dismantling its plants when abandoned but decided to make an exception this time and has communicated on this to the press.
- Retraining of the employees and relocation of plant USA to a new site. Retraining and relocation of staff is estimated to be €1,500,000 and €500,000 respectively.
- **There is a constructive obligation**
  - A formal restructuring plan has been detailed
  - The plan has been announced, and
  - The entity has **initiated the plan** by entering into irrevocable contracts
  - Necessary costs **do not** include
  - Retraining and relocation of staff (EUR 2 000 000 total)
- But they **do include**
  - Closure, downsizing and dismantling of EUR 3 000 000
  - Therefore – restructuring provision of EUR 3 000 000 to be recognised

DISCLOSURE REQUIREMENTS OF IAS37

For each class of **provision**, an entity shall disclose:

a) the carrying amount at the beginning and end of the period;

b) additional provisions made in the period, including increases to existing provisions;

c) amounts used (i.e. incurred and charged against the provision) during the period;

d) unused amounts reversed during the period; and

e) the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.

Along with

a) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;

b) an indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity shall disclose the major assumptions made concerning future events, as addressed in paragraph 48; and

the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement (reimbursement → contigent asset)

An entity shall disclose for each class of **contingent liability** at the end of the reporting period:

a) brief description of the nature of the contingent liability and, where practicable

b) an estimate of its financial effect, measured under paragraphs 36–52;

c) an indication of the uncertainties relating to the amount or timing of any outflow; and

d) the possibility of any reimbursement.

An entity shall disclose for each class of **contingent asset** at the end of the reporting period:

a) brief description of the nature of the contingent asset and, where practicable

b) an estimate of its financial effect;

Disclosure Exception

In extremely rare cases, disclosure of some or all of the information required can be expected to **prejudice seriously** the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset.

In such cases, an entity **need not disclose the information**, but shall disclose the general nature of the dispute, together with the fact that, and reason **why, the information has not been disclosed**.

Examples disclosure - BP:

⇨ Deepwater Horizon – oil spill in the Mexican gulf in 2010

21. Provisions

$ million

	Decommissioning	Environmental[a]	Litigation and claims	Clean Water Act penalties	Other	Total
At 1 January 2014	17,205	3,454	4,911	3,510	2,880	31,960
Exchange adjustments	(489)	(18)	(12)	–	(122)	(641)
Acquisitions	8	–	–	–	13	21
New or increased provisions	2,216	561	1,290	–	1,101	5,168
Write-back of unused provisions	(60)	(92)	(27)	–	(252)	(431)
Unwinding of discount	202	19	12	–	24	257
Change in discount rate	778	21	14	–	9	822
Utilization	(682)	(1,098)	(1,449)	–	(565)	(3,794)
Deletions	(458)	–	–	–	(6)	(464)
At 31 December 2014	18,720	2,847	4,739	3,510	3,082	32,898
Of which – current	836	927	1,420	–	635	3,818
– non-current	17,884	1,920	3,319	3,510	2,447	29,080
Of which – Gulf of Mexico oil spill[b]	–	1,141	3,954	3,510	–	8,605

[a] Spill response provisions are now included within environmental provisions as they are no longer individually significant.
[b] Further information on the financial impacts of the Gulf of Mexico oil spill is provided in Note 2.

The decommissioning provision comprises the future cost of decommissioning oil and natural gas wells, facilities and related pipelines. The environmental provision includes provisions for costs related to the control, abatement, clean-up or elimination of environmental pollution relating to soil, groundwater, surface water and sediment contamination. The litigation and claims category includes provisions for matters related to, for example, commercial disputes, product liability, and allegations of exposures of third parties to toxic substances. Included within the other category at 31 December 2014 are provisions for deferred employee compensation of $553 million (2013 $602 million).

For information on significant estimates and judgements made in relation to provisions, including those for the Gulf of Mexico oil spill, see Provisions, contingencies and reimbursement assets within Note 1.

Provisions and contingent liabilities

Provisions

BP has recorded provisions relating to the Gulf of Mexico oil spill in relation to environmental expenditure (including spill response costs), litigation and claims, and Clean Water Act penalties that can be measured reliably at this time.

Movements in each class of provision during the year and cumulatively since the incident are presented in the tables below.

$ million

	2014			
	Environmental	Litigation and Claims	Clean Water Act	Total
At 1 January	1,679	4,157	3,510	9,346
Increase in provision	190	1,137	–	1,327
Unwinding of discount	1	–	–	1
Change in discount rate	2	–	–	2
Utilization – paid by BP	(83)	(307)	–	(390)
– paid by the trust fund	(648)	(1,033)	–	(1,681)
At 31 December	1,141	3,954	3,510	8,605
Of which – current	528	1,174	–	1,702
– non-current	613	2,780	3,510	6,903

$ million

	Cumulative since the incident			
	Environmental	Litigation and Claims	Clean Water Act	Total
Net increase in provision	14,599	26,595	3,510	44,704
Unwinding of discount	13	6	–	19
Change in discount rate	19	–	–	19
Reclassified to other payables	–	(4,283)	–	(4,283)
Utilization – paid by BP	(11,687)	(4,080)	–	(15,767)
– paid by the trust fund	(1,803)	(14,284)	–	(16,087)
At 31 December 2014	1,141	3,954	3,510	8,605

Litigation and claims

The litigation and claims provision includes amounts that can be estimated reliably for the future cost of settling claims by individuals and businesses for damage to real or personal property, lost profits or impairment of earning capacity and loss of subsistence use of natural resources ('Individual and Business Claims'), and claims by state and local government entities for removal costs, damage to real or personal property, loss of government revenue and increased public services costs, under OPA 90 and other legislation ('State and Local Claims'), except as described under Contingent liabilities below. Claims administration costs and legal costs, including legal costs under indemnification agreements, have also been provided for. The timing of payment of litigation and claims provisions classified as non-current is dependent upon ongoing legal activity and is therefore uncertain.

BP has provided for its best estimate of the cost associated with the PSC settlement agreements with the exception of the cost of business economic loss claims, which are provided for where an eligibility notice had been issued before the end of the month following the balance sheet date and is not subject to appeal by BP within the claims facility. As disclosed in *BP Annual Report and Form 20-F 2013*, as part of its monitoring of payments made by the DHCSSP, BP identified multiple business economic loss claim determinations that appeared to result from an interpretation of the Economic and Property Damages Settlement Agreement (EPD Settlement Agreement) by the claims administrator that BP believes was incorrect.

Contingent liabilities

BP has provided for its best estimate of amounts expected to be paid that can be measured reliably. It is not possible, at this time, to measure reliably other obligations arising from the incident, nor is it practicable to estimate their magnitude or possible timing of payment. Therefore, no amounts have been provided for these obligations as at 31 December 2014.

Natural resource damage claims

As described above in Provisions, a provision has been made for natural resource damage assessment and early restoration projects under the $1-billion framework agreement. Natural resource damages resulting from the oil spill are currently being assessed. BP and the federal and state trustees are collecting extensive data in order to assess the extent of damage to wildlife, shoreline, near shore and deepwater habitats, and recreational uses, among other things. The study data will inform an assessment of injury to the Gulf Coast natural resources and the development of a restoration plan to address the identified injuries.

Detailed analysis and interpretation continue on the data that have been collected. Any early restoration projects undertaken pursuant to the $1-billion framework agreement could mitigate the total damages resulting from the incident. Accordingly, until the size, location and duration of the impact is assessed, it is not possible to estimate reliably either the amounts or timing of the remaining natural resource damage claims and associated legal costs, therefore no such amounts have been provided as at 31 December 2014.

Examples disclosure - Bayer:

23. Other provisions

Changes in the various provision categories in 2018 were as follows:

B 23/1

Changes in Other Provisions

€ million	Other Taxes	Environmental protection	Restructuring	Trade-related commitments	Litigations	Personnel commitments	Miscellaneous	Total
December 31, 2017	**29**	**243**	**171**	**2,481**	**393**	**2,038**	**355**	**5,710**
Reclassification to refund liabilities	–	–	–	(2,427)	–	–	–	(2,427)
Reclassification to inventories	–	–	–	76	–	–	–	76
Acquisitions	–	480	33	275	596	258	339	1,981
Additions	21	57	720	732	661	2,553	626	5,370
Utilization	(7)	(41)	(122)	(524)	(228)	(1,803)	(168)	(2,893)
Reversal	(6)	(6)	(30)	(108)	(25)	(551)	(108)	(834)
Reclassification to current liabilities	–	–	(1)	–	–	(14)	–	(15)
Interest cost	–	6	–	–	4	3	3	16
Exchange differences	(2)	15	2	6	13	13	2	49
December 31, 2018	**35**	**754**	**773**	**511**	**1,414**	**2,497**	**1,049**	**7,033**
of which current	15	88	230	499	445	1,765	644	3,686

Roundup™ (Glyphosate): As of January 28, 2019, lawsuits from approximately 11,200 plaintiffs claiming to have been exposed to glyphosate-based products manufactured by Bayer's subsidiary Monsanto had been served upon Monsanto in the United States. Glyphosate is the active ingredient contained in a number of Monsanto's herbicides, including Roundup™-branded products. Plaintiffs allege personal injuries resulting from exposure to those products, including non-Hodgkin lymphoma (NHL) and multiple myeloma, and seek compensatory and punitive damages. Plaintiffs claim, inter alia, that the glyphosate-based herbicide products are defective and that Monsanto knew, or should have known, of the risks allegedly associated with such products and failed to adequately warn its users. Additional lawsuits are anticipated. The majority of plaintiffs have brought actions in state courts in Missouri and California. Cases pending in U.S. federal courts have been consolidated in an MDL in the Northern District of California for common pre-trial management.

In August 2018, a state court jury in San Francisco, California, awarded roughly US$39 million in compensatory and US$250 million in punitive damages to a plaintiff who claimed that a Monsanto product caused his NHL. While the punitive damages were subsequently reduced by the trial court to roughly US$39 million, we still disagree with the verdict and have filed an appeal with the California Court of Appeal. More than 800 scientific studies and regulatory authorities all over the world confirm that glyphosate is safe for use when used according to label instructions. This includes an independent study which followed more than 50,000 licensed pesticide applicators for more than 20 years which found no association between glyphosate-based herbicides and cancer, and the U.S. Environmental Protection Agency's 2017 risk assessment which examined more than 100 studies and concluded that glyphosate is "not likely to be carcinogenic to humans." We continue to believe, therefore, that we have meritorious defenses and we intend to defend ourselves vigorously in all of these lawsuits. The next two trials are currently scheduled for February and March 2019 before a federal court in San Francisco and a state court in California, respectively. Another five trials are currently scheduled in California and Missouri for the remainder of 2019. However, trial dates in all venues remain subject to change depending on court schedules and rulings.

Knowledge check: Definition of provision

Which of the following example(s) can be treated as a 'provision' under IAS 37?

Select one or more option(s):

A. A payable to a supplier for trading goods received but the invoice is outstanding

B. Anticipated costs to fulfil obligations under local warranty legislation relating to past sales

C. Future cost relating to buying a new equipment

D. An unsettled court case that it is very likely to be lost based on the lawyer's advice

⇨ Solution – B&D

A: liability is not of an uncertain nature
C: there is no obligating event

Knowledge check: Contingent liabilities and contingent assets

Fact pattern:

Company A fired an employee in July 2018.

During that year, the employee sued the Company, because he considers that the amount of the compensation was not enough for him. At the end of 2018, the lawyer advised that the probability of the entity having to pay further compensation was remote, because the compensation given complied with the law.

But at the end of 2019, the lawyers say that under the last assessment of the claim, there would be a possibility of facing a charge against the entity, due to new information being discovered.

At the end of 2018 and 2019, shall Company A disclose a contingent liability under IAS 37?

⇨ At the end of 2018, Entity A does not have to disclose any contingent liability as the probability of any outflow is regarded as remote.
⇨ At the end of 2019, Entity A shall disclose the contingent liability as the probability of any outflow is regarded as possible. If further assessment indicates the event becomes probable, the entity shall recognize a provision.

CHAPTER 12: EVENTS AFTER THE REPORTING PERIOD (IAS10)

Events after the reporting period (IAS 10)

Events after the reporting period are defined as: "**those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue**".

ADJUSTING EVENTS AND NON-ADJUSTING EVENTS

- **Adjusting events** : Adjusting events are those "that provide evidence of conditions that existed at the end of the reporting period":
  - Settlement of a court case in which the company was involved at the end of the reporting period
  - Bankruptcy of a customer who owed money to the company at the end of the reporting period
  - Discovery of fraud or errors which show that the financial statements for the period are incorrect
- **Non-adjusting events** : Non-adjusting events are "those that are indicative of conditions that arose after the reporting period":
  - Decline in the fair value of investments held at the end of the reporting period

Financial statements should be **adjusted** to reflect adjusting events that occur after the reporting period.

Material non-adjusting events should be **disclosed** in the notes to the financial statements.

Knowledge check: adjusting or non-adjusting event?

Speed Ltd sells motorbikes. Shortly after year-end, Speed discovers that one of its employees has stolen five motorbikes (these motorbikes were stolen before year-end). These motorbikes are included in the inventory balance in the draft financial statements. Later that week, management approved the year-end bonuses (based on the year-end financial statements). In addition, Speed Ltd discovered an error that showed that the financial statements were incorrect as of year-end. They have immediately fired the employee responsible. Speed's management authorizes the financial statements for issue in the following week.

Which of these events after the balance sheet date is **not** an adjusting event?

- ❑ Discovering the stolen motorbikes
- ❑ Approval of year-end bonuses
- ❑ Firing of the employee
- ❑ Discovering an error in the financial statements

⇨ 3rd is correct : employer has been fired after the period → Subsequent period

Sticky Ltd manufactures glue. Shortly after year-end, a Sticky truck crashed and spilled tons of glue into a local river. Clean-up costs are estimated at €1 million. The financial statements will be authorized for issue later this month.

How should Sticky Ltd disclose the glue spillage in its financial statements?

- ❑ No disclosure is required, as this event occurred in a different fiscal year.

- ❑ No disclosure is required, as this is an adjusting event.
- ❑ "A vehicle accident in January resulted in a chemical spillage."
- ❑ "A vehicle accident in January resulted in a chemical spillage and clean-up costs are estimated to be €1 million."

⇨ 4th is correct : adjusting because the event that caused the event has already occurred in 2019

Company A closes its accounts on 31 December 2020 and publishes the results on 20 February 2021.

On 20 January 2021, Company A settles a litigation with one of its suppliers.

The settlement relates to a claim that was initiated in 2019, following a workers' accident incurred by the supplier while working at Company A.

⇨ Adjusting

Company A closes its accounts on 31 December 2020 and publishes the results on 20 February 2021.

One of the production facilities of Company A in South-East Asia was destroyed by an earthquake on 26 January 2021.

⇨ Non-adjusting but disclose! Earthquake happened after year end! It has no effect on the prepared financial statement. It should be disclosed because it is materiam. Careful in case of going concern issues resulting from this!

Company A closes its accounts on 31 December 2020 and publishes the results on 20 February 2021.

On 6 February 2021, a major customer of Company A is declared bankrupt.

Company A had unpaid invoices from this customer, some of which were already more than 12 months overdue. Company A stopped selling to this customer in November 2020.

⇨ Adjusting event, non-payement of customer was already known before yead-end !

Company A closes its accounts on 31 December 2020 and publishes the results on 20 February 2021.

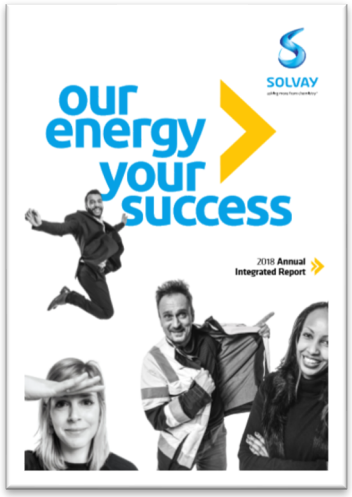
Company A received an order from Company B on 28 December 2020, which they were able to complete after the Christmas holidays. The product was delivered and installed on 30 January 2021.

On 2 February 2021, the product broke down.

A claim was received from Company B on 16 February 2021.

⇨ Non-adjusting because the completion of the order happened after year-end. It will not be material so we do nothing.

Example disclosure Subsequent events – **Solvay**



NOTE F42
Events after the reporting period

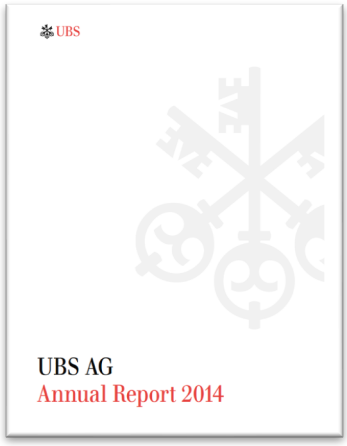
Accounting policy

Events after the reporting period which provide evidence of conditions that existed at the end of the reporting period (adjusting events) are recognized in the consolidated financial statements. Events indicative of conditions that arose after the reporting period are non-adjusting events and are disclosed in the notes if material.

On January 18, 2019, the European Commission cleared the divestment of Solvay's Polyamides activities to BASF, a key milestone in the completion of Solvay's transformation into an advanced materials and specialty chemicals company. The closing of the transaction is expected in the second part of 2019 after all remaining closing conditions have been fulfilled.

These conditions include the divestment of a remedy package to a third-party buyer to address the European Commission's competition concerns. BASF has offered remedies involving part of the assets originally in the scope of the acquisition. These entail among others the manufacturing assets of Solvay's polyamide intermediates, technical fibers, and engineering plastics business as well as its innovation capabilities in Europe.

Example disclosure Subsequent events – **UBS**



Note 37 Events after the reporting period

Adjustments to 2014 results

After the issuance of the unaudited fourth quarter 2014 financial report on 10 February 2015, management adjusted the 2014 results to account for subsequent events. The net impact of these adjustments on net profit attributable to UBS AG shareholders was a loss of CHF 112 million, which decreased basic and diluted earnings per share by CHF 0.03. The principal change arose due to an increase in charges for provisions for litigation, regulatory and similar matters of CHF 134 million. The other adjustment made to the income statement in 2014 was an increase in the net tax benefit of CHF 22 million.

Impact of Swiss National Bank actions

On 15 January 2015, the Swiss National Bank (SNB) discontinued the minimum targeted exchange rate for the Swiss franc versus the euro, which had been in place since September 2011. At the same time, the SNB lowered the interest rate on deposit account balances at the SNB that exceed a given exemption threshold by 50 basis points to negative 0.75%. It also moved the target range for three-month LIBOR to between negative 1.25% and negative 0.25%, (previously negative 0.75% to positive 0.25%). These decisions resulted in a considerable strengthening of the Swiss franc against the euro, US dollar, British pound, Japanese yen and several other currencies, as well as a reduction in Swiss franc interest rates. As of 28 February 2015, the Swiss franc exchange rate was 0.95 to the US dollar, 1.07 to the euro, 1.47 to the British pound and 0.80 to 100 Japanese yen. Volatility levels in foreign currency exchange and interest rates also increased.

A significant portion of the equity of UBS's foreign operations is denominated in US dollars, euros, British pounds and other foreign currencies. The appreciation of the Swiss franc would have led to an estimated decline in total equity of approximately CHF 1.2 billion or 2% when applying currency translation rates as of 28 February 2015 to the reported balances as of 31 December 2014. This includes a reduction in recognized deferred tax assets, mainly related to the US, of approximately CHF 0.4 billion (of which CHF 0.2 billion relates to temporary differences deferred tax assets), which would be recognized in *Other comprehensive income*.

On a fully applied basis for Swiss systemically relevant banks (SRB), UBS AG would have experienced the following approximate declines in its capital balances when applying currency translation rates as of 28 February 2015 to the reported balances as of 31 December 2014: CHF 0.5 billion or 2% in fully applied common equity tier 1 (CET1) capital and CHF 0.8 billion or 2% in fully applied total capital.

In aggregate, UBS AG did not experience negative revenues in its trading businesses in connection with the SNB announcement. However, the portion of operating income denominated in non-Swiss franc currencies is greater than the portion of operating expenses denominated in non-Swiss franc currencies. Therefore, appreciation of the Swiss franc against other currencies generally has an adverse effect on earnings in the absence of any mitigating actions.

In addition to the estimated effects from changes in foreign currency exchange rates, UBS AG's equity and capital are affected by changes in interest rates. In particular, the calculation of its net defined benefit assets and liabilities is sensitive to the assumptions applied. Specifically, the changes in applicable discount rate and interest rate related assumptions for its Swiss pension plan during January and February would have reduced equity and fully applied Swiss SRB CET1 capital by around CHF 0.7 billion. Also, the persistently low interest rate environment would continue to have an adverse effect on replication portfolios, and net interest income would further decrease.

Furthermore, the stronger Swiss franc may have a negative impact on the Swiss economy, which, given its reliance on exports, could impact some of the counterparties within UBS AG's domestic lending portfolio and lead to an increase in the level of credit loss expenses in future periods.

Sale of real estate

In January 2015, UBS AG sold a real estate property in Geneva, Switzerland for CHF 535 million, resulting in a gain on sale of CHF 377 million, which will be recognized in the income statement within Corporate Center in the first quarter of 2015. As of 31 December 2014, the property was classified on the balance sheet as property held-for-sale, which is measured at the lower of carrying value or fair value less costs to sell.

