Young Memebrs Empowerment Committee

Introduction to the IFRS Framework

By;

CA MAYUR CHOKSHI

Mumbai

mayur@mcnco.in

IFRS Framework

- Principles & objective based; less voluminous
- "Framework" setting out principles – discusses 5 elements – assets, liabilities, equity, income, expenses.
- Conceptual Framework applied when no specific guidance in any standards
- Substance over form
- Sets out the concepts that underlie the preparation & presentation of financial statements
- A platform from which standards are developed
- The Framework is not an accounting standard and it does not contain detailed requirements

Objective of Financial Reports

- Providing information about the financial position, performance and changes in financial position
- Providing information enabling user to take economic decisions
- Providing results of stewardship of management and accountability of management for resources entrusted.
- Components of financial statements

  - SOFP (BS), SOCI(PLA) , OCI, Cash Flows, Notes,Disclosures, Explanatory statements etc. BUT NOT Directors Report, MDA
- USERS OF FINANCIAL STATEMENTS

PURPOSE OF FRAMEWORK

- Help for Future Development
- Regulations
- Guidance
- Opinion where standard is silent
- Standard prevails upon Framework

Background - fundamental assumptions of IFRS

Accrual Basis of Accounting

- Effects of transactions & other events recognised when they occur **not** when cash is paid or received. Thus , event based
- Recorded in the period to which they relate

Going Concern Basis

- Prepared on the assumption that the entity will continue to operate for the foreseeable future
- If intention to liquidate or curtail, a different basis may be appropriate

Framework – QUALITATIVE characteristics of IFRS

- **Understandability- Disclosure,**
- **Comparability** **(Prev Yr, Chg in Policy, etc.)**
- **Reliability**
  - **Faithful representation**
  - **Neutrality(No bias0**
  - **Completeness**
  - **Substance over form**
  - **Prudence (Caution)**
- **Relevance**
  - **to decision making by the user to make economic decision**
  - **Prediction from Fin Stmnt (Extraordinary,abnormal in PLA)**
- **Materiality**

Framework - qualitative characteristics of IFRS

- SUBSTANCE OVER FORM
  - Economic Reality rather than its legal form
- NEUTRALITY
- PRUDENCE (Conservatism)
- COMPLETENESS

CONSTRAINTS

Timeliness, Balance between Cost and Benefit, Balance Qualitative characteristics, True and Fair

Reporting Entity Concept

- The Framework applies to the financial statements of all commercial, industrial and business reporting entities, whether in the public or the private sectors.
- A reporting entity is an entity for which there are users who rely on the financial statements as their major source of financial information about the entity.
- Reporting Entity is an "area of economic activity whose financial information has the potential to be useful to present and potential equity investors, lenders and other capital providers for decisions in their capacity as capital providers."

Framework – Definitions

Element	Definition	Comments	Examples
Asset	**A resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity.**	An asset may be utilised by a business in a number of ways but all will lead to the generation of future economic benefits.	Cash, inventories, receivables, prepayments and property, plant & equipment.

Framework – Definitions

Element	Definition	Comments	Examples
Liability	A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow of the entity's resources.	An obligation is simply a duty or responsibility to perform in a certain way. A future commitment is not a present obligation.	Trade payables, unpaid taxes and outstanding loans.

Framework – Definitions

Element	Definition	Comments	Examples
Equity	The residual interest in an entity's assets after deducting all its liabilities.	Equity = ownership interest = net assets.	Share capital, retained earnings and other reserves.

Framework – Definitions

Element	Definition	Comments	Examples
Income	Increases in economic benefits not resulting from contributions made by equity holders.	Comprises both revenue and gains. Revenue arises from an entity's normal operating activities.	Revenue, revaluations, profit on sale of non-current assets and interest received.

Framework – Definitions

Element	Definition	Comments	Examples
Expenses	Decreases in economic benefits not resulting from distributions to equity holders.	Expenses include losses, for example write-downs of non-current assets	Material & labour costs, depreciation, interest paid on loans and write-down of an asset.

Framework – Recognition

- An item is classed as 'recognised' when it is included in the financial statements.
- An item should be recognised if it is probable that there will be an inflow or outflow of economic benefits associated with the asset or liability and the asset or liability can be measured reliably.
- Revenue should be earned before it is recognised in the income statement.
- Expenses are recognised when there is a decrease in an asset or an increase in a liability.

Framework – Measurement

- The measurement bases referred to in the IASB Framework and commonly used are:
  - **Historical cost.** Assets are recorded at their original cost. Liabilities are recorded at their original amount received or the cash expected to be paid out to settle them;
  - **Current cost**. Assets are recorded at the amount that would have to be paid out at the balance sheet date for an equivalent asset. Liabilities are recorded at the value that they could be settled for at the balance sheet date;
  - **Realisable or settlement value**. Assets are recorded at the amount that they could be sold for now and similarly liabilities are recorded at the amount expected to be paid out; and
  - **Present value.** This measurement basis involves discounting future cash flows to take account of the time value of money.

- Although the IASB Framework includes an explanation of the different measurement options, IFRS are primarily based on **historical cost** and **present value** (though later standards move towards fair value approach)

Background – asset & liability approach

Standards **mainly** focus on assets and liabilities

identification

recognition

measurement

derecognition

Movements reflected in income (or equity) can create **volatility**

Some standards deal with income / expense recognition directly, Construction.

Operating Cycle

- Time between the acquisition of assets for processing and their realisation in cash or cash equivalents
- When the normal operating cycle is not clearly identifiable, it is assumed to be 12 months
- Current assets include assets (such as inventories and trade receivables)
    - that are sold, consumed or realised as part of the normal operating cycle
    - even when they are not expected to be realised within 12 months.

TERMINOLOGY

- Investment Property
- Approved for Issue
- Preference Shares are Liability and not Equity

- ✓ *OVERALL PRINCIPLE BASED AND NOT RULE BASED*
- ✓ *UNDERSTAND THE ECONOMIC REALITY OF THE TRANSACTIONS*
- ✓ *LOGICAL CONCLUSION APPLYING FRAMEWORK PRINCIPLES*

TECHNIQUES EMBDDED IN IFRS

- Substance over the Form
- Fair Value, and Present Value
- Measurement Cash &Cash Equivalent, Present Value
- Onerous Contract
- Depreciation is Estimates
- Policy V/S Estimates
- Combining and Segmenting of Transactions
- No Prior Period Items, Extraordinary Items
- Bifurcation of Convertible Deb. into Equity & Debts
- Interest Free Loans
- No Proposed Dividend

CONCEPTS – FAIR VALUE

The PRICE that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at measurement date i.e. Exit Price

<u>Price</u> : At the Principle mkt (or most advantageous market under current market conditions)

<u>Asset or Liability</u> : stand alone or group (CGU); Highest and best use

<u>Transaction</u> : in a principal or most advantageous mkt

<u>Mkt Participants</u> : Buyers and sellers in principal mkt, are Independent of each other , knowledge abt asset or liability, willing to enter into transaction

THUS MAKT BASED AND NOT ENTITY SPECIFIC MEASUREMENT

Questions ? ? ? ?

CA MAYUR CHOKSHI

Tibrewala House, 33, Swastic Soc, NS Road No 3, JVPD Scheme, MUMABI 400 056.

Be in touch through :

E-mail : mayur@mcnco.in