CHAPTER 14: EMPLOYEE BENEFITS (IAS19)

CATEGORIES OF EMPLOYEE BENEFITS

IAS19 specifies **four main categories** of employee benefits. These are:

- short-term employee benefits
- post-employment benefits (e.g. pensions)
- other long-term employee benefits
- termination benefits

➔ IAS19 prescribes the accounting treatment for each class of employee benefits.

SHORT-TERM EMPLOYEE BENEFITS

IAS19 defines short-term employee benefits as "*employee benefits … that are expected to be settled wholly before twelve months after the end of the … period in which the employees render the related service*".

These include:

- wages, salaries and employer's social security contributions
- short-term holiday pay and sick pay
- bonuses payable within 12 months of the end of the period in which the related services are performed
- non-monetary benefits for current employees

➔ Financial statements should recognize as an expense the short-term benefits due to employees for services rendered during the accounting period

POST-EMPLOYMENT BENEFITS

Post-employment benefits consist mainly of retirement benefits, such as pensions. IAS19 distinguishes between **two types of pension schemes** or "plans":

- **Defined contribution plans**. The employer's contributions are fixed. The employer is not obliged to make any further contributions. The risk that the fund's assets will be insufficient to pay the expected level of benefits falls upon the employee.
- **Defined benefit plans**. The employer is obliged to make sufficient contributions to the pension fund to ensure that an agreed level of employee benefits can be paid. The risk that these contributions will need to be increased (e.g. if the fund's investments perform badly) falls upon the employer.

ACCOUNTING FOR DEFINED CONTRIBUTION PENSION PLANS

general, if employees have rendered services to an employer during an accounting period, the employer's financial statements for that period should **recognise**:

(a) an **expense** equal to the amount of the contributions payable by the employer into the defined contribution plan in exchange for those services, and

(b) a **liability** (accrued expense) equal to any part of this expense that has not been paid by the end of the period.

If the contributions paid by the employer during the period exceed the amount due, the excess should normally be recognised as a prepaid expense.

ACCOUNTING FOR DEFINED BENEFIT PENSION PLANS:

In general, if employees have rendered services to an employer during an accounting period, the employer's financial statements for that period should recognise:

(a) an **expense** equal to the cost of the retirement benefits that will eventually be paid to the employees as a result of the services provided during that period

(b) a **liability (or asset)** equal to the difference between the plan total assets and the employer's total accumulated obligations under the plan.

TERMINOLOGY

The **defined benefit obligation** is the amount of the accumulated benefits which past and present employees have earned in return for their services to date.

The **current service cost** is the extra amount of such benefits that employees have earned in return for their services during the current period.

The **interest cost** is the increase during the current period in the present value of the defined benefit obligation which was calculated at the end of the previous period.

Actuarial gains and losses arise from the effects of changes in actuarial assumptions.

The **interest income** for a period is the amount obtained by multiplying the fair value of the plan assets at the start of the period by the interest rate that was used when calculating interest cost (but taking account of changes in plan assets during the period).

The **return on plan assets** consists of income, dividends etc. derived from the plan assets, together with gains or losses (e.g. on the disposal of assets), less the interest income for the period.

THE DEFINED BENEFIT EXPENSE

The **defined benefit liability** which is recognised in the statement of financial position at the end of an accounting period is equal to:

- the **present value of the defined benefit obligation** at the end of the period

less

- the **fair value of the plan assets** at the end of the period.

If the result of this calculation is negative, it is recognised as an asset.

THE DEFINED BENEFIT LIABILITY

A liability is recognised in balance sheet if benefit obligations exceed plan assets

Accounting for defined benefit plans

Accounting for defined benefit plans is highly complex and involves several steps.

Complexity arises from the following:

- Expense = cost to the employer of retirement benefits as a result of the services that they have received
- Problem
  - Benefits will be payable in many years' time
  - Cost will depend on a number of factors which are difficult to determine in advance such as
    - Employee mortality rates
    - Employee turnover
    - Future returns on investment

Accounting for defined benefit plans - **Steps**

a) At the end of each accounting period

- **Reliable estimates** should be made to determine the amount of the benefits that employees have earned in return for their services in prior periods ('the defined benefit obligation') and in the current period (the 'current service cost').
- These estimates involve the making of **assumptions** with regard to such matters as employee mortality, employee turnover and future salary increase.

b) These estimates are **discounted** so as to determine the present value of the defined benefit obligation and the present value of the current service cost.

c) The '**interest cost**' for the period is calculated. This is equal to the increase during the current accounting period of the present value of the defined benefit obligation calculated at the end of the previous period. This increase arises because the accumulated benefits which the employees had earned at the end of the previous period are now **one period closer to being paid**.

d) **Actuarial gains and losses** with regard to the defined benefit obligation may now be calculated:

- Adjustments arising from differences between actuarial assumptions which were made at the end of the previous period and actual events which occurred during the current period
- The effect of changes in actuarial assumptions between the start and end of the current period

The overall actuarial gain or loss with regard to the defined benefit obligation for an accounting period is calculated by summarising the changes in that obligation during the period and inserting **a balancing figure**:

Present value of defined benefit obligation at start of period	xxx
Add: Interest cost	xxx
Present value of current service cost	xxx
Deduct: Benefits paid during the period	xxx
	xxx
Actuarial losses/(gains)	xxx
Present value of DBO at the end of the period	**xxx**

e) The final step in the process is to determine the **fair value of the plan assets** at the end of the accounting period and to calculate the actuarial gains and losses which have occurred during the period with regard to those assets.

These actuarial gains and losses may arise because the actual returns achieved on plan assets during the period do not equal the expected returns

Fair value of plan assets at the start of period	xxx
Add:	
Expected return on plan assets	xxx
Contributions received from employer	xxx
Contributions received from employees	xxx
Deduct:	
Benefits paid during the period	xxx

	xxx
Actuarial losses/(gains)	xxx
Fair value of plan assets at the end of the period	xxx

- Actuarial valuations are done using individual plan participants' data (i.e. liabilities are not estimated based on average plan participant characteristics or aggregate participants' data)
- Calculations are typically carried out by independent actuaries (e.g. Aon, Conac, Esofac, Hewitt, Mercer Human Resource Consulting, Towers Watson, Vanbreda Risk & Benefits, …)
- Company remains responsible for selection of actuarial assumptions!

The defined benefit expense

The defined benefit expense which is recognised when calculating the entity's profit or loss for the accounting period is arrived at by *adding*:

(a) the present value of the current service cost for the period
(b) the interest cost for the period

and then *subtracting*:

(c) employee contributions in the period
(d) interest income for the period

➔ Actuarial gains and losses and the return on plan assets are shown in other comprehensive income.

Illustration of the methodology

- A company which prepares annual accounts to 31 December has operated a defined benefit scheme for many years.
- At 31 December 2020, the company's SOFP showed a defined benefit liability of 575.000, made up as follows

31/12/2020	(-000)
Present value defined benefit obligation	2.430
Fair value of plan assets	1.855
Defined benefit liability	**575**

The following figures relate to the year 2021

	(-000)
Present value of the current service cost for the year	415
Interest cost	170
Interest income	130
Return on plan assets (before deducting interest income)	235
Employer contributions	450
Benefits paid	375
Present value of defined benefit obligation at end of year	2.760
Fair value of plan assets at end of year	2.165

Let's calculate the defined benefit expense for the year to 31 December 2021.

Also calculate the defined benefit liability (or asset) which should be shown in the company's SOFP as at that date.

Calculation of actuarial gains or losses

2021	(-000)
Present value of the DB obligation at start of year	2.430
Interest cost	170
Present value of current service cost for the year	415
Benefits paid during the year	-375
	2.640
Actuarial losses (**balancing figure**)	120
Present value of defined benefit obligation at end of year	2.760

Reconciliation of the fair value of plan assets

2021	(-000)
Fair value of plan assets at start of year	1.855
Interest income	130
Return on plan assets (after deducting interest income)	105
Employer contributions	450
Benefits paid during the year	-375
Present value of plan assets at end of year	2.165

The amounts which should be shown in the company's financial statements for the year ended 31 December 2021 are as follows:

- Defined benefit expense

2021	(-000)
Present value of the current service cost for the year	415
Interest cost	170
Interest income	-130
Expense recognised in profit or loss	455
Actuarial losses	120
Return on plan assets	-105
Expense recognised in other comprehensive income	15

- Defined benefit liability

2021	(-000)
Present value of the defined benefit obligation at end of year	2.760
Fair value of plan assets at end of year	-2.165
Defined liability in statement of financial position	595

  - The defined benefit expense for the year = 470.000 (455.000 + 15.000).
  - Employer contributions were only 450.000.

This is why the defined benefit liability (i.e. deficit) has increased by 20.000 during the year, from 575.000 to 595.000.

Belgian defined contribution plans

- Belgian defined contribution pension plans subject to
  - A minimum guaranteed return (formerly 3.25 % on employer contributions and 3.75 % on employee contributions – now market driven minimum returns)
  - Minimum factors to convert lump sum into pension at retirement
- Since there is a risk that the employer has to pay supplementary contributions, those plans currently qualify as defined benefit plan

DISCLOSURES RELATING TO DEFINED BENEFIT PLANS

The main disclosures required by IAS19 with regard to defined benefit plans are:

- a general **description of the type of plan** and any risks to which the entity is exposed because of the plan
- a **reconciliation** of opening and closing balances for the defined benefit obligation and for the plan assets
- the **significant actuarial assumptions** used to determine the present value of the defined benefit obligation
- information which describes how the entity's defined benefit plan may affect its **future cash flows**.

Example disclosure Employee benefits - Bekaert

Employee benefit obligations

The parent company and several of its subsidiaries have pension, death benefit and health care benefit plans covering a substantial part of their workforce.

Defined-benefit plans

Most pension plans are defined-benefit plans with benefits based on years of service and level of remuneration. For defined-benefit plans, the amount recognized in the balance sheet (net liability or asset) is the present value of the defined-benefit obligation less the fair value of any plan assets. The present value of the defined-benefit obligation is the present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods. The present value of the defined-benefit obligation and the related current and past service costs are calculated using the projected unit credit method. The discount rate used is the yield at balance sheet date on high-quality corporate bonds with remaining terms to maturity approximating those of the Group's obligations. In case the fair value of plan assets exceeds the present value of the defined-benefit obligations, the net asset is limited to the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The net interest on the net defined-benefit liability/asset is based on the same discount rate. Actuarial gains and losses comprise experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred) and the effects of changes in actuarial assumptions. Past service cost is the change in the present value of the defined-benefit obligation for employee service in prior periods and resulting in the current period from a plan amendment or a curtailment. Past service costs are recognized immediately through profit or loss. Remeasurements of the net defined-benefit liability (asset) comprise (a) actuarial gains and losses, (b) the return on plan assets, after deduction of the amounts included in net interest on the net defined-benefit

In the income statement, current and past service cost, including gains or losses from settlements, are included in the operating result (EBIT), and the net interest on the net defined-benefit liability (asset) is included in interest expense, under interest on interest-bearing provisions. Pre-retirement pensions in Belgium and plans for medical care in the United States are also treated as defined-benefit plans.

Defined-contribution plans

Obligations in respect of contributions to defined-contribution pension plans are recognized as an expense in the income statement as they fall due. By law, defined-contribution pension plans in Belgium are subject to minimum guaranteed rates of return. Before 2015, the defined-contribution plans in Belgium were basically accounted for as defined-contribution plans. New legislation dated December 2015 however triggered the qualification. As a consequence, the defined-contribution plans are reported as defined-benefit obligations, whereby as from year end 2016 an actuarial valuation was performed.

6.16. Employee benefit obligations

The total net liabilities for employee benefit obligations, which amounted to € 262.7 million as at 31 December 2020 (€ 261.7 million as at year-end 2019), are as follows:

in thousands of €	2019	2020
Liabilities for		
Post-employment defined-benefit plans	*120 248*	*118 892*
Other long-term employee benefits	*4 437*	*4 700*
Cash-settled share-based payment employee benefits	*1 662*	*2 556*
Short-term employee benefits	*125 051*	*116 014*
Termination benefits	*20 794*	*38 580*
Total liabilities in the balance sheet	**272 193**	**280 742**
of which		
Non-current liabilities	*123 409*	*130 948*
Current liabilities	*148 784*	*149 793*
Assets for		
Defined-benefit pension plans	*-10 470*	*-18 082*
Total assets in the balance sheet	**-10 470**	**-18 082**
Total net liabilities	**261 722**	**262 660**

OTHER LONG-TERM EMPLOYEE BENEFITS

Other long-term employee benefits include:

(a) long-term paid absences such as long-service leave and sabbatical leave
(b) long-term disability benefits
(c) profit-sharing and bonus payments

as long as these are not expected to be settled wholly before twelve months after the end of the period in which the employees render the related services.

The accounting treatment of these benefits is similar to the treatment required for defined benefit post-employment plans.

TERMINATION BENEFITS

Termination benefits generally consist of payments or other benefits provided to employees in exchange for terminating their employment (e.g. redundancy pay or compensation for loss of office).

Termination benefits should be recognised as a liability and an expense at the earlier of the following dates:

(a) when the entity can no longer withdraw the offer of those benefits

(b) when the entity recognises restructuring costs which involve the payment of employment benefits

CHAPTER 15: TAXATION IN FINANCIAL STATEMENTS (IAS 12)

Current tax: Amount payable to or recoverable by the tax authorities in respect of the current and previous periods

Deferred tax: The future tax consequences of recovering or settling the carrying amount of an asset or liability (the consequence whether it has a positive (you have to pay less) of a negative impact)

CURRENT TAX

- IAS12 defines current tax as "the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period."

    - Taxes linked to profit of companies

- The term "income taxes" refers to any tax which is payable on an entity's profits, regardless of the name given to that tax in the country concerned.

→ Taxes are everywhere on the income statement not only on profit

ACCOUNTING FOR CURRENT TAX

- The amount of current tax for an accounting period should be recognised as an expense.
- Any adjustments necessary to reflect underestimates or overestimates of current tax in previous periods should be included in the tax expense for the current period. (→ taxes of the past)
- The amount of any current tax unpaid at the end of the period should be recognised as a liability.
    - Tax pre-payements : credit cash – receivable on balance sheet or deduct immediately on liability (see textbook)
- Any current tax that arises from a transaction or event which is recognised in other comprehensive income should also be recognised in other comprehensive income.
- Current tax should be measured using tax rates and tax laws "that have been enacted or substantively enacted by the end of the reporting period".

→ How should the term 'substantive enactment' be applied?

The determination as to whether or not new tax rates are considered to be 'substantively enacted' is a matter requiring judgement, based on the specific facts and circumstances. Factors to consider include:

- the legal system and related procedures or processes necessary for enactment of the tax law change;
- the nature and extent of the remaining procedures or processes;
- the extent to which the remaining procedures or processes are perfunctory (perfunctory = a formality only); and
- the timing of the remaining procedures or processes.

    → If you see that the tax rate is going to change when you close your book

Example 1: facts

31/12/2022:

- Assume Company M earned profit before tax = € 252.000
- During 2022 three company cars Tesla Model 3 (EV) are acquired which cost = € 150.000 and have a residual value of zero
    - Expected useful life = 10 years

- Depreciation of € 15.000 has been charged

- Tax authorities permit an electric car to be 120% depreciated (see next page)
- Tax rate = 20%

1. Determine the taxable basis and the amount of current taxes.

2. How to record the current tax entry?

- Tax deductibility of cars

CO2-uitstoot diesel	CO2-uitstoot benzine	Fiscale aftrek beperkt tot
100% elektrisch	100% elektrisch	120%
0 – 60 g	0 – 60 g	100%
61 – 105 g	61 – 105 g	90%
106 – 115 g	106 – 125 g	80%
116 – 145 g	126 – 155 g	75%
146 – 170 g	156 – 180 g	70%
171 – 195 g	181 – 205 g	60%
> 195 g (of niet gekend)	> 205 g (of niet gekend)	50%

Solution:

Tax calculation

Accounting pre-tax profit = Add back	€ 252.000
- Initial booked depreciation	€ 15.000
	€ 267.000
Less	
- Tax rules based depreciation	€ - 18.000
Taxable profit	€ 249.000
Current tax at 20% =	49.800

Entry for 2022:

Income tax charge (I/S)	49.800
@ Current tax liability (B/S – STL)	49.800

⇨ Tax law decreases the tax base: Lower taxes

Example 2: facts

31/12/2022:

- Accounting profit biotech company = € 150.000
- € 20.000 royalty income is tax exempt (difference between accountancy and tax !)
- € 5.000 meal expenses are not deductible (add back back to deductible base & tax)

- Bad debt expense for € 2.500 included € 500 estimate not deductible until actual write-off.
    - Companies needs to make provision: estimates on loss: receivable of cost does not pay as accountancy where it can be seen as reserves (if the costs are not sure). The taxes don't like that and if you don't demonstrate that the client will not pay you have to pay taxes! You must demonstrate that the client will go bankrupt.
- Accelerated tax depreciation is € 43.000, accounting depreciation is € 35.000.
    - It lowers profit before the tax and IFRS wants to know the real value of the product.
- Tax rate = 15%

1. Determine the taxable basis and the amount of current taxes.

Tax calculation	
Accounting pre-tax profit	€ 150.000
Add Back	
- nondeductible meals	€ 5.000
- nondeductible bad debts	€ 500
Less	
- nontaxable royalty	€ -20.000
- additional tax depreciation	€ - 8.000
Taxable profit	€ 127.500
Current tax at 15%	€ 19.125

Preliminary conclusions

- Profit Before Tax is not necessarily the same amount as Taxable profit.
    - PBT = based on IFRS
    - Taxable profit = based on the tax rules
- You need to understand the tax rules/tax law in order to bridge the PBT as per the financial statements to the Taxable profit as per the rules of the tax authorities.
- Tax authorities = country legislation
- Some tax authorities even completely ignore IFRS financial statements.
- In those countries financial departments of international groups need to have a thorough understanding of:
    - Local GAAP
    - IFRS/US GAAP
    - Tax rules

DEFERRED TAX – WHAT IS THE PROBLEM?

- In most jurisdictions, rules for recognition and measurement of certain assets, liabilities, income and expenses for tax purposes often differ from the equivalent rules under IFRS.
- This results in different figures in the financial statements and in the tax return. Current tax charges are based on tax authorities' view of the profit, not the accounting view. The objective for financial reporting is to fairly report on the activities of a company. The objective for income tax purposes is for the government to raise taxes.
- This implies there can be differences between pre-tax financial income and taxable income: pre-tax financial income is determined based on accounting rules whereas taxable income is based on tax rules.
- This causes temporary differences.
- Temporary: because usually these differences eliminate over time.
    - E.g., depreciation of an asset: 10 yrs ⇔ 15 yrs
    - E.g. deductibility of a cost: in year X ⇔ in year X+1

DEFERRED TAX - DEFINITION

Some of the income or expenses for an accounting period may be dealt with for tax purposes in a different period. IAS12 requires that such "temporary differences" are dealt with as follows:

a) In a period in which temporary differences cause taxable profits (tax return) to be lower than accounting profits (IFRS books)
→ IFRS results will be higher/better
→ But we know the temporary advantage will reverse in future
→ So we know we will have a higher taxable amount in future

In such case the tax expense for the period is increased by a transfer to a deferred tax liability account. So we record the future negative tax impact on a deferred tax account.

b) In a period in which temporary differences cause taxable profits to be higher than accounting profits, the tax expense for the period is decreased by a transfer from the deferred tax account. So you reflect a Deferred Tax Asset on the Balance Sheet.

ACCOUNTING FOR DEFERRED TAX

Examples of temporary differences

- Some items taxed on cash basis but recognised in financial statements on accrual basis: authorities only allow you to deduct an expense if it is also paid.
  => So taxable profit is higher than accounting profit in the year the accrual is booked because the deduction is not allowed until payment in future.

- Differences in depreciation method for tax purposes and accounting purposes: e.g. double declining depreciation rather than linear depreciation.
  => So taxable profit is lower than accounting profit in the beginning period when double declining > linear.

- Revaluation of certain assets under IFRS not allowed for tax purposes: eg revaluation of fixed assets but the depreciation on such revalued assets is not deductible.

=> So taxable profit is higher than accounting profit because in accounting you depreciate the revaluation.

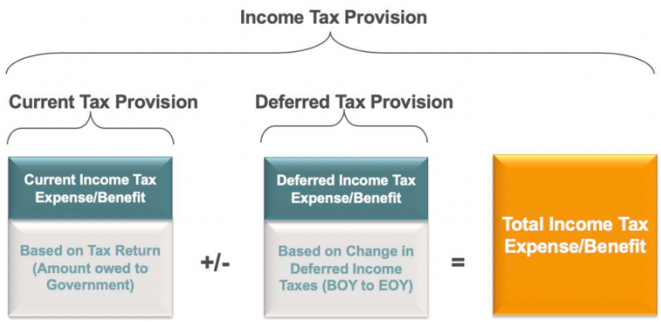
Two types of temporary differences defined by IAS12

- Taxable temporary differences are temporary differences "that will result in taxable amounts in ... future periods". Taxable temporary differences result in deferred tax liabilities.
- Deductible temporary differences are temporary differences "that will result in amounts that are deductible in ... future periods". Deductible temporary differences result in deferred tax assets.

What is the solution?

- Deferred tax seek to address the mismatch between accounting and tax profit.
- Recognizing the tax effects of temporary differences resulting from the difference between tax and accounting rules, ensures that the correct tax expense is recognised in the financial statements.
- The recognition of this additional amount gives rise to deferred taxation either payable or recoverable in a subsequent accounting period.

➔Therefore, the tax charge in the income statement comprises deferred tax as well as current tax.



Numerical Example

Difference in depreciation method for tax purposes and accounting purposes

- Machine Purchase: 01/01/2017
- Gross Book Value: 100
- Useful life: 4 years
- Tax-based depreciation: 2 years
- Tax rate: 34%

Result: current tax charge based on tax authorities view of the profit, not the accounting view

Tax return	2017	2018	2019	2020	2021
Sales	1.000	1.000	1.000	1.000	1.000
COS	-750	-750	-750	-750	-750
Depreciation	-50	-50	0	0	0
Taxable income	200	200	250	250	250
Income tax	-68	-68	-85	-85	-85
Net income	132	132	165	165	165

⇨ Depreciation over 2 years in the tax return

The relationship between the accounting "profit before tax" and the tax charge will be distorted

Financial statements	2017	2018	2019	2020	2021
Sales	1.000	1.000	1.000	1.000	1.000
COS	-750	-750	-750	-750	-750
Depreciation	-25	-25	-25	-25	0
Taxable income	225	225	225	225	250
Income tax	-76,5	-76,5	-76,5	-76,5	-85
- Current	-68,0	-68,0	-85,0	-85,0	-85,0
- Deferred	-8,5	-8,5	+8,5	+8,5	0,0
Net income	148,5	148,5	148,5	148,5	165

⇨ Depreciation over 4 years in the F/S
⇨ Deferred tax liability in 2017 and 2018, reversal thereafter

Temporary and permanent differences between taxable profit and accounting profit

- Temporary differences are those differences between accounting profit and taxable profit for an accounting period that arise whenever the measurement of assets and liabilities for income tax purposes differ from the measurement of assets and liabilities in accordance with IFRS. These result in Deferred Tax Assets/Liabilities.

  For example: a different depreciation method.

- Permanent differences are those differences between accounting profit and taxable profit that arise when income is not taxed or expenses are not tax deductible. (no reversal over time : no further use)

  For example, tax-free interest income is not included in taxable profit, even though it is part of the accounting profit.

  These do not result in Deferred Tax Assets/Liabilities.

  ⇨ *You know how to treat it! You don't need to recognize it!*

Example

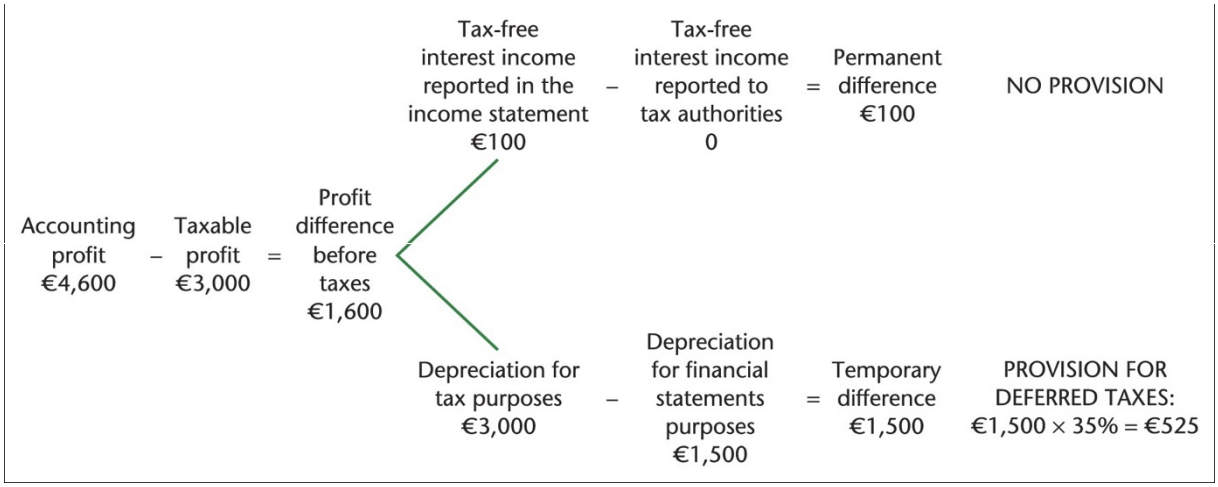
- Difference in depreciation period: 3.000 ⇔ 1.500
- Tax-exempted income (permanently tax-free): 100

Income tax return	€	Income statement	€
Income from operations before depreciation and income taxes	6,000	Income from operations before depreciation and income taxes	6,000
Tax-free interest income*		Tax-free interest income	100
Depreciation	(3,000)	Depreciation**	(1,500)
Taxable profit	3,000	Pretax profit	4,600

Income taxes payable to tax authorities (35% of 3,000)	1,050	Income tax expense • Current • Deferred	1,575*** 1,050 525 1,575***

* Tax-free interest income is excluded from taxable profit.
** (€5,000 ÷ 10 years) + (€10,000 ÷ 10 years) = €1,500.
*** €4,600 – €100 = €4,500 × 35% = €1,575

Differences between accounting profit and taxable profit and deferred taxes



THE "TAX BASE" CONCEPT

- IAS12 requires that the "tax base" of each asset and liability at the end of the accounting period should be compared with its "carrying amount" (i.e. the amount at which it is "carried" or shown in the financial statements).
- The tax base of an asset or liability is defined as "the amount attributed to that asset or liability for tax purposes".
- If the tax base of an asset or liability is not the same as its carrying amount, this is evidence of a temporary difference and a deferred tax adjustment is required.

TAX BASE OF AN ASSET

- IAS12 defines the tax base of an asset as "the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset". The amount deductible for tax purposes is not necessarily equal to the carrying amount in the financial statements.

TAX BASE OF A LIABILITY

- IAS12 defines the tax base of a liability as "its carrying amount, less any amount that will be deductible for tax purposes in respect of that liability in future periods".
    - Because of the temporary difference there can be a difference between tax books and accountancy books

IAS12 REQUIREMENTS (DEFERRED TAX)

Deferred taxes – Calculation steps

Step 1: Determine the tax base of each asset and liability

Step 2: Calculate the temporary difference between the carrying amount and tax base, if any

Step 3: Calculate the temporary difference between the carrying amount and tax base, if any

Step 4: Calculate the deferred tax attributable using the appropriate tax rate

Step 5: Recognise net movement for the period

Deferred taxes – temporary differences

Deferred taxes arising from temporary differences

Carrying amount - Tax base = temporary difference

Temporary difference x Tax rate = Deferred tax asset / liability

Example Deferred Tax Liability

31/12/2019:
Company M buys land in 2019 for € 1.500.000.

31/12/2020:
Company M revalues the land to € 2.500.000

31/12/2022:
The land is sold in 2022 for an amount of € 2.500.000

The corporate tax rate = 20%

Solution Deferred Tax Liability

31/12/2019		
Land (B/S – NCA)	1.500.000	
@ Bank (B/S – CA)		1.500.000
31/12/2020		
Land – revaluation (B/S – NCA)	1.000.000	
@ Revaluation surplus (OCI)		1.000.000
Deferred tax charge (OCI)	200.000	
@ Deferred tax provision (B/S – Liability)		200.000
31/12/2022		
Bank (B/S – CA)	2.500.000	
@ Land (B/S – NCA)		1.500.000

Land Revaluation (B/S – NCA) 1.000.000

Deferred tax provision (B/S – LTL) 200.000

@ Current tax provision (B/S – STL) 200.000

Example Deferred Tax Asset

31/12/2021:

Company M charged pension cost of € 200.000 in computing accounting profit for the year 2021,

but these costs are not paid until 2022.

Tax authorities allow pension costs as a deduction from taxable profit when they are paid. This means they do not accept the cost and related liability (tax basis of liability = zero).

The rate of the corporate tax = 25%

Solution Deferred Tax Asset

<u>31/12/2021</u>
Pension costs (I/S) 200.000
@ Pension cost accrual (B/S – LTL) 200.000

Deferred tax asset (B/S – NCA). 50.000
@ Deferred tax credit (I/S) 50.000

(and subsequent reversal of the DTA in 2022 upon actual payment when the payment becomes deductible for tax purposes).

Deferred Taxes – in a nutshell

<u>Asset</u>:

Accounting base < tax base => Deferred Tax Asset

examples: an impairment of an asset that was rejected for tax purposes, depreciation under tax rules which is slower than in the F/S.

Accounting base > tax base => Deferred Tax Liability

examples: double declining depreciation for tax purposes vs. linear for F/S purposes, prepaid rent expenses when incurred for F/S purposes, tax deductible when paid.

<u>Liability:</u>

Accounting base < tax base => Deferred Tax Liability

Accounting base > tax base => Deferred Tax Asset

example: a provision which is only deductible for tax purposes when paid.

Deferred Taxes – Class Exercise

Consider each of the following assets and liabilities which appear in the company's statement of financial position at 31 December 2017.

a) A truck which costed 100,000 EUR is shown at its Net Book Value of 20,000 EUR. For tax purposes, the value is 30,000 EUR;

b) A loan payable is shown at 60,000 EUR. The repayment of the loan will have no tax consequences;

c) An amount receivable is shown at 45,000 EUR. Of this amount 25,000 EUR has already been taxed but the remaining 20,000 EUR will be taxed in the accounting period in which it is received. The full amount of 45,000 EUR has already been included in accounting profit.

d) An amount payable is shown at 3,000 EUR. This relates to an expense which has already been deducted when computing accounting profit but which will not be deducted for tax purposes until it is paid.

Compute the tax base of each of these assets and liabilities and identify any taxable or deductible temporary difference.

Calculate for each of these assets and liabilities the amount of deferred taxes. Determine (and explain why) whether the deferred tax is a deferred tax asset (DTA) or a deferred tax liability (DTL).

The tax rate = 20%

Explain the difference between deferred tax asset and a deferred tax liability.

Deferred Taxes – Class Exercise - Solution

	Accounting Base	Tax base	Difference	Deffered tax
(a)	20.000	30.000	10.000	2.000
(b)	60.000	60.000	/	/
(c)	45.000	25.000	20.000	4.000
(d)	3.000	0	3.000	6.000

A deferred tax asset should be recognised for deductible temporary differences, unused tax losses and unused tax credits. It shows the tax effect of in the future deductible amounts from the tax base. Deferred tax assets should only be recognised to the extent that it is probable that taxable profit will be available against which they can be offset.

a) A deferred tax liability should be recognised for all taxable temporary differences. It shows the tax effect of in the future taxable amounts that will be added to the tax base. A)A truck which costed 100,000 EUR is shown at its Net Book Value of 20,000 EUR. For tax purposes, the value is 30,000 EUR;
b) A loan payable is shown at 60,000 EUR. The repayment of the loan will have no tax consequences;

c) An amount receivable is shown at 45,000 EUR. Of this amount 25,000 EUR has already been taxed but the remaining 20,000 EUR will be taxed in the accounting period in which it is received. The full amount of 45,000 EUR has already been included in accounting profit.
d) An amount payable is shown at 3,000 EUR. This relates to an expense which has already been deducted when computing accounting profit but which will not be deducted for tax purposes until it is paid.

Deferred tax assets - special case Recognition of DTA on unused tax losses and credits

- Unused tax losses/credits have a value. They reduce the future tax burden given tax legislation allows to offset these losses and credits against future profits.

Unused tax losses/ credits X credit rate = deferred tax asset

- But watch out! You cannot simply recognize every deferred tax asset!

Carryforward of unused tax losses and unused tax credits

- A DTA should be recognised to the extent that it is probable ("more likely than not") that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised.
    - In case of tax consolidation (e.g., France, US), recovery to be assessed at consolidation level
- The carrying amount of the DTA should be reviewed at each balance sheet date. The carrying amount should be reduced to the extent that it is no longer probable that sufficient taxable profit will be available to utilise the asset.
- This is often a time-consuming exercise involving several stakeholders in order to ensure the right judgement is made and all relevant facts considered (CEO, CFO, Tax Department, Board of Directors, Auditor, ...)
- See ESMA statement of 2019 separately provided (Toledo).

Tax rate changes

Example

- On 31 December 2020, the balances of deferred tax accounts for Construct NV/SA were as follows:

Deferred tax asset € 44,400

Deferred tax liability €109,200

- In June 2021, the tax authorities reduced the tax rate from 40% to 30%, effective from 1 January 2022.

	Deferred tax asset	Deferred tax liability
Opening balance	€44,400	€109,200
Adjustment for change in tax rate: (40–30) ÷ 40	(€11,100)	(€27,300)
Restated balance	€33,300	€81,900

The adjusting journal entry is:		
Dr Deferred tax liability	€27,300	
Cr Deferred tax asset		€11,100
Cr Income tax expense		€16,200

(Recognition of the impact of a change in taxe rate on deferred tax amounts)

Measurement and recognition under IAS 12

- Tax rates/laws that have been enacted or substantively enacted by the end of the reporting period
- Deferred tax = income or expense except for:
    - Transactions recognised outside P & L = OCI or directly in equity
    - Business combinations
- Discounting not permitted
- Presentation – offset only if
    - Entity has a legally enforcable right to set off current tax assets against current tax liabilities
    - Deferred tax assets and liabilities relate to income taxes levied by the same tax authority

IAS12 requirements (deferred tax)

- A deferred tax liability must be recognised for all taxable temporary differences.
- A deferred tax asset must be recognised for a deductible temporary difference if it is probable that this temporary difference will be utilised in the future.
- The carrying amount of deferred tax assets must be reviewed at the end of each accounting period. Utilisation in future OK?
- Deferred tax assets and liabilities must be measured at the tax rates that are expected to apply to the period in which the asset is realised or the liability is settled.
- Deferred tax assets and liabilities must not be discounted.
- Transfers to or from the deferred tax account should usually be recognised in the calculation of profit or loss.

IAS12 DISCLOSURE REQUIREMENTS

- The tax expense in the statement of comprehensive income must be analysed into:
    - the current tax expense (or income) for the period
    - any adjustments relating to previous periods
    - transfers to or from the deferred tax account
    - amounts of tax recognised in other comprehensive income.

- The following must also be disclosed separately:
    - an explanation of the relationship between the accounting profit for the period and the tax expense for the period
    - for each type of temporary difference, the amount of the deferred tax asset or liability recognised in the statement of financial position and the amount of the deferred tax expense or income recognised in the statement of comprehensive income.

Example Colruyt

8.1. Income taxes recognised in profit or loss

(in million EUR)	2020/21	2019/20
A) Effective tax rate		
Profit before tax (excluding share in the result of investments accounted for using the equity method)	524,4	509,2
Income tax expense	104,9	129,9
Effective tax rate[2]	**20,01%**	**25,52%**
B) Reconciliation between the effective tax rate and the applicable tax rate[1]	**24,70%**	**28,62%**
Profit before tax (excluding share in the result of investments accounted for using the equity method)	524,4	509,2
Income tax expense (based on applicable tax rate)	**129,5**	**145,8**
Non-taxable income/non tax-deductible expenses	4,1	6,5
Permanent differences	1,9	2,6
Impact of tax deductions[2]	(74,2)	(23,6)
Other	(6,4)	(1,4)
Income tax expense	**104,9**	**129,9**
Effective tax rate	**20,01%**	**25,52%**
C) Income tax expense recognised in profit or loss		
Current year taxes	80,6	135,3
Deferred taxes	24,5	(4,0)
Adjustments relating to prior years	(0,2)	(1,4)
Total income tax expense	**104,9**	**129,9**

(1) The applicable tax rate is the weighted average tax rate for the Company and all its consolidated subsidiaries in different jurisdictions (Belgium: 25,00%, France: 28,00%, Grand Duchy of Luxembourg: 24,94%, India: 25,17%, Hong Kong: 16,50%, Senegal: 30,00%).
(2) The tax rate was affected in 2020/21 by the reform of the Belgian corporation tax, the investments in innovation and change projects and the contribution of Eoly Energy NV into Virya Energy NV.

17. Deferred tax assets and liabilities

Deferred tax assets and liabilities can be detailed as follows:

17.1. Net carrying amount

	Assets		Liabilities		Balance	
(in million EUR)	31.03.21	31.03.20	31.03.21	31.03.20	31.03.21	31.03.20
Intangible assets	7,1	9,1	(0,2)	(0,1)	6,9	9,0
Property, plant and equipment	0,6	0,7	(126,9)	(127,1)	(126,3)	(126,4)
Inventories	0,1	0,2	(1,1)	(0,9)	(1,0)	(0,7)
Receivables	1,2	4,0	(7,3)	(6,1)	(6,1)	(2,1)
Liabilities related to employee benefits	28,0	31,3	-	-	28,0	31,3
Other provisions	2,7	2,3	(10,9)	(9,9)	(8,2)	(7,6)
Other liabilities	59,5	47,4	(3,8)	(0,8)	55,7	46,6
Tax loss carry-forwards, deductible items and reclaimable tax paid	72,4	88,1	-	-	72,4	88,1
Gross deferred tax assets/(liabilities)	**171,6**	**183,1**	**(150,2)**	**(144,9)**	**21,4**	**38,2**
Unrecognised tax assets/liabilities	(95,8)	(82,2)	20,7	9,7	(75,1)	(72,5)
Offsetting tax assets/liabilities	(63,5)	(80,8)	63,5	80,8	-	-
Net deferred tax assets/(liabilities)	**12,3**	**20,1**	**(66,0)**	**(54,4)**	**(53,7)**	**(34,3)**

17.2. Change in net carrying amount

	Assets		Liabilities		Balance	
(in million EUR)	2020/21	2019/20	2020/21	2019/20	2020/21	2019/20
Net carrying amount at 1 April	**20,1**	**20,7**	**(54,4)**	**(51,2)**	**(34,3)**	**(30,5)**
Changes recognised in profit or loss	(13,8)	(0,6)	(10,7)	4,6	(24,5)	4,0
Changes recognised in other comprehensive income	2,0	-	(0,9)	(7,8)	1,1	(7,8)
Changes to the consolidation scope	4,0	-	-	-	4,0	-
Net carrying amount at 31 March	**12,3**	**20,1**	**(66,0)**	**(54,4)**	**(53,7)**	**(34,3)**

On 31 March 2021 Colruyt Group did not recognise deferred tax assets and liabilities in an amount of EUR 75,1 million (EUR 72,5 million on 31 March 2020). This amount relates to temporary differences as well as tax losses and unused tax credits carried forward in a total amount of EUR 289,4 million (EUR 252,1 million in financial year 2019/20) of which EUR 284,3 million can be carried forward indefinitely to future reporting periods (EUR 247,5 million in financial year 2019/20).

Colruyt Group only recognises deferred tax assets to the extent that it is probable that future taxable profit will be available against which the unused tax losses and unused tax credits can be utilised. Colruyt Group sets a time horizon of five years for these estimates.

Example Galapagos

Consolidated statements of income and comprehensive income/loss (-)

Consolidated income statement

	Year ended 31 December		
(thousands of €, except per share data)	2020	2019(*)	Notes
Revenues	478,053	834,901	6
Other income	52,207	50,896	6
Total revenues and other income	**530,260**	**885,797**	
Research and development expenditure	(523,667)	(420,090)	7
Sales and marketing expenses	(66,468)	(24,577)	7
General and administrative expenses	(118,757)	(72,382)	7
Total operating expenses	**(708,892)**	**(517,049)**	
Operating profit/loss (-)	**(178,632)**	**368,748**	
Fair value re-measurement of share subscription agreement and warrants	3,034	(181,644)	9
Other financial income	18,667	21,389	10
Other financial expenses	(152,844)	(59,968)	10
Profit/loss (-) before tax	**(309,775)**	**148,525**	
Income taxes	(1,226)	165	11
Net profit/loss (-) from continuing operations	**(311,001)**	**148,689**	

Taxes recognized in profit or loss

For the purpose of the disclosure below corporation tax was calculated at 25% (2019: 29.58%) - which is the tax rate applied in Belgium - on the estimated assessable profit for the year. The applied tax rate for other territorial jurisdictions was the tax rate that is applicable in these respective territorial jurisdictions on the estimated taxable result of the accounting year.

	Year ended 31 December	
(thousands of €)	2020	2019
Profit/loss (-) before tax	**(309,775)**	**148,525**
Income tax debit/credit (-), calculated using the Belgian statutory tax rate on the accounting profit/loss (-) before tax (theoretical)	(77,444)	43,934
Tax expenses/income (-) in income statement (effective)	**1,226**	**(165)**
Difference in tax expenses/income to explain	**78,670**	**(44,097)**
Effect of tax rates in other jurisdictions	184	960
Effect of non-taxable revenues	(10,196)	(13,079)
Effect of share-based payment expenses without tax impact	19,990	10,318
Effect of expenses/income (-) not subject to tax	(639)	53,394
Effect of non-tax-deductible expenses	1,053	724
Effect of recognition of previously non recognized deferred tax assets	(475)	(2,286)
Effect of tax losses (utilized) reversed	(150)	(136)
Effect from under or over provisions in prior periods	(25)	30
Effect of non-recognition of deferred tax assets	69,141	47,413
Effect of derecognition of previously recognized deferred tax assets	157	-
Effect of use of investment deduction	(370)	-
Effect of use of IID	-	(141,435)
Total explanations	**78,670**	**(44,097)**

The consolidated tax losses, innovation income deduction, dividend received deduction and investment deduction carried forward and the deductible temporary differences on 31 December 2020 amounted in total to €1,485.8 million (2019: €1,179.0 million), €2.7 million were related to tax losses with expiry date between 2026 and 2034.

The available statutory tax losses carried forward that can be offset against future statutory taxable profits amounted to €478.6 million on 31 December 2020 (€374.1 million on 31 December 2019). These statutory tax losses can be compensated with future statutory profits for an indefinite period except for an amount of €2.7 million in the United States and the Netherlands with expiry date between 2026 and 2034. On 31 December 2020, the available tax losses carried forward in Galapagos NV (Belgium) amounted to €416.6 million (2019: €307.7 million). In addition to the latter, Galapagos NV (Belgium) also benefits from the Belgian innovation income deduction regime which led to report, on 31 December 2020, a carried forward tax deduction amounting to €247.2 million (2019: €224.7 million) that can also be offset against future statutory taxable results. In addition, Galapagos NV (Belgium) also has available investment deduction carried forward of €1 million (2019: €1 million) and dividend received deduction carried forward of €8.4 million (2019: nil) that can be offset against future taxable profits. There is no limit in time for the innovation income deduction, the dividend received deduction and investment deduction carried forward.

With the exception of 2019, we have a history of losses. We forecast to continue incurring taxable losses in the foreseeable future as we continue to invest in clinical and preclinical development programs and discovery platforms. Consequently, no deferred tax asset was set up as at 31 December 2020, except for four subsidiaries operating on a cost plus basis , for which deferred tax assets were recognized for €4.5 million (2019: €4.2 million).

FUTURE OF TAX REPORTING

Future of tax reporting – towards greater transparency

- The lack of qualitative and quantitative data on corporate taxation has become a major limitation.
- Tax and its impact on corporate reputation is a key business issue. External stakeholders such as the media, civil society organisations, government and the public at large are showing an interest in a company's tax affairs including its strategy, and the amount of tax that it pays and where it pays those taxes.
- The OECD has taken initiatives to create greater transparency through its "country-by-country" tax reporting (not in the scope of IFRS). The expected outcome involves greater visibility into the profits realized by multinational companies in the different jurisdictions it operates in and the taxation paid per jurisdiction.
- It cannot be excluded that this greater visibility/transparency will also be translated in future in enhanced IFRS disclosure requirements allowing investors greater insights into the tax structure of companies.

CHAPTER 16 STATEMENT OF CASH FLOWS (IAS7)

PURPOSE OF A STATEMENT OF CASH FLOWS

- the flows of cash in and out of a business entity during an accounting period.
- Cash is a vital resource. Without cash a business cannot pay its employees, suppliers etc. and will eventually fail.

- Profit is not a reliable indicator of an entity's cash situation since profits are computed on the accruals basis, not the cash basis.
- The statement of cash flows focuses on the entity's cash flows and draws attention to any cash problems.

CASH AND CASH EQUIVALENTS

IAS7 states that cash comprises *"cash on hand and demand deposits"*. Bank overdrafts are generally treated as negative cash. (Cash in your hands and on bank accounts)

Cash equivalents are *"short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value"*.

"The total of cash and cash equivalents could be negative if the business has a bank overdraft."

Statements of Cash flows

- Going concern of a company is more dependent on cash resources than on its ability to generate profits

→ Why ?

Statement of cash flow example

Balance sheet at interim date:

(thousands of €)	As at 30 June 2015	As at 31 December 2014
Assets		
Intangible assets	1,575	2,015
Property, plant and equipment	11,178	10,091
Deferred tax assets	1,761	293
Non-current R&D incentives receivables	50,639	43,944
Non-current restricted cash	306	306
Other non-current assets	559	215
Non-currents assets	**66,018**	**56,864**
Inventories	361	281
Trade and other receivables	4,461	3,211
Current R&D incentives receivables	7,340	7,351
Cash and cash equivalents	397,477	187,712
Current restricted cash	6,855	10,422
Other current assets	5,751	4,625
Current assets	**422,245**	**213,603**
Total assets	**488,263**	**270,467**

(thousands of €)	Six months ended 30 June, 2015	2014
Cash and cash equivalents at beginning of period	187,712	138,175
Net income / loss (–)	(34,183)	55,866
Adjustments for:		
Tax income (–) / expenses	(1,468)	233
Financial income (–) / expenses	68	(1,538)
Depreciation of property, plant and equipment	1,165	2,151
Amortization and impairment of intangible fixed assets	638	647
Net realized gain / loss (–) on foreign exchange transactions	(309)	148
Share based compensation	985	1,540
Decrease in provisions	(80)	(52)
Increase in pension liabilities	146	
Gain on sale of service division		(67,480)
Operating cash flows before movements in working capital	(33,038)	(8,485)

Depreciation/ amortization is not a cash item, so you add these items

Operating cash flows before movements in working capital	(33,038)	(8,485)
Increase in inventories	(80)	(48)
Increase in receivables	(7,847)	(12,375)
Decrease in payables	(21,681)	(21,389)
Cash used in operations	(62,647)	(42,297)
Interest paid	(23)	(70)
Interest received	463	571
Net cash flows used in operating activities	(62,207)	(41,796)
Purchase of property, plant and equipment	(2,264)	(1,233)
Purchase of and expenditure in intangible fixed assets	(200)	(150)
Proceeds from disposal of property, plant and equipment	49	9
Disposals of subsidiaries, net of cash disposed		130,845
Increase (–) / decrease in restricted cash	3,000	(7,421)

Operational cash drain

Basically no cash from investing

Cash drain = the amount that the company use in its operations.

Rest cash = cash that you cannot free use

F.e: you take a loan and the bank ask you to have at least a certain amount on your bank account

Net cash flows generated in investing activities	585	122,050
Repayment of obligations under finance leases and other debts	(20)	(139)
Proceeds from Capital and Share premium increases	288,917	2,382
Issue costs of capital increase paid	(17,654)	
Net cash flows generated in financing activities	271,243	2,243
Effect of exchange rate differences on cash and cash equivalents	144	133
Increase in cash and cash equivalents	209,765	82,630
Cash and cash equivalents at end of period	397,477	220,805

Material cash from capital increase

Going concern confirmed

= 209.765 KEUR => The cash flow statement explains where this amount comes from/how it is generated

CLASSIFICATION OF CASH FLOWS BY ACTIVITY

Cash flows should be classified by activity. IAS7 identifies three classes of activity:

- Operating activities are "*the principal revenue-producing activities of the entity*".

- Investing activities consist of "*the acquisition and disposal of long-term assets and other investments not included in cash equivalents*".
- Financing activities are "*activities that result in changes in the size and composition of the contributed equity and borrowings of the entity*".

OPERATING ACTIVITIES

Cash flows arising from operating activities include:

(a) cash receipts from the sale of goods and services

(b) cash receipts from royalties, fees, commissions and other revenue (other income)

(c) cash payments to suppliers for goods and services (cost of sales, operating expenses)

(d) cash payments to and on behalf of employees (payroll expenses)

(e) cash payments or cash refunds of taxes unless specifically identified with investing or financing activities. (tax paid or received)

INVESTING ACTIVITIES

Cash flows arising from investing activities include:

(a) cash payments to acquire property, plant and equipment or other long-term assets

(b) cash receipts from the sale of property, plant and equipment or other long-term assets

(c) cash payments to acquire shares or debt instruments of other entities

(d) cash receipts from the sale of equity or debt instruments of other entities

(e) cash advances and loans made to other parties

(f) cash receipts from the repayment of advances and loans made to other parties.

FINANCING ACTIVITIES

Cash flows arising from financing activities include:

(a) cash proceeds from issuing shares

(b) cash payments to owners to acquire or redeem the entity's own shares

(c) cash proceeds from issuing debentures, loans and other borrowings

(d) cash repayments of amounts borrowed

(e) cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

TREATMENT OF INTEREST, DIVIDENDS, AND TAXES

In general:

- Interest received and dividends received are treated as cash inflows from investing activities.

- Interest paid on a loan acquired for operating purposes is classified under operating activities. Alternatively, interest paid might be classified under financing activities.
- Dividends paid might be classified under operating activities or financing activities.
- Cash flows arising from taxes are classified under operating activities unless specifically associated with investing or financing activities.

Interest, dividends and taxes should be classified consistently from period to period.

DIRECT METHOD AND INDIRECT METHOD

Reporting cash flows from operating activities

Cash flows from operating activities may be reported using either:

a) the **DIRECT** method, whereby major classes of receipts and payments arising from operating activities are disclosed individually, or

b) the **INDIRECT** method, which begins with the profit or loss for the period (before tax) and then makes a number of adjustments so as to calculate the total amount of cash generated from operations.

Obviously, both methods will give the same bottom-line result for cash generated from operations.

Statement of cash flows – example

Balance sheet at year-end:

(EUR million)		As at 31 December	
ASSETS	Note	2020	2021
NON-CURRENT ASSETS		**7,120**	**7,548**
Goodwill	3	2,465	2,588
Intangible assets with finite useful life	4	1,047	1,113
Property, plant and equipment	5	3,169	3,311
Right-of-use assets	6	285	274
Lease receivable		7	6
Contract costs	7	108	110
Investments in associates and joint ventures	8	0	34
Deferred income tax assets	10	12	6
Equity investments measured at fair value	9	1	1
Pension assets	11	0	80
Other non-current assets	12	24	24
CURRENT ASSETS		**1,660**	**1,685**
Inventories	13	106	132
Trade receivables	14	868	879
Lease receivable		4	0
Contract assets	14	111	120
Current tax assets	10	119	166
Other current assets	15	139	140
Investments	16	3	0
Cash and cash equivalents	17	310	249
TOTAL ASSETS		**8,779**	**9,233**

		As at 31 December	
(EUR million)	Note	2020	2021
Cash flow from operating activities			
Net income		582	445
Adjustments for:			
Depreciation and amortization	4/5/6	1,116	1,183
Impairment on current and non-current assets	3/4/5	0	2
Increase of provisions	20	3	9
Deferred tax expense/ (income)	10	14	-12
Loss from investments accounted for using the equity method	8.3	1	10
Fair value adjustments on financial instruments	29	0	1
Adjustments for finance cost (1)		2	-2
Gain on disposal of property, plant and equipment	24	-3	-1
Other non-cash movements		-1	0
Operating cash flow before working capital changes		**1,715**	**1,634**
Decrease / (increase) in inventories		27	-26
Decrease in trade receivables		123	11
Decrease/(increase) in other assets		5	-54
Decrease/ (increase) in trade payables		-68	144
Decrease in other liabilities		-50	-15
Decrease in net liability for pensions, other post-employment benefits and termination benefits	11	-238	-74
Decrease in working capital, net of acquisitions and disposals of subsidiaries		**-201**	**-13**
Net cash flow provided by operating activities		**1,515**	**1,621**

Net cash flow provided by operating activities		**1,515**	**1,621**
Cash flow from investing activities			
Cash paid for acquisitions of intangible assets and property, plant and equipment	4/5	-1,089	-1,137
Cash paid for investments in associates and joint ventures	8.4	0	-44
Cash paid for acquisition of consolidated companies, net of cash acquired	8.5	-2	-130
Net Cash received from sales of property, plant and equipment and other non-current assets		11	6
Net cash used in investing activities		**-1,081**	**-1,305**
Cash flow before financing activities		**434**	**316**
Lease payments excluding interest paid	6	-82	-79
Free cash flow		**352**	**237**
Cash flow from financing activities other than lease payments			
Dividends paid to shareholders	31	-485	-388
Dividends to and transactions with non controlling interests	18.2	-26	-217

The direct method

Major classes of operating receipts and payments are disclosed individually and are then aggregated to give the total cash generated from operations.

Typically, a statement of cash flows prepared using the direct method will disclose for operating cash flows:

- total cash receipts from customers
- total cash paid to suppliers of goods and services
- total cash paid to employees.

Subsequently you will have the cash flows from investing and financing activities.

The indirect method

This method begins with the profit or loss before tax and then makes the following adjustments:

- any non-cash expenses (e.g. depreciation, losses on disposal of plant) are added back
- any non-cash income (e.g. a decrease in the allowance for doubtful debts) is subtracted
- any increases or decreases in inventories, trade receivables/payables, accruals/prepayments are adjusted for
- any items of income or expense which are not derived from operating activities are adjusted for.

Statement of cash flows – class exercise

Statement of comprehensive income of Bramble Ltd for the year ended 31 December 2010

	2010 €'000
Revenu	1,800
Cost of sales	(950)
Gross profit	850
Distribution costs	(120)
Administrative expenses	(80)
Other expenses	(100)
Finance costs	(20)
Profit before tax	530
Income tax expense	(148)
Profit for the year from continuing operations	382

Statement of financial position of Bramble Ltd at 31 December 2010

	2010 €'000	**2009 €'000**
Assets		
Non-current assets		
Property, plant and equipment	1,693	555
Intangible assets	250	250
	1,943	805
Current assets		
Inventories	269	240
Trade receivables	395	322
Cash and cash equivalents	155	130
	819	692

PPE so by definition we know that they have done investment

Statement of financial position of Bramble Ltd at 31 December 2010

	2010 €'000	2009 €'000
Liabilities		
Current liabilities		
Trade payables	212	182
Accrued interest	5	3
Current tax payable	148	130
	365	315
Non-current liabilities		
Term loan	120	135
Net assets	2,277	1,047
Equity		
Share capital	270	100
Share premium	1,150	402
Revaluation reserve	80	80
Retained earnings	777	465
Total equity	2,277	1,047

Out of that 20 (income statement) I've only have paid 2(3 → 5, accrued interest)

Short capital => capital increase

The following information is available:

(i) Cost of sales includes depreciation of € 60,000.
(ii) There were no disposals of non-current assets during 2010.
(iii) Expenses in the statement of comprehensive income include the following payments to employees:
* cost of sales € 250,000
* distribution € 25,000
* administration € 20,000
(iv) A dividend of € 70,000 was paid in March 2010.

Direct method

(a) Statement of cash flows for the year ended 31 December 2010 (direct method)

	€'000	€'000
Cash flows from operating activities		
Cash receipts from customers	1,727	
Cash paid to suppliers	(894)	
Cash paid to employees	(295)	
Cash generated from operations	538	
Interest paid	(18)	
Income tax paid	(130)	
Net cash flow from operating activities		390
Cash flows from investing activities		
Purchase of property, plant and equipment		(1,198)
Cash flows from financing activities		
Proceeds from issue of share capital	918	
Repayment of long-term loan	(15)	
Dividends paid	(70)	
Net cash flow from financing activities		833
Net increase in cash and cash equivalents		25
Cash and cash equivalents at 1 January 2010		130
Cash and cash equivalents at 31 December 2010		155

Profit bel tax	530
Depreciation	+60
Interest expense	+20
	=610

INDIRECT METHOD

(b) Statement of cash flows for the year ended 31 December 2010 (indirect method)

	€'000	€'000
Cash flows from operating activities		
Profit before taxation	530	
Adjustments for:		
Depreciation	60	
Interest expense	20	
	610	
Increase in trade receivables	(73)	
Increase in inventories	(29)	
Increase in trade payables	30	
Cash generated from operations	538	
Interest paid	(18)	
Income tax paid	(130)	
Net cash from operating activities		390
Cash flows from investing activities		
Purchase of property, plant and equipment		(1,198)
Cash flows from financing activities		
Proceeds from issue of share capital	918	
Repayment of long-term loan	(15)	
Dividends paid	(70)	
Net cash flow from financing activities		833
Net increase in cash and cash equivalents	25	
Cash and cash equivalents at 1 January 2010	130	
Cash and cash equivalents at 31 December 2010	155	

DISCLOSURES REQUIRED BY IAS7

Entities must disclose the components of their cash and cash equivalents and present a reconciliation of these amounts in the statement of cash flows with the equivalent items reported in the statement of financial position.

Entities are also encouraged (but not required) to supply further information, such as:

- the amount of any undrawn borrowing facilities
- an analysis of cash flows by segment (where a segment is a distinguishable component of a business entity).

CHAPTER 24 SEGMENT INFORMATION (IFRS8)

INTRODUCTION TO SEGMENTAL ANALYSIS

- An entity whose shares are publicly traded may engage in a wide variety of business activities and operate in a number of economic environments.
- Each activity or environment may be subject to differing rates of profitability, differing opportunities for growth, differing future prospects and differing risks.
- A segment report provides separate information about each of an entity's "segments" and enables users to evaluate the nature and financial effects of the activities in which the entity engages and the economic environments in which it operates.

DEFINITION OF "OPERATING SEGMENT"

IFRS8 defines an operating segment as *"a component of an entity…":*

a) *that engages in business activities from which it may earn revenues and incur expenses…,*

b) *whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and*

c) *for which discrete financial information is available."*

In general, each operating segment will be managed by a segment manager who reports to the chief operating decision maker.

REPORTABLE SEGMENTS

- IFRS8 requires an entity to provide separate information about each of its **"reportable segments".** This information is disclosed in the notes to the financial statements.
- A reportable segment will usually comprise a single operating segment but two or more operating segments may be combined into one reportable segment if they have similar economic characteristics and are similar in certain other respects.
- So in order to identify reportable segments, you first need to identify the operating segments. Subsequently you assess whether two or more operating segments can be combined into one reportable segment.

THE 10% THRESHOLDS

A reportable segment is a single or combined operating segment which meets any of the following quantitative thresholds:

- its revenue (external and internal) is at least 10% of total revenue, or
- its profit or loss is at least 10% of the total profit of the segments that reported a profit or the total loss of the segments that reported a loss, whichever is the greater
- its assets are at least 10% of total assets.

THE 75% RULE

If the total external revenue attributable to reportable segments is less than 75% of total external revenue, additional segments must be identified as reportable (even though they are beneath all the 10% thresholds) until at least 75% of total external revenue is included in reportable segments.

REQUIRED DISCLOSURES:

- General information
- Information about reportable segments
- Reconciliations to overall financial statements (aggregate of segments = consolidated financials)
- Entity-wide information

GENERAL INFORMATION

- An entity should disclose the factors used to identify its reportable segments and the types of products or services from which each reportable segment earns its revenues.

- The way in which the entity is organised internally should be made clear.
- The entity should also disclose whether or not any operating segments have been combined for segment reporting purposes.

INFORMATION ABOUT EACH REPORTABLE SEGMENT

- Segment profit or loss
  and, if provided to the chief operating decision maker:
- Segment total assets
- Segment total liabilities
- Segment external and internal revenue
- Segment interest expense and interest revenue
- Segment depreciation and amortisation
- Segment tax expense or income
- Segment non-cash items other than depreciation and amortisation (if material)
- Segment additions to non-current assets

RECONCILIATIONS

- total revenue of reportable segments to the entity's revenue
- total profit or loss of reportable segments to the entity's profit or loss
- total assets of reportable segments to the entity's assets
- total liabilities of reportable segments to the entity's liabilities

ENTITY-WIDE INFORMATION

- revenue for each product or service (or each group of products or services)
- revenue and non-current assets for the entity's home country and (in total) for all foreign countries
- if any single customer accounts for at least 10% of total external revenue, the amount of revenue derived from each such "major customer"

Example 1 – Ahold Delhaize

6 SEGMENT REPORTING

Reportable segments

Ahold Delhaize's retail operations are presented in two reportable segments. In addition, Other retail, consisting of Ahold Delhaize's unconsolidated joint ventures JMR – Gestão de Empresas de Retalho, SGPS, S.A. ("JMR") and P.T. Lion Super Indo ("Super Indo"), as well as Ahold Delhaize's Global Support Office, is presented separately.

All reportable segments sell a wide range of perishable and non-perishable food and non-food consumer products.

Reportable segment	Operating segments included in the Reportable segment
The United States	Stop & Shop, Food Lion, The GIANT Company, Hannaford, Giant Food, FreshDirect and Peapod[1]
Europe	Albert Heijn (including the Netherlands and Belgium) Delhaize ("Delhaize Le Lion" including Belgium and Luxembourg) bol.com (including the Netherlands and Belgium) Albert (Czech Republic) Alfa Beta (Greece) Mega Image (Romania) Delhaize Serbia (Republic of Serbia) Etos (the Netherlands) Gall & Gall (the Netherlands)

Other	Included in Other
Other retail	Unconsolidated joint ventures JMR (49%) and Super Indo (51%)
Global Support Office	Global Support Office staff (the Netherlands, Belgium, Switzerland and the United States)

1 On February 18, 2020, Ahold Delhaize USA closed the Midwest division of its Peapod online grocery sales business.

Example 2 – Carrefour

NOTE 5: SEGMENT INFORMATION

Accounting principles

IFRS 8 – *Operating Segments* requires the disclosure of information about an entity's operating segments derived from the internal reporting system and used by the entity's chief operating decision-maker to make decisions about resources to be allocated to the segment and assess its performance. The Group's operating segments consist of the countries in which it conducts its business through the integrated store network, as each country's results are reviewed monthly by the Group's Chief Executive Officer who is the chief operating decision-maker within the meaning of IFRS 8.

Countries located in the same region are considered to have similar characteristics and have been combined to create four geographical segments, as allowed by IFRS 8. These segments are:

- France;
- Rest of Europe: Spain, Italy, Belgium, Poland and Romania;
- Latin America: Brazil and Argentina;
- Asia: Taiwan.

The income and expenses of certain support entities are allocated to the various countries proportionately to the services provided to each, with any unallocated income and expenses reported under "Global functions".

Segment assets include goodwill, other intangible assets, property and equipment, investment property, right-of-use assets and "other segment assets", corresponding to inventories, trade receivables, consumer credit granted by the financial services companies and other receivables. Segment liabilities comprise lease commitments, suppliers and other creditors, consumer credit financing and other payables.

Segment capital expenditure corresponds to the acquisitions of property and equipment and intangible assets (other than goodwill) reported in the statement of cash flows.

The disclosures in the tables below have been prepared using the same accounting policies as those applied to prepare the consolidated financial statements.

5.1 Segment results

2021 *(in millions of euros)*	**Group total**	**France**	**Europe**	**Latin America**	**Asia**	**Global Functions**
Net sales	72,958	35,283	21,283	13,895	2,497	–
Other revenue	2,181	759	567	699	90	67
Recurring operating income before depreciation and amortisation	**4,550**	**1,797**	**1,560**	**993**	**243**	**(43)**
Recurring operating income	**2,272**	**757**	**718**	**768**	**78**	**(49)**
Capital expenditure [1]	1,653	677	403	493	69	12
Depreciation and amortisation expense [2]	(2,277)	(1,040)	(843)	(224)	(165)	(6)

2020 *(in millions of euros)*	**Group total**	**France**	**Europe**	**Latin America**	**Asia**	**Global Functions**
Net sales	70,719	34,135	21,239	13,245	2,100	–
Other revenue	2,183	789	608	635	88	62
Recurring operating income before depreciation and amortisation	**4,465**	**1,693**	**1,565**	**999**	**225**	**(18)**
Recurring operating income	**2,173**	**629**	**698**	**786**	**94**	**(33)**
Capital expenditure [1]	1,491	582	314	548	34	14
Depreciation and amortisation expense [2]	(2,292)	(1,065)	(867)	(214)	(131)	(15)

Example 3 – Greenyard

4. Segment information

For management purposes, the Group is organised into two operating segments based on the Group's activities.

The Fresh segment is a worldwide market leader and supplier of fresh fruit and vegetables, flowers and plants, and fresh produce logistics. Segment Long Fresh includes the Frozen and Prepared activities. Frozen is a pioneer and market leader that processes freshly harvested fruits and vegetables into frozen food products that are easy to store and take little or no time to prepare. Prepared is a global player in freshly preserved fruit, vegetables, mushrooms and other ambient food products that are easy to store and ready to eat.

An overview of the companies included in the different segments is provided in note 7.1. *Subsidiaries, associates, joint ventures and investments recorded at cost.*

Management assesses segment performance and allocates resources based on adjusted EBITDA and sales. Note that we presented an adjusted EBITDA pre-IFRS 16 as well as post-IFRS 16, in transition to a full post-IFRS 16 EBITDA segment reporting in 21/22.

The segment's assets are assets belonging directly to it. Segment assets and segment sales are presented before elimination of intersegment transactions. Sales between segments are on an arm's length basis in a manner similar to transactions with third parties.

Segment information AY 20/21	Continuing operations				
	Fresh	Long Fresh	Eliminations [1]	Unallocated [2]	Consolidated
	€'000	€'000	€'000	€'000	€'000
Sales	3 593 362	823 892	-1 027	-	4 416 227
Third party sales	3 592 680	823 547	-	-	4 416 227
Intersegment sales	682	346	-1 027	-	-
Adjusted EBITDA (post-IFRS 16)	95 064	62 562	-	-706	156 919
IFRS 16 impact	-35 423	-4 573	-	-371	-40 367
Adjusted EBITDA	59 641	57 989	-	-1 077	116 552
Total assets at 31 March 2021	1 279 702	571 153	-31 039	122 316	1 942 133

Segment information AY 19/20	Continuing operations				
	Fresh	Long Fresh	Eliminations [1]	Unallocated [2]	Consolidated
	€'000	€'000	€'000	€'000	€'000
Sales	3 264 386	797 976	-1 370	-	4 060 992
Third party sales	3 263 356	797 636	-	-	4 060 992
Intersegment sales	1 030	340	-1 370	-	-
Adjusted EBITDA (post-IFRS 16)	76 303	58 389	-	-1 250	133 442
IFRS 16 impact	-32 902	-4 470	-	-369	-37 741
Adjusted EBITDA	43 401	53 919	-	-1 619	95 701
Total assets at 31 March 2020	1 276 383	548 064	-57 094	197 571	1 964 923

CHAPTER 21 – PART 1 RELATED PARTY DISCLOSURES (IAS 24)

OBJECTIVE OF IAS24

The objective of IAS24 is to ensure that financial statements contain certain **disclosures.** These should draw attention to the possibility that an entity's financial performance and position may have been affected by the existence of related parties and transactions with those parties. (You want to know how much of your sales are related to another party)

Related Party disclosures are necessary because related parties might enter into transactions that unrelated parties would not.

Such transactions may involve:

(a) the transfer of assets or liabilities at prices which are above or below their true value

(b) the supply of services at reduced or increased prices
(c) the making of loans at interest rates which differ from market rates.

DEFINITION OF A RELATED PARTY

A person P or a close member of that person's family is related to a reporting entity if either of the following conditions applies:

- P has control, joint control or significant influence over the reporting entity;
- P is a member of the key management personnel of either the reporting entity or a parent of the reporting entity.

Entity E is related to a reporting entity if any of the following conditions apply:

i. E and the reporting entity belong to the same group
ii. E is an associate or joint venture of the reporting entity (or vice versa)
iii. E and the reporting entity are both joint ventures of the same third party

iv. E is an associate of a third entity and the reporting entity is a joint venture of that same third entity (or vice versa)
v. E is a pension scheme for the benefit of the employees of the reporting entity or of any entity which is related to the reporting entity.

Entity E is also related to the reporting entity if either of the following conditions applies:

vi. E is controlled or jointly controlled by a person who is related to the reporting entity
vii. A person who has control, joint control or significant influence over the reporting entity (or a close family member of such a person) has significant influence over E or is a member of the key management personnel of E or of a parent of E.

IAS24 DISCLOSURE REQUIREMENTS

The main disclosures required by IAS24 include:

- Parent-subsidiary relationships (whether or not there have been any transactions between these parties)
- Employee benefits paid or payable to key management personnel
- For related parties with whom there have been transactions:
    - the nature of the relationship
    - information about the transactions and any outstanding balances
- As necessary for an understanding of the effect of the relationship on the financial statements.

Example disclosure Related parties – Proximus

Note 33. Related party disclosures

Note 33.1. Consolidated companies

Subsidiaries, joint operations, joint-ventures and associates are listed in note 8.

Commercial terms and market prices apply for the supply of goods and services between Group companies.

The transactions between Proximus SA and its subsidiaries being related parties, are eliminated for the preparation of the consolidated financial statements. The transactions between Proximus SA and its subsidiaries are as follows:

Proximus SA transactions with its subsidiairies and joint operations	Year ended 31 December	
(EUR million)	2019	2020
Revenues	174	156
Costs of materials and services related to revenue	-146	-140
Net finance costs	1	1
Dividends received	92	391
Gain on contribution of financial fixed assets	437	94

Proximus SA transactions with its subsidiairies and joint operations	As of 31 December	
(EUR million)	2019	2020
Trade receivables	32	27
Trade payables	-42	-33
Interest-bearing receivables/liabilities	-1.022	-767
Other receivables and liabilities	-1	-1

The state is a related party of Proximus. They own +-50% of Proximus.

Note 33.2. Relationship with shareholders and other State-controlled enterprises.

The Belgian State is the majority shareholder of the Group, with a stake of 53.51%. The Group holds treasury shares for 4.54%. The remaining 41.95% are traded on the First Market of Euronext Brussels.

Relationship with the Belgian State

The Group supplies telecommunication services to the Belgian State and State-related entities. State related enterprises are those that are either State-controlled or State-jointly-controlled or State-influenced. All such transactions are made within normal customer/supplier relationships on terms and conditions that are not more favourable than those available to other customers and suppliers. The services provided to State-related enterprises do not represent a significant component of the Group's net revenue, meaning less than 5%.

Note 33.3. Relationship with key management personnel

The remuneration of the Board of Directors was decided by the General Shareholders' Meeting of 2004.

The principles of this remuneration remained applicable in 2020 and no substantial change of the policy is expected: it foresees an annual fixed compensation of EUR 50,000 for the Chairman of the Board of Directors and of EUR 25,000 for the other members of the Board of Directors, with the exception of the CEO. All members of the Board of Directors, with the exception of the CEO, have the right to an attendance fee of EUR 5,000 per attended meeting of the Board of Directors. This fee is doubled for the Chairman.

Entities controlled by the state are also related parties (minesteries...)

CHAPTER 21 – PART 2 THE EFFECT OF CHANGES IN FOREIGN EXCHANGE RATES (IAS21)

IAS21 DEFINITIONS

IAS21 includes the following definitions:

- An entity's **functional currency** is "the currency of the primary economic environment in which the entity operates".
    - For the most Belgium companies it's the Euro
    - But for example AB InBev it's the US dollar.
- A **foreign currency** is "a currency other than the functional currency of the entity".
- An entity's **presentation currency** is "the currency in which the financial statements are presented".
- A **foreign operation** is "an entity that is a subsidiary, associate, joint arrangement or branch of a reporting entity, the activities of which are based or conducted in a country

DETERMINATION OF FUNCTIONAL CURRENCY

When determining its functional currency, an entity should consider the following main factors:

- the currency that mainly influences sales prices for its goods and services (which is often the currency in which these prices are denominated and settled)
- the currency of the country whose competitive forces and whose regulations mainly determine the sales prices of its goods and services
- the currency that mainly influences labour, materials and other costs of providing goods and services (which is often the currency in which such costs are denominated and settled).

FOREIGN CURRENCY TRANSACTIONS

IAS21 defines a foreign currency transaction as "a transaction that is denominated or requires settlement in a foreign currency". This definition includes transactions arising when an entity:

- buys or sells goods or services whose price is denominated in a foreign currency;
- borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency;
-
- otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

Initial recognition of foreign currency transactions

On initial recognition, a foreign currency transaction should be recorded in the entity's functional currency by applying the spot exchange rate between the functional currency and the foreign currency as at the date of the transaction.

→ The spot exchange rate is defined as "the exchange rate for immediate delivery".

Subsequent measurement of foreign currency transactions

Foreign currency items appearing in the statement of financial position should be translated as follows:

- monetary items should be translated using the spot exchange rate at the end of the period;
- non-monetary items carried at cost should be translated using the exchange rate at the date of the transaction which gave rise to the item;
- non-monetary items carried at fair value should be translated using the exchange rate at the date that the item's fair value was measured.

TRANSLATION TO A PRESENTATION CURRENCY

Although most entities present their financial statements in their functional currency, IAS21 allows entities to use a different presentation currency if they wish.

The process of translating from the functional currency to the presentation currency is as follows:

- Assets and liabilities are translated at the closing rate at the end of the reporting period;
- Income and expenses are translated at the exchange rates which applied on the dates of the transactions concerned;
- The resulting exchange differences are recognised in other comprehensive income.

TRANSLATION OF A FOREIGN OPERATION

- If an entity has a foreign operation (e.g. a foreign subsidiary, associate or joint venture) it will be necessary to translate the financial statements of that operation into the same currency as is used in the entity's own financial statements.
- Only then will it be possible to include the foreign operation in the entity's financial statements by consolidation or by the equity method.

- The translation process is the same as the process adopted when translating an entity's financial statements from a functional currency to a presentation currency.

For example, give an employee a stock option in place of a party of the loan.

For example start-ups prefers to give their cash to their research! Afterwards their employees will be rewarded in the long run when their company will do some benefits.

But flip-side: tax and decline of share price

PART 1: SCOPE OF IFRS 2

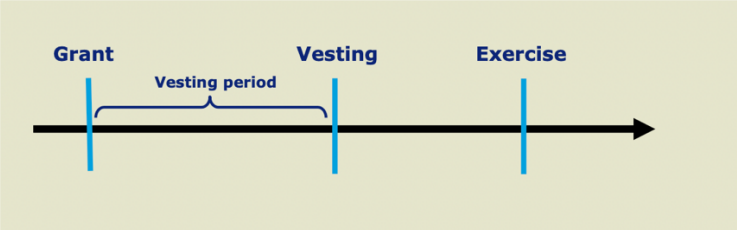
Share-based payment transactions

- A shared-based payment transaction is a transaction in which the entity:
  - Receives goods or services from the supplier of those goods or services (including an employee) in a share-based payment arrangement, or
  - Incurs an obligation to settle the transaction with the supplier in a share-based payment arrangement when another group entity receives those goods or services.
- A share-based payment arrangement is "an agreement between the entity (or another group entity or any shareholder of any group entity) and another party (including an employee) that entitles the other party to receive:
  - Cash or other assets of the entity for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity or another group entity, or
  - Equity instruments (including shares or share options) of the entity or another group entity, provided the specified vesting conditions, if any, are met.

Focus for this session is on share-based payments made to employees!!

General principles

The life of a stock option:



(Know more info about stocks)

(Vesting period: the period to be the full owner of a stock options)

- The issuance of shares or rights to shares requires an increase in a component of equity.
- IFRS 2 requires the offsetting debit entry to be expensed when the payment for goods or services does not represent an asset. The expense should be recognised as the goods or services are consumed.
- The amount charged as an expense will be measured at the fair value of the goods or services received unless, for equity-settled transactions, that fair value cannot be estimated reliably.
- In these cases, which are deemed to include employee share options, the fair value of the equity instruments granted should be measured.

PART 2: CLASSIFICATION AND RECOGNITION

Context: we pay our employee with stock options.

TOPIC 1: GRANT DATE AND MEASUREMENT DATE

Grant date

In a share-based payment arrangement with employees:

The grant date is the date on which an entity and an employee agree to a share-based payment arrangement.

Typically this is when the stock options are offered and accepted by the employee.

Measurement date

Measurement date is defined as "the date at which the fair value of the equity instruments granted is measured... For transactions with parties other than employees (and those providing similar services), the measurement date is the date the entity obtains the goods or the counterparty renders service.".

In a share-based payment arrangement with employees

In case the payments take the form of equity instruments (stock options), the grant date is the measurement date. (So, in our context it is the same day!)

Key learning points

Grant date is the date at which:

- The entity and another party (including an employee) agree to a share-based payment arrangement.
- The entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met; and
- Approval is obtained (if subject to an approval process).

Measurement date is the date at which the fair value of the equity instruments granted is measured.

- It is the grant date for the transactions with the employees and others providing similar services.
- It is the date that the entity obtains the goods or the counterparty renders service for the transactions with parties other than employees (and those providing similar services).

TOPIC 2: CASH-SETTLED VS EQUITY-SETTLED TRANSACTIONS

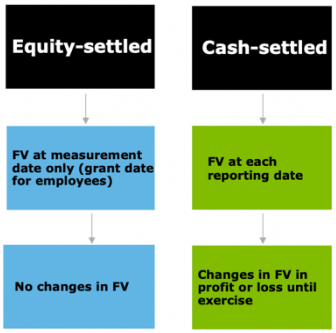
Cash-settled and equity-settled

The goods or services received or acquired in a share-based payment transaction are recognized when the goods are obtained or as the services are received.

A corresponding increase in equity is recognised if the goods or services were received in an equity-settled transaction.

A liability is recognised if the goods or services were acquired in a cash-settled transaction.

Cash-settled and equity-settled transactions – measurement



Equity-settled share based payment

- The fair value of the share-based payment is measured at grant date, and is not subsequently remeasured.
- For transactions with employees, the fair value of the equity instruments granted shall be measured at grant date.

Cash-settled share based payment

- Cash-settled transactions will result in the credit side of the entry being a liability (not equity).
- The liability will continue to be re-measured until the liability is settled.
- IFRS 2 clarifies that the effects of remeasurement should be recognized in profit or loss.

Fair value determination

= Fair value of the equity instruments granted

Fair value = the amount at which market participants would be willing to conduct transactions (the observable market price).

When market prices do not exist for share options, the fair value should be determined by applying a valuation technique, usually in the form of an option pricing model:

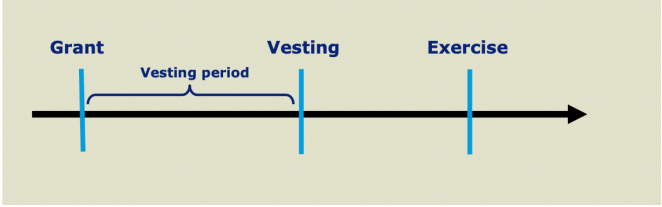
- Black-Scholes model
    - Just some excel
- Binomial model
- Monte Carlo model
    - ⇨ For the two other model companies bring an expert in

These models can get complex and require management to determine many parameters in the model.

Examples of parameters affecting the valuation of share-based payments:

- The exercise price of the option
- Current price of the underlying shares
- The expected life of the option
- The expected volatility of the share price
- The dividends expected on the shares
- The risk-free interest rate over the expected life of the option

TOPIC 3: VESTING CONDITION



Vesting condition

Vesting = "to become an entitlement"

> to have fully earned the right to the shares under a share-based payment plan, after all vesting conditions have been met

The vesting of shares or share options to an employee is often conditional on the employee remaining in the employment of the entity for a specified period of time (=service condition).

Alternatively, or in addition, there may be performance conditions that must be satisfied, such as the entity achieving a specified growth in earnings per share or a specified increase in the entity's share price.

The vesting of equity instruments might be conditional upon satisfying such specified vesting conditions.

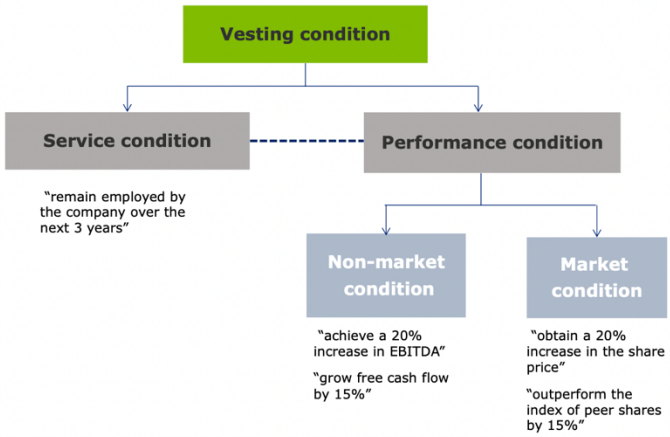
Vesting period

The vesting period is the period during which all the specified vesting conditions of a share-based payment arrangement are (to be) satisfied.

If the equity instruments granted do not vest until the counterparty completes a specified period of service, it is presumed that the service period equals the vesting period.

Types of vesting conditions

- Performance condition
  ... a vesting condition that requires:
  a) The counterparty to complete a specified period of service (i.e., a service condition); the service requirement can be explicit or implicit; and
  b) Specified performance target(s) to be met while the counterparty is rendering the service



A performance target is defined by reference to:

- The entity's own operations (or activities) or the operations or activities of another entity in the same group (i.e., a non-market condition) or
- The price (or value) of the entity's equity instruments or the equity instruments of another entity in the same group (including shares and share options) (i.e., a market condition).

- Market condition

  ... a performance condition upon which the exercise price, vesting or exercisability of an equity instrument relates to the market price (or value) of the equity instruments of the entity (or its another entity in the same group), such as:

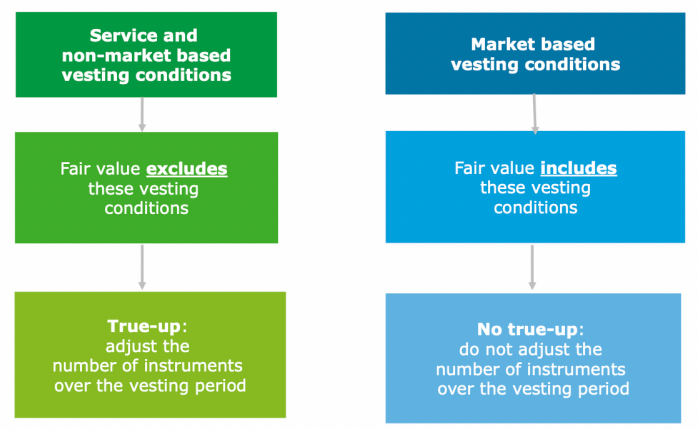
  - Attaining a specified share price
  - Attaining a specified amount of intrinsic value of a share option

- Achieving a specified target relative to an index of market prices of equity instruments of other entities

A market condition requires the counterparty to complete a specified period of service (i.e., a service condition); the service requirement can be explicit or implicit.

TOPIC 4: RECOGNITION OVER THE VESTING PERIOD

Recognition of share-based payment transactions



Example: True up

Facts:

Entity A grants 50 employees 100 share options each, which vest if the employees remain in the employment of Entity A for three years. The fair value of the options at grant date is CU10.

Vesting period	Estimated no. of employees remain in employment	Calculation	IFRS 2 expense
At the outset	45	45*100*CU10*1/3	CU15,000
End of year 1	44	44*100*CU10*1/3	CU14,666
End of year 2	43	(43*100*CU10*2/3) -14,666	CU14,000
End of year 3	40 (actual)	(40*100*CU10*3/3)-14,666-14,000	CU11,334

At the end of year 1 we revisit the number of employees we expect.

Employee turnover is the only parameter that we can no estimate with the black-Scholes method.

Example: Vesting date (not seen in class)

Facts:

Entity A issued share appreciation rights ("SARs") to 10 of its employees that vest after 3 years, if the employees remain employed by Entity A. Each SAR provides for a cash payment equal to the amount the share price of Entity A's common shares exceeds $10 per share. No payment will be made if Entity

A's share price is at, or below, $10. The fair values of the SARs expected to vest over a three-year vesting period are:

- End of year 1: $120
- End of year: $210
- End of year 3: $300

Assume the number of employees expected to remain in employment at the end of years 1 and 2 are 10 and 9, respectively. At the end of year 3, 8 employees remain.

What should be the journal entries for years 1 to 3?

The following entries would be made:

Year 1	
Dr Expense	$400 ($120 x 10 x 1/3)
Cr Liability	$ 400
Year 2	
Dr Expense	$860 ($210 x 9 x 2/3 – 400)
Cr Liability	$ 860
Year 3	
Dr Expense	$1,140 ($300 x 8 x 3/3-860-400)
Cr Liability	$ 1,140

If the SARs are not exercised at the vesting date, the liability should continue to be re-measured at its fair value, with changes recognized in profit or loss.

Key learning points

Vesting conditions affect the timing of recognition and measurement of share-based payment transactions.

Share-based payments are recorded and accounted for over the vesting period.

The distinction between the accounting for market and non-market conditions is:

- For equity-settled share-based payment transactions, market conditions will be taken into account once - on valuation on the measurement date.
  This measurement would not change over the life of the instrument.
- For cash-settled share-based payment transactions, e.g., SARs, fair value is determined at each reporting date and therefore takes into account changes in market based vesting conditions during the period.
- Non-market conditions will not affect grant date valuation, but will affect the number of shares used in calculating the IFRS 2 expense.

Overview recognition and measurement

Equity-settled	Cash-settled	With cash-alternatives
Expensed* against equity	Expensed* against liability	Expensed* against liability/equity ("Split accounting")
Fair value measured at grant date only	Fair value measured at each balance sheet date	Equity Component Cash Component

* Except when the goods or services received / acquired qualify for recognition as assets

Disclosures

- Nature and extent of share-based payment arrangements
- Description of each type of share-based payment
- Number and weighted average exercise prices of share options
- The weighted average share price at the date of exercise of share options exercised during the period
- How the fair value of goods or services received, or the fair value of equity instruments granted was determined
- The effect of share-based payment transaction
    - on the entity's profit or loss for the period
    - on its financial position

Example disclosure share based payments- Galapagos

Share-based payments

(i) Equity-settled share-based payments

We grant equity-settled incentives to certain employees, members of the supervisory board and consultants in the form of subscription rights. Equity-settled subscription rights are measured at fair value at the date of acceptance. The fair value determined at the acceptance date of the subscription rights is expensed over time until the end of the vesting period, based on our estimate of subscription rights that are expected to be exercised. Fair value is measured by use of the Black & Scholes model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioral considerations.

Consolidated statements of changes in equity

(thousands of €)	Share capital	Share premium account	Translation differences	Other reserves	Accumul. losses	Total
On 1 January 2019	236,540	1,277,780	(1,557)	(735)	(297,779)	1,214,249
Change in accounting policy (modified retrospective application IFRS 16)					416	416
Restated total equity at 1 January 2019	236,540	1,277,780	(1,557)	(735)	(297,363)	1,214,665
Net profit					149,845	149,845
Other comprehensive income/loss (-)			415	(4,107)		(3,692)
Total comprehensive income/loss (-)			415	(4,107)	149,845	146,154
Share-based compensation					38,297	38,297
Derecognition of financial liability from share subscription agreement and warrant A		135,702				135,702
Issue of new shares	36,945	923,142				960,087
Share issue costs	(4,447)					(4,447)
Exercise of warrant A by Gilead	14,162	353,873				368,035
Exercise of subscription rights	4,082	13,085				17,167
On 31 December 2019	287,282	2,703,583	(1,142)	(4,842)	(109,223)	2,875,658

29. Share based payments

Subscription right plans

Presented below is a summary of subscription right activities for the reported periods. Various subscription right plans were approved for the benefit of our employees, and for members of the supervisory board and independent consultants of Galapagos NV.

The subscription rights granted under subscription right plans created from 2011 onwards vest at the end of the third calendar year following the year of the grant, with no intermediate vesting.

The subscription rights offered to members of the supervisory board vest over a period of 36 months at a rate of 1/36th per month. As of 2020, we no longer grant subscription rights to supervisory board members.

Subscription rights cannot be exercised before the end of the third calendar year following the year of the grant. In the event of a change of control over Galapagos NV, all outstanding subscription rights vest immediately and will be immediately exercisable.

The table below sets forth a summary of subscription rights outstanding and exercisable on 31 December 2020, per subscription right plan:

Subscription right plan	Allocation date	Expiry date	Exercise price (€)	Outstanding per 1 January 2020	Granted during the year	Exercised during the year	Forfeited during the year	Expired during the year	Outstanding per 31 December 2020	Exercisable per 31 December 2020
BNL (2006)	21.12.2007	20.12.2020	7.12	1,050		(1,050)			-	-
2007 RMV	25.10.2007	24.10.2020	8.65	14,980		(14,980)			-	-
2008	26.06.2008	25.06.2021	5.60	1,365					1,365	1,365
2012	03.09.2012	02.09.2020	14.19	80,040		(80,040)			-	-
2013	16.05.2013	15.05.2021	19.38	120,434		(64,770)			55,664	55,664
2014	25.07.2014	24.07.2022	14.54	252,340		(83,000)			169,340	169,340
2015	30.04.2015	29.04.2023	28.75	282,473		(63,000)			219,473	219,473
2015 (B)	22.12.2015	21.12.2023	49.00	329,500		(68,000)			261,500	261,500
2015 RMV	22.12.2015	21.12.2023	49.00	57,500		(17,500)			40,000	40,000
2016	01.06.2016	31.05.2024	46.10	504,250		(161,625)			342,625	342,625
2016 RMV	01.06.2016	31.05.2024	46.10	120,000		(51,000)			69,000	69,000
2016 (B)	20.01.2017	19.01.2025	62.50	150,000		(140,000)			10,000	10,000
2017	17.05.2017	16.05.2025	80.57	595,500					595,500	-
2017 RMV	17.05.2017	16.05.2025	80.57	127,500					127,500	-
2018	19.04.2018	18.04.2026	79.88	1,085,245			(2,000)		1,083,245	-

The table below sets forth the inputs into the valuation of the subscription rights.

	2020	2020 RMV	2019	2019 RMV
	17 April 2020	17 April 2020	10 April 2019	10 April 2019
Exercise Price (€)	168.42	168.42	95.11	95.11
Weighted average share price at acceptance date (€)	178.95	178.95	107.05	107.45
Weighted average fair value on the acceptance date (€)	86.45	85.79	40.04	40.05
Weighted average estimated volatility (%)	51.30	51.32	35.86	35.63
Weighted average expected life of the subscription right (years)	6	6	6	6
Weighted average risk free rate (%)	(0.44)	(0.44)	(0.27)	(0.28)
Expected dividends	None	None	None	None

The exercise price of the subscription rights is determined pursuant to the applicable provisions of the Belgian Law of 26 March 1999.

The weighted average estimated volatility is calculated on the basis of the implied volatility of the share price over the expected life of the subscription rights.

The weighted average expected life of the subscription right is calculated as the estimated duration until exercise, taking into account the specific features of the plans.

Our share based compensation expense in 2020 amounted to €79,959 thousand (2019: €38,297 thousand).

CHAPTER 18 :THE GROUP STATEMENT OF FINANCIAL POSITION (IFRS10, IFRS3)

⇨ consolidation aspects related to the balance sheet

CONSOLIDATED FINANCIAL STATEMENTS

- IFRS10 defines consolidated financial statements as *"the financial statements of a group … presented as those of a single economic entity"*.
- Consolidated financial statements are often referred to as group financial statements, or simply *group accounts*.
- A group consists of a parent company together with one or more subsidiary companies which are controlled by the parent company. The shareholders of a parent company have an indirect interest in the net assets and in the profits or losses of the company's subsidiaries.

Accordingly, parent companies are required to prepare and present a set of accounts for the group as a whole.

KEY DEFINITIONS

IFRS10 includes the following key definitions:

- A group is *"a parent and its subsidiaries".*
- A parent is *"an entity that controls one or more entities".*
- A subsidiary is *"an entity that is controlled by another entity".*
- Control exists *"when the investor is exposed ... to variable returns from its involvement with the investee* AND *has the ability to affect those returns through its power over the investee".*

EXEMPTIONS

A parent company need not prepare group accounts if:

- the parent company is itself a wholly-owned subsidiary or a partially-owned subsidiary (and its other owners do not object to the company not preparing group accounts), *and*
- the parent's shares are not publicly traded, *and*
- the parent's ultimate parent company presents group accounts that comply with international standards.

CONTROL

An investor company has control over an investee if it has the power to direct the investee's activities. Rights which may give this power include:

- voting rights
- the right to appoint or remove members of the investee's key management personnel
- the right to direct the investee to enter into transactions for the investor's benefit
- contractual rights.

In straightforward cases, power is achieved by owning more than 50% of the investee's ordinary shares.

However business reality is often not straightforward! Careful analysis is needed of the facts and circumstances.

GROUP STATEMENT OF FINANCIAL POSITION ON THE DATE OF ACQUISITION

- A group statement of financial position is prepared by adding together (line by line) the individual statements of financial position of all of the companies in the group. This process is known as "consolidation".

- Items which appear as an asset in the financial statements of one group company and as a liability (or equity) in the financial statements of another group company are cancelled out.

- In particular, the cost of the parent's investment in a wholly-owned subsidiary is cancelled out with the subsidiary's share capital and reserves.

The adjustments required for partly-owned subsidiaries are more complex.

GOODWILL ARISING ON CONSOLIDATION

IFRS3 requires that goodwill arising on consolidation should be calculated as follows:

- Each of the subsidiary's assets and liabilities is adjusted to its fair value on the date that the parent company acquired the subsidiary's shares.

- If the parent company has paid more than fair value to acquire its stake in a subsidiary, the excess is "goodwill arising on consolidation". This is shown as an asset in the consolidated statement of financial position.

- Goodwill should be tested annually for impairment and written down as necessary.

What does it mean to fair value assets and liabilities in business combinations?

- This is also referred to as Purchase Accounting.

- A complex process whereby the acquirer needs to analyze in great detail all assets and liabilities of the acquiree and needs to determine the fair value of these assets and liabilities at the date of acquisition.

- Purchase Accounting projects are time consuming and typically require management to involve various experts: appraisers, actuaries, tax specialists, lawyers, accountants, auditors.

- This process sometimes takes months to complete and therefore the standard setters (IASB + FASB) allow preparers to take up to a year to complete the purchase accounting exercise.

Example 1:

On 31 May 2023, A Ltd pays £35,000 to acquire all of the shares of B Ltd. The statements of financial position of the two companies just after this transaction are as follows:

	A Ltd £	B Ltd £
Assets		
Non-current assets		
Property, plant and equipment	200,000	27,000
Investment in B Ltd	35,000	
	235,000	
Current assets	109,000	12,000
	344,000	39,000
Equity		
Ordinary share capital	250,000	30,000
Retained earnings	58,000	5,000
	308,000	35,000
Liabilities		
Current liabilities	36,000	4,000
	344,000	39,000

Solution

	A Ltd £	B Ltd £	Group £
Assets			
Non-current assets			
Property, plant and equipment	200,000	27,000	227,000
Investment in B Ltd	~~35,000~~		
	235,000		
Current assets	109,000	12,000	121,000
	344,000	39,000	348,000
Equity			
Ordinary share capital	250,000	~~30,000~~	250,000
Retained earnings	58,000	~~5,000~~	58,000
	308,000	35,000	308,000
Liabilities			
Current liabilities	36,000	4,000	40,000
	344,000	39,000	348,000

This is the most straightforward example.

Reality will be far more complex. The purchase price will rarely correspond to the net-assets of the acquiree. Furthermore, the assets and liabilities will rarely be at fair value.

Example 2

On 30 June 2023, C Ltd pays £60,000 to acquire all of the shares of D Ltd. The statements of financial position of the two companies just after this transaction are as follows:

	C Ltd £	D Ltd £
Assets		
Non-current assets		
Property, plant and equipment	410,000	30,000
Investment in D Ltd	60,000	
	470,000	
Current assets	231,000	25,000
	701,000	55,000
Equity		
Ordinary share capital	400,000	25,000
Retained earnings	187,000	17,000
	587,000	42,000
Liabilities		
Current liabilities	114,000	13,000
	701,000	55,000

The fair value of the property, plant and equipment of D Ltd on 30 June 2023 is £40,000.
Prepare a consolidated statement of financial position as at 30 June 2023.

	C Ltd £	D Ltd £	Group £
Assets			
Non-current assets			
Property, plant and equipment	410,000	40,000	450,000
Investment in D Ltd	~~60,000~~		
Goodwill			8,000
	470,000		458,000
Current assets	231,000	25,000	256,000
	701,000	65,000	714,000

	C Ltd £	D Ltd £	Group £
Equity			
Ordinary share capital	400,000	~~25,000~~	400,000
Revaluation reserve		~~10,000~~	
Retained earnings	187,000	~~17,000~~	187,000
	587,000	52,000	587,000
Liabilities			
Current liabilities	114,000	13,000	127,000
	701,000	65,000	714,000

ounting 1

Accounting for business combinations – real life example (2020)

Take Away

Just Eat and Takeaway.com cleared to form £6.2bn food courier giant

Further growth on the menu as Dutch firm's boss hails merger as 'dream combination'

Takeaway.com's offer will give Just Eat shareholders a 58% stake in the merged company. Photograph: Just Eat

Shareholders in Just Eat have given the green light to a £6.2bn merger with Dutch food delivery firm Takeaway.com, which will create one of the largest food delivery groups in the world.

11 Business combinations

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of assets transferred by the Company, liabilities incurred by the Company to the former owners of the acquiree and the equity interest issued by the Company in exchange for control of the acquiree. Acquisition-related costs are recognised in profit or loss as incurred.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

When the consideration transferred by the Company in a business combination includes a contingent consideration arrangement, the contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination. Changes in fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with corresponding adjustments against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the 'measurement period' (which cannot exceed one year from the acquisition date) about facts and circumstances that existed at the acquisition date.

The subsequent accounting for changes in the fair value of the contingent consideration that do not qualify as measurement period adjustments depends on how the contingent consideration is classified. Contingent consideration that is classified as shareholders' equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within shareholders' equity. Other contingent consideration is remeasured to fair value at subsequent reporting dates with changes in fair value recognised in profit or loss.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, Just Eat Takeaway.com reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period, or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognised at that date.

€ millions	Total 2020
Ordinary share issued (82.8 million)	7,430
Total consideration	**7,430**
Other intangible assets	3,040
Property and equipment	18
Investments in associates and joint ventures	1,730
Right-of-use assets	64
Deferred tax assets	56
Other non-current assets	1
Trade and other receivables	80
Current tax asset	16
Inventories	4
Cash and cash equivalents	113
Borrowings	(348)
Deferred tax liability	(607)
Other non-current liabilities	(3)
Lease liability	(64)
Provisions (current)	(7)
Trade and other liabilities	(268)
Current tax liability	(6)
Total fair value of net identifiable assets and liabilities	**3,819**
Non-controlling interests	(5)
Goodwill recognised	**3,616**

The initial accounting for the Just Eat Acquisition has only been provisionally determined as at the end of the reporting period. The provisional purchase price allocation is based on an estimation of the identifiable assets acquired and liabilities assumed. This estimation requires the Management Board to estimate the future cash flows expected to arise from the assets and a suitable discount rate in order to calculate present value. The main reason for being provisional is related to the resolution of the (contingent) liabilities such as the gig economy matters and uncertain tax positions. Just Eat Takeaway.com will continue to review this matter during the measurement period. If new information is obtained within one year of the date of acquisition about facts and circumstances that existed at the date of acquisition, then the accounting for the acquisition will be revised.

The Management Board believes that the assumptions used in the provisional purchase price allocation are appropriate as at 31 December 2020. The measurement period will end no later than 15 April 2021, and no subsequent adjustments have been made to the amounts provisionally recorded as at the date these financial statements were authorised for issue.

Goodwill recorded in connection with the Just Eat Acquisition represents future economic benefits specific to Just Eat Takeaway.com arising from assets that do not qualify for separate recognition as intangible assets.

ABInBev

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BUSINESS

SABMiller, AB InBev Shareholders Approve $100 Billion-Plus Merger

Deal turns AB InBev into a brewing powerhouse with an estimated 46% of global beer profits

Shareholders in SABMiller have approved a combination with AB InBev, maker of Stella Artois.

2016 ACQUISITIONS

The following transactions took place in 2016:

COMBINATION WITH SABMILLER

On 11 November 2015, the boards of AB InBev and SABMiller plc ("SABMiller") announced that they had reached an agreement on the terms of the proposed business combination between SABMiller and AB InBev (the "Combination").

The Combination was implemented through a series of steps and completed on the 10th of October. During the final step of the proposed structure, Anheuser Busch InBev SA/NV, the holding of the AB InBev group, merged into Newbelco SA/NV (Newbelco), which was formed for the purpose of effecting the Combination, so that following completion of the Combination, Newbelco became the new holding company for the combined AB InBev and SABMiller group. Newbelco has been renamed Anheuser-Busch InBev SA/NV.

Under the terms of the Combination, each SABMiller shareholder was entitled to elect to receive 45.00 pounds sterling in cash in respect of each SABMiller share (subject to the terms and conditions of the Combination). The Combination also included a partial share alternative (the "Partial Share Alternative"), under which SABMiller shareholders could elect to receive 4.6588 pounds sterling in cash and 0.483969 restricted shares in respect of each SABMiller share in lieu of the full cash consideration to which they would otherwise be entitled under the Combination (subject to scaling back in accordance with the terms of the Partial Share Alternative and the other terms and conditions of the Combination).

In accordance with IFRS, the merger between the former AB InBev into Newbelco is considered for accounting purposes as a reverse acquisition, operation by which Newbelco legally absorbed assets and liabilities of former AB InBev. As a consequence, the legal acquirer (Newbelco) is considered as the accounting acquiree and the legal acquiree (former AB InBev) is considered the accounting acquirer. Therefore, the consolidated financial statements represent the continuation of the financial statements of former AB InBev. The assets and liabilities of former AB InBev remained recognized at their pre-combination carrying amounts. The identified assets, liabilities and non-controlling interests of SABMiller are recognized in accordance with IFRS 3 Business Combinations and have only been provisionally determined at the end of the reporting period.

The provisional allocation of the purchase price included in the balance sheet and detailed in the table below is based on the current best estimates of AB InBev's management with input from independent third parties. The completion of the purchase price allocation may result in further adjustment to the carrying value of SABMiller's recorded assets, liabilities and non-controlling interests and the determination of any residual amount that will be allocated to goodwill.

The SABMiller purchase consideration is calculated as follows:

	Newbelco number of shares	Newbelco valuation in million pound sterling	Newbelco valuation in million euro	
Tender offer (cash consideration)	102 890 758 014	46 301	52 522	
Converted to restricted shares	60 385 979 086	29 099	33 009	(i)
	163 276 737 100	**75 400**	**85 531**	
Total equity value at offer in million euro			85 531	
Purchase from option holders			5	
Total equity value in million euro			**85 536**	
Total equity value in million US dollar			**95 288**	
Foreign exchange hedges and other			7 848	(ii)
Purchase consideration			**103 136**	
Add: fair market value of total debt assumed			11 870	
Less: total cash acquired			(1 198)	
Gross purchase consideration			**113 808**	

The following table presents the provisional allocation of purchase price to the SABMiller business:

Million US dollar	Provisional fair values
Non-current assets	
Property, plant and equipment	9 060
Intangible assets	20 040
Investment in associates	4 386
Investment securities	21
Deferred tax assets	179
Derivatives	579
Trade and other receivables	59
Current assets	
Inventories	977
Income tax receivable	189
Derivatives	60
Trade and other receivables	1 257
Cash and cash equivalents	1 410
Assets held for sale	24 805
Non-current liabilities	
Interest-bearing loans and borrowings	(9 021)
Employee benefits	(195)
Deferred tax liabilities	(5 801)
Derivatives	(24)
Trade and other payables	(146)
Provisions	(688)
Current liabilities	
Bank overdraft	(212)
Interest-bearing loans and borrowings	(2 849)
Income tax payable	(4 310)
Derivatives	(156)
Trade and other payables	(3 520)
Provisions	(847)
Net identified assets and liabilities	**35 253**
Non-controlling interests	**(6 200)**
Goodwill on acquisition	**74 083**
Purchase consideration	**103 136**

POST-ACQUISITION CHANGES IN THE RESERVES OF A SUBSIDIARY

The reserves of a subsidiary will change after acquisition by the parent. When preparing the group accounts in subsequent years, such changes should be dealt with as follows:

- Any post-acquisition increase in the reserves of a subsidiary should be added to the group reserves shown in the group statement of financial position.
- Any post-acquisition decrease in the reserves of a subsidiary should be subtracted from group reserves.

In simple words, this just means that the results of a 100% subsidiary are fully included in the group results as of the moment of its acquisition.

PARTLY-OWNED SUBSIDIARIES

- If a parent company does not own 100% of a subsidiary's share capital, the remainder of the subsidiary's shares are held by non-controlling shareholders.
- In these circumstances, IFRS10 requires that the group statement of financial position should include *all* of the subsidiary's net assets (exactly as if the subsidiary were wholly-owned) but should then identify separately the amount of those net assets which is attributable to the non-controlling shareholders. This amount is referred to by IFRS10 as the *"non-controlling interest"*.
- If a parent company does not own 100% of a subsidiary's share capital, the remainder of the subsidiary's shares are held by non-controlling shareholders.
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Non-Controlling interest - example

EQUITY AND LIABILITIES			
Equity			
Issued capital	23	1 736	1 736
Share premium		17 620	17 620
Reserves		23 769	(13 168)
Retained earnings		28 214	35 949
Equity attributable to equity holders of AB InBev		**71 339**	**42 137**
Non-controlling interests	33	10 086	3 582
		81 425	**45 719**
Non-current liabilities			
Interest-bearing loans and borrowings	24	113 941	43 541
Employee benefits	25	3 014	2 725
Deferred tax liabilities	18	16 678	11 961
Derivatives	29H	471	315
Trade and other payables	28	1 328	1 241
Provisions	27	1 409	677
		136 841	**60 460**
Current liabilities			
Bank overdrafts	21	184	13
Interest-bearing loans and borrowings	24	8 618	5 912
Income tax payables		3 922	669
Derivatives	29H	1 263	3 980
Trade and other payables	28	23 086	17 662
Provisions	27	869	220
Liabilities associated with assets held for sale	22	2 174	-
		40 116	**28 456**
Total equity and liabilities		**258 381**	**134 635**

The statements of financial position of G Ltd and H Ltd at 31 March 2024 are as follows:

	G Ltd £	H Ltd £
Assets		
Non-current assets		
Property, plant and equipment	527,000	39,000
Investment in H Ltd	48,000	
	575,000	
Current assets	326,000	31,000
	901,000	70,000
Equity		
Ordinary share capital	600,000	32,000
Retained earnings	148,000	22,000
	748,000	54,000
Liabilities		
Current liabilities	153,000	16,000
	901,000	70,000

On 1 April 2020, G Ltd had paid £48,000 to acquire 75% of the ordinary shares in H Ltd. On that date, the retained earnings of H Ltd were £10,000 and the fair value of the company's non-current assets was £8,000 more than their book value. This revaluation has not been reflected in the books of H Ltd.

H Ltd has issued no shares since being acquired by G Ltd. The goodwill arising on consolidation has suffered an impairment loss of 40% since acquisition. Prepare a consolidated statement of financial position as at 31 March 2024.

⇨ 48.000 paid
for 75% of:
32.000
10.000
8.000
50.000 EUR

So 48.000 paid for something worth 37.500, hence initial GW = 10.500

Impairment = 4.200 (40%)

Solution

Group statement of financial position as at 31 March 2024

	£	
Assets		
Non-current assets		
Property, plant and equipment (£527,000 + £39,000 + £8,000)	574,000	
Goodwill (W1)	6,300	➡ GW = 10.500 - 4.200 = 6.300
	580,300	
Current assets (£326,000 + £31,000)	357,000	
	937,300	
Equity		
Ordinary share capital	600,000	
Retained earnings (W2)	152,800	➡ = 148.000 + (22.000-10.000) X 0.75 – 4.200
	752,800	
Non-controlling interest (W3)	15,500	↘ = (32.000+22.000 +8.000) X 0.25
	768,300	
Liabilities		
Current liabilities (£153,000 + £16,000)	169,000	
	937,300	

INTRA-GROUP BALANCES

Intra-group balances are cancelled out when preparing a group statement of financial position. Such balances may arise as follows:

- One group company may lend money to another group company. The loan will be an asset for the lending company and a liability for the borrowing company.
- One group company may buy goods or services on credit from another group company. The supplier company will have a trade receivable and the customer company will have a trade payable.
- One group company may have a current account with another group company. The balance on this account is an asset for one company and a liability for the other.

UNREALISED PROFITS

The assets shown in the financial statements of a group company may include items acquired from another group company at a price in excess of original cost. The unrealised profit must be eliminated in the group accounts.

- IFRS10 requires that profits or losses on intra-group transactions must be eliminated in full on consolidation, irrespective of whether the subsidiary companies involved are wholly-owned or partly-owned.
- If an asset is sold from parent to subsidiary, any unrealised profit on the transaction is subtracted from group retained earnings.
- If an asset is sold from subsidiary to parent, any unrealised profit on the transaction is allocated proportionately between group retained earnings and the non-controlling interest.

CHAPTER 19: THE GROUP STATEMENT OF COMPREHENSIVE INCOME (IFRS10, IFRS3)

⇨ consolidation aspects related to the income statement)

PURPOSE OF A GROUP STATEMENT OF COMPREHENSIVE INCOME

- The purpose of a group statement of comprehensive income is to report the profit or loss of the group as a whole.
- Also known as the *"consolidated statement of comprehensive income".*
- IFRS10 requires that a group statement of comprehensive income should be prepared and presented in recognition of the fact that a parent company and its subsidiaries are, in effect, a single economic entity.

PREPARATION OF A GROUP STATEMENT OF COMPREHENSIVE INCOME

- The group statement of comprehensive income is prepared by adding together (line by line) the individual statements of comprehensive income of all of the companies in the group. This process is known as "consolidation".

- Any intra-group items are cancelled out in the consolidation process.

INTRA-GROUP ITEMS

- Intra-group sales are included in the sales revenue of the selling company and in the cost of sales of the buying company. So intra-group sales are deducted from group sales revenue and from group cost of sales when preparing the group statement of comprehensive income.
- Other intra-group items that may arise (and which must be cancelled out) include interest payable by one group company to another and management expenses charged by one group company to another.
- Dividends paid by a subsidiary to its parent company (shown in the subsidiary's statement of changes in equity) are cancelled against the dividends received shown in the parent's statement of comprehensive income.

OTHER ADJUSTMENTS

- Any unrealised profit on inventories is deducted from the inventories figure shown in the group statement of financial position. A reduction in closing inventory causes an increase in cost of sales, so the cost of sales figure in the group statement of comprehensive income must be *increased* by the amount of any unrealised profit.
- If the goodwill arising on consolidation has suffered an impairment loss during the accounting period, this loss is shown as an expense in the group statement of comprehensive income.

PARTLY-OWNED SUBSIDIARIES

- If a group includes one or more partly-owned subsidiaries, part of the group's profit after tax is attributable to the non-controlling shareholders (the *"non-controlling interest"*).
- The amount of profit attributable to the non-controlling interest is deducted in the group statement of comprehensive income, leaving the profit attributable to the group.
- Any dividends paid by a subsidiary to its non-controlling shareholders are shown in the non-controlling interest column of the consolidated statement of changes in equity.

Non-Controlling interest – example

For the year ended 31 December Million US dollar, except earnings per shares in US dollar	Notes	2016	2015
Revenue		**45 517**	**43 604**
Cost of sales		(17 803)	(17 137)
Gross profit		**27 715**	**26 467**
Distribution expenses		(4 543)	(4 259)
Sales and marketing expenses		(7 745)	(6 913)
Administrative expenses		(2 883)	(2 560)
Other operating income/(expenses)	7	732	1 032
Profit from operations before non-recurring items		**13 276**	**13 768**
Restructuring	8	(323)	(171)
Business and asset disposal	8	377	524
Acquisition costs business combinations	8	(448)	(55)
Impairment of assets	8	-	(82)
Judicial settlement	8	-	(80)
Profit from operations		**12 882**	**13 904**
Finance cost	11	(5 860)	(2 417)
Finance income	11	652	1 178
Non-recurring net finance income/(cost)	8	(3 356)	(214)
Net finance income/(cost)		**(8 564)**	**(1 453)**
Share of result of associates and joint ventures		16	10
Profit before tax		**4 334**	**12 461**
Income tax expense	12	(1 613)	(2 594)
Profit from continuing operations		**2 721**	**9 867**
Profit from discontinued operations	22	48	-
Profit of the year		**2 769**	**9 867**
Profit from continuing operations attributable to:			
Equity holders of AB InBev		1 193	8 273
Non-controlling interest		1 528	1 594

SUBSIDIARY ACQUIRED PART WAY THROUGH AN ACCOUNTING PERIOD

- If a subsidiary is acquired part of the way through the accounting period for which group accounts are being prepared, it is necessary to apportion the subsidiary's profit for that period into its pre-acquisition and post-acquisition components.
- The group's share of the subsidiary's pre-acquisition profit is cancelled out in the goodwill calculation. The group's share of the subsidiary's post-acquisition profit is included in the consolidated statement of comprehensive income.

CHAPTER 20: ASSOCIATES AND JOINT ARRANGEMENTS (IAS28, IFRS11)

ASSOCIATES AND SIGNIFICANT INFLUENCE

IAS28 includes the following definitions:

- An associate is *"an entity over which the investor has significant influence".*
- Significant influence is *"the power to participate in the financial and operating policy decisions of the investee but is not in control or joint control over these policies".*

When an investor company owns (directly or indirectly) at least 20% of the voting power of an investee company, significant influence is presumed to exist unless it can be clearly demonstrated that this is not the case. Owning at least 20% of a company's voting power normally means owning at least 20% of that company's ordinary shares.

EVIDENCE OF SIGNIFICANT INFLUENCE

The existence of significant influence may be evidenced by:

- representation on the board of directors which governs the investee company
- participation in policy-making processes of the investee, including participation in decisions about dividends or other distributions
- material transactions between the investor and the investee
- interchange of managerial personnel
- provision of essential technical information.

THE EQUITY METHOD

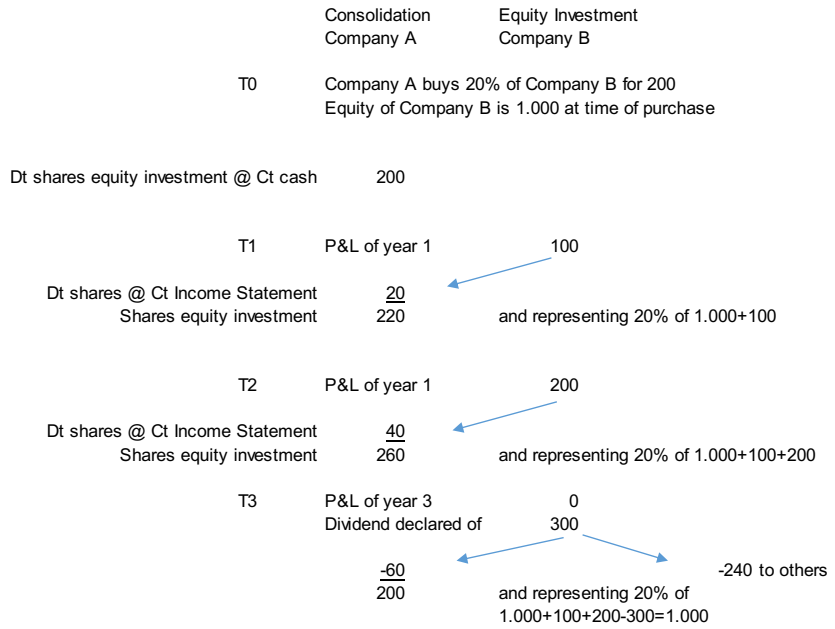
- IAS28 requires that an investment in an associate should normally be accounted for using the "*equity method*".
- The equity method is defined as *"a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets*".
- The profit or loss of the investor should include the investor's share of the investee's profit or loss.

APPLICATION OF THE EQUITY METHOD

The investment made by the investing company is recorded initially at cost. In subsequent years:

- The investor's share of the investee's profit or loss for the year is recognised in the investor's statement of comprehensive income and is either added to or subtracted from the carrying amount of the investment shown in the investor's statement of financial position.
- Any dividends received from the investee are subtracted from the carrying amount of the investment.

➔ Why deducted from investment and not considered income?
Answer: because already recorded as income in the past.



UPSTREAM AND DOWNSTREAM TRANSACTIONS

These are transactions between an investor and an associate. IAS28 requires that unrealised profits resulting from such transactions should be eliminated to the extent of the investor's interest in the associate, as follows:

- Upstream. In the investor's financial statements, the unrealised profit is subtracted from the investor's share of profit from associates. This automatically reduces the investment in associates figure shown in the investor's statement of financial position.
- Downstream. The unrealised profit is subtracted from the investor's gross profit (usually by increasing cost of sales) and is also subtracted from the investment in associates figure shown in the investor's statement of financial position.

JOINT ARRANGEMENTS

IFRS11 includes the following definitions:

- A joint arrangement is "*an arrangement of which two or more parties have joint control.*"
- Joint control is "*the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.*"

The important characteristic of a joint arrangement that distinguishes it from a subsidiary or associate is that there is a contractual arrangement to share control.

TYPES OF JOINT ARRANGEMENT

IFRS11 identifies two types of joint arrangement:

- Joint operations. A joint operation is "a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement."
- Joint ventures. A joint venture is "a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement."

IFRS11 also prescribes the accounting treatment for each type of joint arrangement.

JOINT OPERATIONS

- This form of joint arrangement does not usually involve the establishment of a new business entity. Instead, the "joint operators" each use their own assets for the purposes of the operation and incur their own liabilities. An agreement between the joint operators specifies the way in which the revenue and expenses of the operation should be shared between them.
- The assets, liabilities, revenues and expenses associated with the operation are recognised in the individual financial statements of the joint operators. There is no need to prepare financial statements for the joint operation itself.

JOINT VENTURES

- This form of joint venture usually involves the establishment of a new business entity. The "joint venturers" have a contractual agreement to jointly control this entity.
- The jointly controlled entity has its own assets, incurs its own expenses and liabilities and earns its own revenue. It maintains its own accounting records and presents its own financial statements.
- Each joint venturer has an interest in the net assets of the jointly controlled entity (generally by virtue of subscribing for shares in that entity) and is entitled to a share of the entity's profits.

Accounting for an interest in a joint venture

- A joint venturer should recognise its interest in a joint venture as an investment in its own financial statements.
- IFRS11 requires that this investment should normally be accounted for by the equity method.

DISCLOSURE REQUIREMENTS

IFRS12 ***Disclosure of Interests in Other Entities*** requires an entity to disclose:

- the significant judgments and assumptions it has made in determining the nature of its interest in other entities
- the nature, extent, and financial effects of its interests in associates and its interests in joint arrangements
- the nature of any risks associated with its interests in associates and joint arrangements.

CHAPTER 15: REVENUE FROM CONTRACTQ WITH CUSTOMER (IFRS 15)

What's the big deal with IFRS 15?

1. Invoicing will not necessarily dictate nor match the amount or pattern of revenue recognition
2. IFRS 15 creates different categories of assets and liabilities
3. Revenue may be recognized before a good/service is fully delivered (if certain conditions are met)
4. Variable elements of the contract pricing must be estimated on day 1 despite the uncertainties that exist
5. Discounts are required to be pro- rated between all goods/services in a contract (with some exceptions)
6. Goods/services that have a functional relationship are not always considered as one "performance obligation" (i.e., one item) – see next slide

To determine whether a promise is separately identifiable, an entity assesses whether there is a'**transformative**' relationship between it and other promises rather than any '**functional** relationship'.

→A 'transformative relationship' is one in which the individual items are transformed in the process of fulfilling the contract into something that is substantially different from or more than the sum of the individual items, eg the building of a wall from the supply of bricks and labour.

➔A 'functional relationship' is one in which one item depends, by its nature, on another, e.g. the supply of a printer and related cartridges needed for the printer to function.

Where a significant service of integrating goods/services is provided; one or more goods/services are significantly modified or customised; or the4goods/services are highly interrelated or interdependent, a transformative relationship exists and the promises to transfer those goods/services are not separable and are therefore combined into a single performance obligation.

If there isn't a transformative relationship, then the promised goods/services will be outputs in their own right and the promises to deliver them will be separate performance obligations.

The 5 step model

Core principle: Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled in exchange for those goods or services

IDENTIFY THE CONTRACT

IFRS15 states that a contract which falls within its scope should be accounted for by an entity only when all of the following conditions are satisfied:

- Parties have approved the contract and are committed to perform
- Entity can identify the payment terms for the goods or services to be transferred
- Entity can identify each party's rights regarding goods or services
- It is probable 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
- Entity can identify the payment terms for the goods or services to be transferred
- Contract has commercial substance (cash flows are supposed to change)

Contract term

Belco enters into a contract with a customer to provide monthly mobile services for a two-year period. The customer can cancel the contract at the end of any moment for any reason without compensating the other party.

What is the contract term?

A. Month to month
B. 2 years
C. There is no defined contract period

When determining the contract term, consider the following:

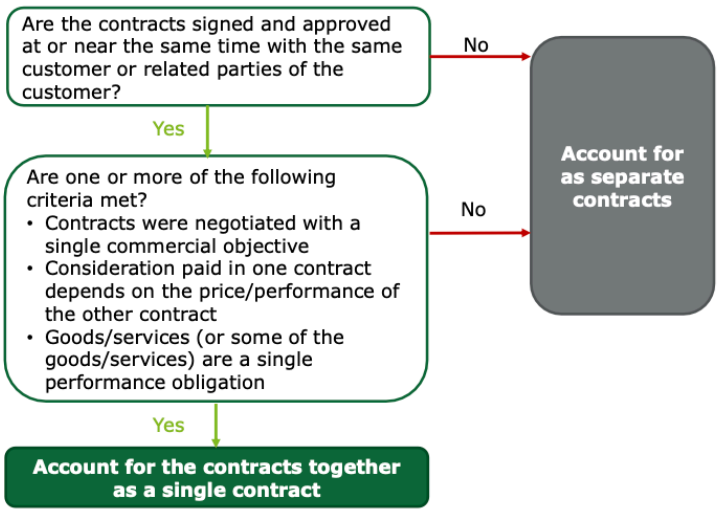
- Enforceable rights and obligations
- Non-cancellable periods
- Termination penalties and the significance of these

Same facts as the previous question, except that the customer must pay a termination penalty if the customer terminates during the first 12 months.

What is the contract term?

A. Month to month
B. 12 months
C. 2 years
D. It depend

Contract combination



Example

JavaCo enters into a contract to license its customer relationship management **software** to a customer.

Three days later, in another contract, JavaCo agrees to provide **consulting services** to significantly customize licensed software previously sold to function in customer's IT environment.

Customer is unable to use software until customization services are complete.

→ Should JavaCo combine these two contracts and account for them as a single contract under IFRS 15?

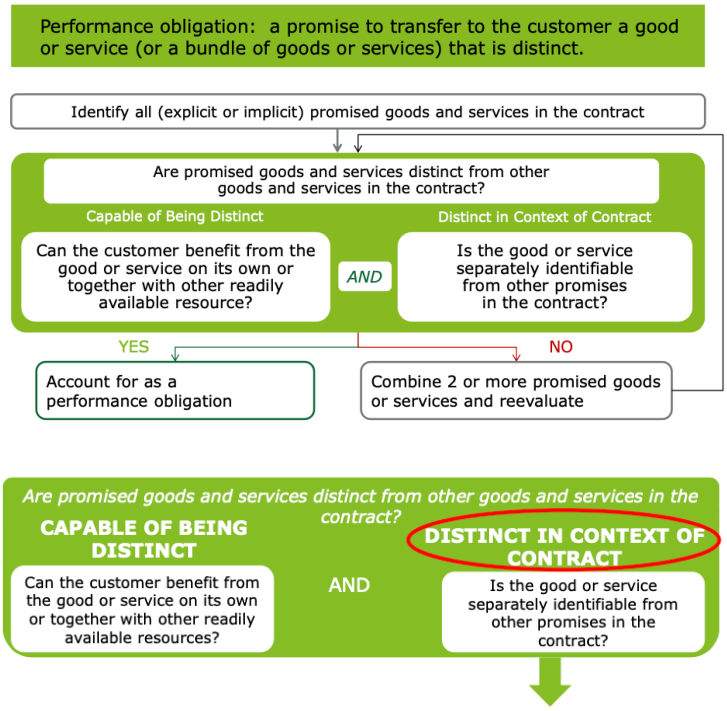
Solution

Two contracts should be combined and accounted for as a single contract under IFRS 15.17 because:

01 They were entered into at or near same time with same customer in accordance with IFRS 15.17; and

02 Promised goods or services under contracts constitute a single performance obligation. This is because JavaCo is providing a **significant service of integrating** license and consulting service into combined item for which customer has contracted. In addition, software will be significantly customized by consulting services.

More on this in Step 2 of the model



Factors that indicate that a promised good or service is distinct include:

- No significant service of integrating the good or service (i.e., the entity is not using the good or service as an input to produce or deliver the combined output specified by the customer)
- The good or service does not significantly modify or customise another good or service promised in the contract
- The good or service is "not highly dependent on, or highly interrelated with" other promised goods or services in the contract

Example:

A software developer, Software Co, enters into a contract with a customer to transfer a software license, perform an installation service and provide unspecified software updates and technical support for a 2-year period. Software Co sells the license, installation service and technical support separately. The installation service is routinely performed by other entities and does not significantly modify the software. The software remains functional without the updates and technical support.

→ What are the performance obligations in the contract?

- The software license
- The installation service
- The software updates
- The technical support

The promised goods and services are the same as in the previous case, except that the contract specifies that, as part of the installation service, the software is to be substantially customised to add significant new functionality to enable the software to interface with other customised software applications used by the customer. The customised installation service can be provided by other entities.

- The customized software (license and installation together)
- The software updates
- The technical support

Material right

A material right exists if:

- An entity grants a customer the option to acquire additional goods or services at a discount (a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market); and
- The customer would not receive this option without first entering into that initial contract.

If the option provides a material right to the customer, the customer in effect pays the entity in advance for future goods or services and the entity recognises revenue when those future goods or services are transferred or when the option expires.

How does IFRS 15 deal with variability that is linked to customer actions or choices ?

- If a contract gives a customer the option to purchase additional distinct goods or services, those goods or services are not treated as performance obligations
- Instead, consider whether customer option gives rise to a material right.If it does, material right itself (and not underlying goods or services) should be treated as a performance obligation.

Example

Force manufactures and sells **aircraft engines** and **parts**. Unlike its competitors, Force does not build its engines or spare parts on a contract by contract basis. Force delivers within a 30-day timeframe and therefore has aircraft engines and spare parts on hand, ready for immediate delivery. Force frequently sells spare parts separately from the engines and vice versa.

FlyJet is a commercial airline that travels internationally.

Force has entered into a written contract with FlyJet to sell:

- 10 aircraft engines for $12 million each (excl. sales tax) and
- 20 specific aircraft engine spare parts (part XY002) for $200,000 each (excl. sales tax)

The 10 engines will be delivered together before the end of December 20X8. The 20 spare parts will be delivered together during January 20X9. Additionally, in the contract, FlyJet has the **option** to buy additional XY002 parts (beyond the 20) for the next 5 years..

Example cont.

Force deliberately prices the aircraft **engines** at less **than the cost of manufacture**, knowing that they will earn a very high margin on part XY002 (based on an estimated average number of spare parts to be sold, as well as the number of spare parts sold upfront) to recoup the initial loss on the engine. If no optional additional spare parts were purchased, the contract would incur a loss. This pricing structure is known in the industry as a "**loss leader contract**".

The standalone price of the aircraft engine is $20 million each. The standalone price of spare parts is $300,000 each.

Force estimates that a total of 75 optional spare parts will be purchased by FlyJet and that the profits on the spare part sales will more than compensate for the discount on the selling price of the aircraft engines. This is based on Force's historical statistical evidence of selling a large number of spare parts.

What are the performance obligations in the contract?

- 10 aircraft engines are capable of being distinct within context of contract
- 20 spare parts are capable of being distinct within context of contract

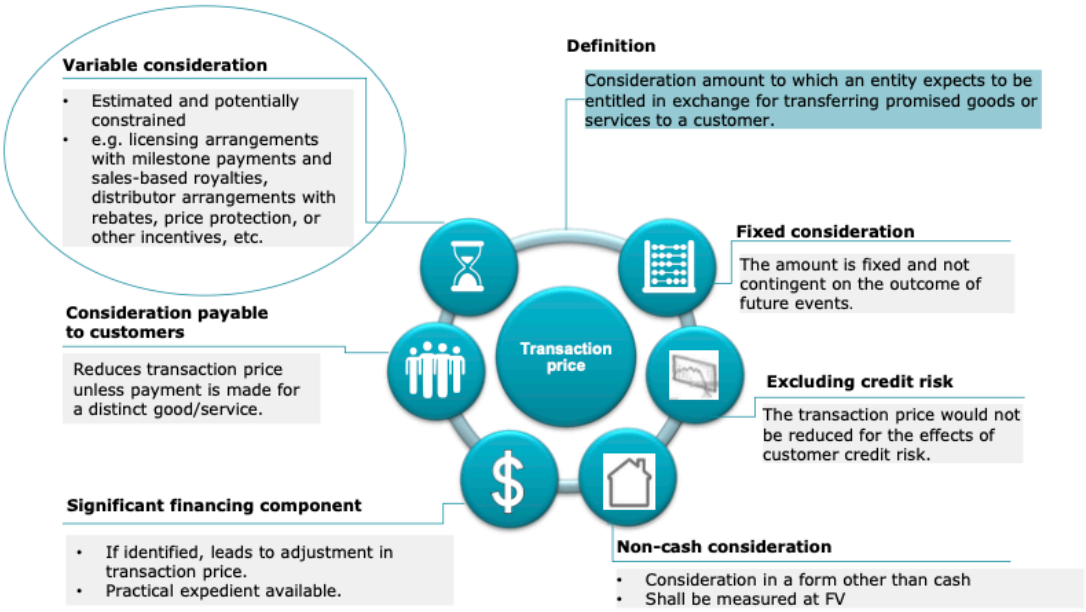
→ Is good or service capable of being distinct? Yes
→ Is good or service distinct within context of the contract? Yes

IFRS 15.10 defines a contract as an agreement between two or more parties that creates enforceable rights and obligations

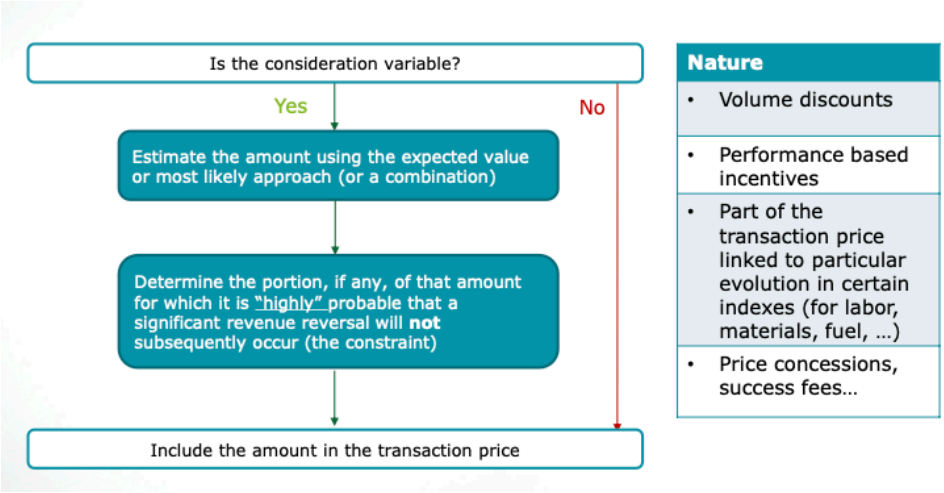
- Optional additional spare parts are sold at discount to their stand-alone selling price
- There is material right granted to the customer and option will be accounted for as a performance obligation

DETERMINE THE TRANSACTION PRICE

What is the transaction price?



Estimating the variable consideration



- An entity recognises a refund liability for consideration received or receivable if it expects to refund some or all of the consideration to the customer

The "constraint"
To assess whether-and to what extent- it should apply this constraint, an entity considers both:

- The likelihood of a revenue reversal arising from an uncertain event; and
- The potential magnitude of the revenue reversal when the uncertainty related to the variable consideration has been resolved

Factors in assessing the "constraint":

- Highly susceptible to factors outside entity's influence
- Uncertainty not expected to be resolved for a long time
- Entity's experience is limited
- Entity typically offers broad range of price concessions/payment terms ▪ Broad range of possible outcomes

Price concession example

DrugCo sells a prescription drug for $1 million payable in 90 days to a customer in a region that is experiencing economic difficulty.

- This is DrugCo's first sale in that region. DrugCo determines that a relationship with customer is critical to help boost market sales and expects region's economy to recover over next two years.
- After review, DrugCo expects to still provide a price concession and ultimately settle this transaction at $600,000 (reduced price is still in excess of its costs of $100,000).

Stated price

- DrugCo assesses collectability of $600,000 and deems collectability to be probable.

→ Is the transaction price variable? Does the contract meet the criteria of Step 1 of the revenue model under IFRS 15?

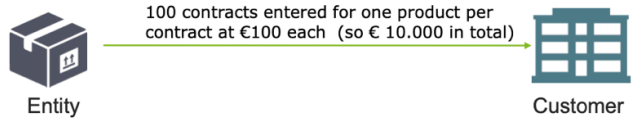
Yes. DrugCo expects to offer price concession at contract inception and to lower its price to $600,000.

Variable consideration includes all consideration that is subject to uncertainty for reasons other than collectability, such as price concessions.

As DrugCo expects to offer a price concession at contract inception and lower settlement price to $600,000, promised consideration is variable.

DrugCo also assesses that collectability of $600,000 (i.e., amount they believe to be entitled to) is probable.

Product returns example



Entity's customary business practice allows customer to return any unused product within 30 days and receive a full refund. Cost of each product is €60.

Using the expected value method, entity estimates that 97 products will not be returned. Entity also considers the following

- it has significant experience in estimating returns for this product and customer class;
- Uncertainty is resolved within a short time-frame

→ *Entity concludes that it is highly probable that a significant reversal in cumulative amount of revenue (€9,700) will not occur*

Accounting upon transfer of control of 100 products:

Revenue of €9,700	€100 x 97 products not expected to be returned
Refund liability of €300	€100 x 3 products estimated to be returned
Asset of €180	€60 x 3 products for right to recover products from customers on settling refund liability *(assume immaterial costs of recovery of products and returned products can be resold at profit*)

- No netting of contract balances
- The return asset to be separately presented from inventories
- The refund liability to be presented separately

The debits and credits in detail

		BS	IS			
1°	**The Sale**					
	DT	AR		10000		your real revenue
	CT		rev		9700	as you know there will be returns
	DT	refund liability			300	to reflect the future refund
	DT		COS	6000		
	CT	inventories			6000	
	Dt	right to recover		180		what you'll receive will have a value of 180
	Ct		COS		180	
2)	**The return**					
	Dt	refund		300		customer returns goods
	Ct		AR		300	and you owe him money
	Dt	AR		300		
	Ct		cash		300	you pay in cash
3)	**Now you have an asset back**					
	Dt	Inventories		180		you have the asset back in your inventories
	Ct		right to recover		180	the right was converted to a "real" asset

Example : accounting policies Zalando

Expected Returns

Zalando presents the expected returns of goods on a gross basis in the statement of profit or loss and reduces revenue by the full amount of sales that is estimated to be returned. The dispatch of goods that is recorded in full upon delivery of the goods is then corrected by the estimated amount of returns.

Zalando also presents expected returns on a gross basis in the statement of financial position. In this context, a right to recover possession of goods from expected returns is recognized in other non-financial assets. The amount of the asset corresponds to the cost of the goods delivered for which a return is expected, taking into account the costs incurred for processing the return and the losses resulting from disposing of these goods.

Trade receivables for which delivered goods are expected to be returned are also derecognized.

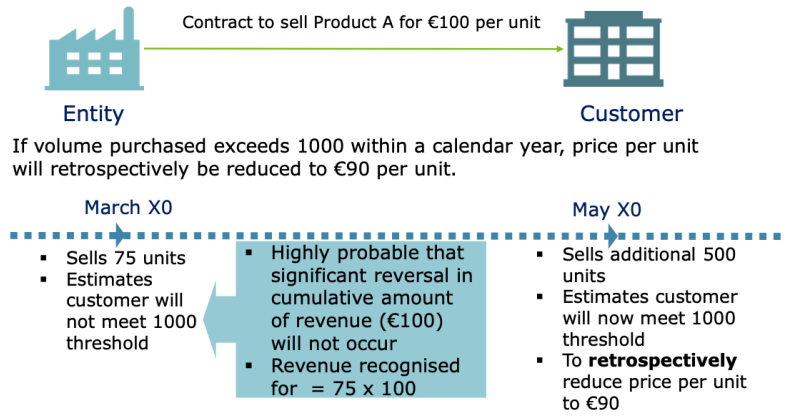
For customer receivables already paid and for which returns are expected in the future, Zalando recognizes a refund obligation vis-à-vis the customer within other current financial liabilities.

Example: Disclosure Zalando for product returns

Other Current Financial and Non-Financial Liabilities

IN EUR M	Dec 31, 2020	Dec 31, 2019	Change
Other current financial liabilities	**145.6**	**128.2**	**17.4**
thereof obligations to reimburse customers for returns	89.3	79.2	10.0
thereof derivative financial instruments	33.8	29.0	4.8
thereof debtors with credit balances	12.2	12.9	–0.8
thereof others	10.4	7.0	3.3
Other current non-financial liabilities	**234.8**	**143.4**	**91.4**
thereof VAT liabilities	180.4	82.6	97.8
thereof liabilities from gift vouchers	41.2	30.7	10.5
thereof liabilities from wage and salary	24.4	28.7	–4.3
thereof others	–11.1	1.4	–12.5

Volume Discount Incentive example



Volume Discount Incentive example cont.

To report for quarter ended 30 June X0:

	€
Sale of 500 units in May X0 (500 x 90)	45,000
75 units sold in March X0, retrospectively adjusted for €10 discount	(750)
Revenue recognised during quarter ended June X0	44,250

Delivery penalties example

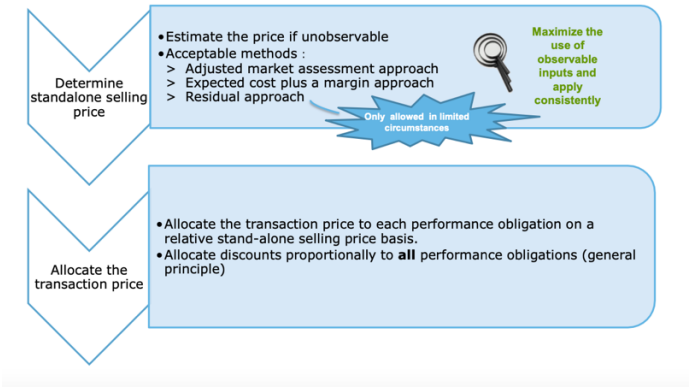
A company enters into a contract to construct an asset for a customer. The agreed price is £500,000 and the specified delivery date is 30 September 2016.

However, if the asset is delivered after this date, the company will suffer a late delivery penalty of £20,000 for each week between 30 September 2016 and the actual date of delivery.

The company estimates that the probability of the asset being delivered on time is 80%. But there is 10% probability that the asset will be delivered one week late and a further 10% probability that the asset will be delivered two weeks late.

→ What is the transaction price for this contract?

Assuming that the expected value method provides the best prediction of the amount of consideration to which the company will be entitled,
the transaction price is £494,000.
(80% * 500 + 10% * 480 + 10% * 460)



Example

Background

Cloud Co contracts with CY B for the following:

- Software implementation for €75,000.
- Software maintenance for 3 years at €30,000 per year.
  Cloud Co deliberately prices the software implementation at less than the cost, knowing they will earn very high margin on the maintenance.
- Standalone selling price of the software implementation is €120,000
- Standalone selling price of the maintenance is € 30,000 per year.

Question

How should the transaction price be allocated?

120,000 / 210,000 — 165,000 * 57.143%

Performance obligation	Stand-alone selling price	%	Allocated price	Invoice price
Software implementation	120.000	57%	94.286	75.000
Software maintenance (3 years)	90.000	43%	70.714	90.000
	210.000		**165.000**	**165.000**

90,000 / 210,000 — 165,000 * 42.857%

Example

TeleCo enters into a contract with a customer to provide a handset for $400 and 24-month wireless services for $10 per month. Customer can get handset or wireless services from any other telecommunications company. Price of wireless service is equal to its stand-alone selling price.

- TeleCo identifies two performance obligations
- handset and wireless services. Handset is sold separately for $575.

→ How should the transaction price be allocated?

Example cont.

- Stand-alone selling price of wireless service is $240 ($10 x 24 months).
- Transaction price is $640 ($400 + $10 x 24 months), allocated to performance obligations based on relative stand-alone selling prices as follows:

Performance obligations	Standalone selling price	Price allocation	
Handset	$575	$452	$640x(575/815)
Wireless service	$240	$188	$640x(240/815)
Total	$815	$640	

SATISFACTION OF PERFORMANCE OBLIGATION

Performance satisfied over time = Revenue recognized over time

- The customer simultaneously receives and consumes the benefit of the seller's performance as the seller performs. Or
- The seller's performance creates or enhances an asset controlled by the customer (WIP under control of the customer) Or
- The seller does not create an asset that has an alternative use to the seller and the seller has the right to be paid for performance to date.

→ If not Revenue recognized at a point in time

IFRS 15.37 requires entities to consider contract terms, as well as laws that apply, when evaluating whether it has an enforceable right to payment for performance completed to date. Consider whether:

- legislation, administrative practice or legal precedent confer upon entity a right to payment for performance to date even though that right is not specified in contract with the customer;
- relevant legal precedent is such that similar rights to payment for performance completed to date in similar contracts have no binding legal effect or are capped; or
- an entity's customary business practices of choosing not to enforce a right to payment has resulted in right being rendered unenforceable in that legal environment

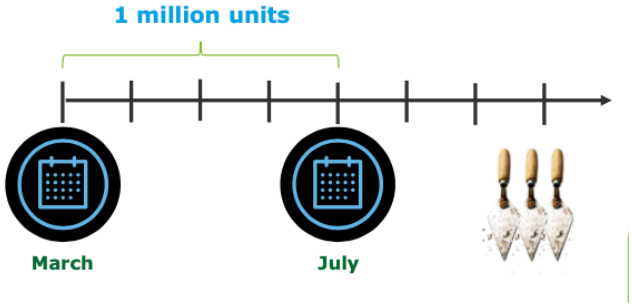
Indicators that control transfers include, but are not limited to, the following:

- The entity has a present right to payment
- The customer has a legal title
- The entity has transferred physical possession
- The customer has the significant risk and rewards of ownership
- The customer has accepted the asset

Example 1

During February, ToolCo, a manufacturer of gardening tools, enters into a contract with a retailer to produce one million shovels.

- ToolCo produces shovels and ships first 100,000 units to retailer in March, followed by 250,000 units in each of April and May, and 200,000 units in each of June and July.
- Shovels are produced according to standard specifications and could be sold to other customers.



→Does ToolCo recognize revenue at a point in time or over time? Why?

→When should the entity recognize the revenue?

Criteria for recognizing revenue over time are not met so ToolCo should recognize revenue for each performance obligation at point in time when customer obtains control of promised asset and performance obligation is satisfied.
ToolCo will therefore recognize revenue in several tranches, when control of each shipment of shovels is obtained by customer.

Example 2

During Feb 2018, RWS, a manufacturer of specific munition, enters into a contract with the South Korean government to produce one million units of a specific munition.

RWS produces the munition and ships the first 100,000 units to the South Korean government in March, followed by 250,000 units in each of April and May, and 200,000 units in each of June and July.

This munition is produced according to particular specifications and contractually there is determined that it might not be sold to other parties.

The contract specifies that in case the South Korean government would cancel the contract for a reason other than RWS failure to perform under the contract, RWS shall be paid its cost for each unit produced or partially produced but not yet delivered, plus a reasonable margin.

→ Does RWS recognize revenue at a point in time or over time? Why?

Criteria for recognizing revenue over time are met (3rd condition specifically) because the munitions have no alternative use to RWS and RWS is entitled to receive compensation for performance completed to date.
RWS will start to recognize revenue from day 1 of the contract according to the % completion method.

Example

Background

Henley Developers Ltd. (Henley) is constructing a high-rise apartment block (called Point Apartments) and it is at an early stage in its construction. Henley has started to enter into real estate sale agreements with buyers for the sale of its apartments. There will be 300 apartments in the completed apartment block.

Contract

The buyer is required to enter into a sales contract with Henley for the sale of a specified apartment. The sales contract specifies terms governing the sale and purchase including:

- **The payment plan.** The payment plan will generally correspond to performance completed by Henley to date. A 5 percent non- refundable deposit of the total purchase price is payable upon signing the sales contract. If the buyer is in default on its payment obligations, it is subject to the financial obligations specified under the termination contract clause.
- **The cancellation clause.** This clause allows the buyer to cancel the purchase of the apartment. If cancelled by the buyer, the buyer is also subject to the financial obligations specified under the termination contract clause.
- **Termination of the contract.** If the buyer defaults on its payment obligations or cancels the purchase of the apartment, Henley is entitled to 100% of the total purchase price (regardless of the stage of construction).
- **The legal transfer of the property.** The property remains at Henley's risk until the time when the apartment is legally assigned to the buyer and the buyer obtains vacant possession of the property from Henley, which is not until the construction of Point Apartments is 100 percent complete.
- **The specified apartment that is being sold/purchased.** Unless the buyer is in default on its payment obligations or elects to apply the cancellation clause, Henley is not allowed to re-sell the specified apartment to another buyer.

Example cont.

Jurisdictional regulations

A law within Henley's operating jurisdiction dictates that when a real estate sale contract is terminated by the buyer, payment by the buyer to compensate the developer is **capped at 25 percent** of the total sales price.

This law overrides any contracts entered into between buyers and developers in this jurisdiction.

→ When should Henley recognize the revenue related to this contract

'...Does not create an asset with an alternative use' (Per IFRS 15.35c)

- First requirement is for specified apartment unit to have no alternative use to Henley.
- Henley is not able to re-sell specified apartment, unless contract is terminated.
- Specified apartment has no alternative use to Henley, once contract is entered into.
  → First requirement is met

...Entity has an enforceable right to payment for performance completed to date' (Per IFRS 15.35c)

- Henley needs to consider contract terms, as well as laws that apply
- Upon termination, law states that buyer's payment to Henley will be capped at 25% of total purchase price.
- Henley must be entitled, **at all times throughout duration of contract**, to amount that at least compensates for performance completed to date if contract is terminated by buyer
  → Second requirement is not met

As sales contract does not satisfy any criteria in IFRS 15.35, revenue **must be recognized at a point in time**

Exact point in time is identified in IFRS 15.33:

"*... Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from an asset*."

Indicators that may assist when determining when control over promised asset has been transferred to customer include whether:

- Henley has present right to payment for property
- Buyer has legal title to property
- Henley has transferred physical possession of property to buyer;
- Buyer has significant risks and rewards of ownership of property; and
- Buyer has accepted property.