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EU4Business

WORLD BANK GROUP

IFRS for SMEs:
selected technical issues

Tbilisi

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Technical session for Georgian IFRS for SMEs trainers

Disclaimer and applicable version of the IFRS for SMEs

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» Unless specified otherwise, the accounting requirements that are the subject matter of this presentation are the International Financial Reporting Standard for Small and Medium-Sized Entities (IFRS for SMEs) as issued by the International Accounting Standards Board (IASB) that are applicable for annual period beginning on or after 1 January 2019.

Objectives of this session

» Understand how, in accordance with the IFRS for SMEs, to account for selected non-financial items and revenue transactions and other events in the Georgian context.

Non-financial asset recognition and measurement

Measurement: conceptual underpinnings

» To a large extent, financial statements are based on estimates, judgements and models rather than exact depictions. Consequently, **measurement is about numbers and words**.

  » a complete depiction may also entail explanations of significant facts about the quality and nature of the items, factors and circumstances that might affect their quality and nature, and the process used to determine the numerical depiction.

  » A representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.

Historical cost 'concept': an asset

» The historical cost of an asset is the consideration given to acquire or to develop it:

  » the amount of cash or cash equivalents paid; or

  » the fair value of the consideration given to acquire it at the time of its development or acquisition.

» Historical cost includes transactions costs incurred to acquire the asset.

Historical cost conventions
Sections 13, 17, 25 and 18 of the IFRS for SMEs

- Historical cost includes all costs **directly attributable** to bringing an asset to the location and condition necessary for it to be capable of operating as intended by management, including:
  - **transactions costs**, non-refundable purchase taxes and professional fees
  - **costs of converting** raw material into finished goods (including an allocation of fixed production overheads)
  - **obligations** incurred for dismantling, removing and restoring the site
  - **cost formula** (FIFO or weighted-average) for similar items
- If **payment is deferred** beyond normal credit terms the interest is computed and cost is net of that interest.

Historical cost of an asset
test your understanding of variable consideration

Example 1 (with three scenarios):

A computer retailer buys computers at a list price of GEL1,000 per unit.

- On 1 July 2019, in a special promotion, the supplier promises a volume rebate of GEL100 on every computer purchased over the ensuing 12 months provided that during the ensuing 12 months you purchase more than 100,000 computers from the supplier.
- When preparing your 31 December 2019 financial statements you observe that you have purchased 60,000 computers from the supplier since 1 July 2019 of which 1,000 are unsold.

Historical cost of an asset
test your understanding of variable consideration

Example 1, Scenario A:

On the basis of historical sales patterns, consistently with sales forecasts you estimate that there is a 99.9% probability that you will satisfy the threshold to qualify for the volume rebate.

What is the historical cost of each of the computers in your inventory at 31/12/2019? Choose one of:

1) GEL1,000 (list price actually paid in 2019); or
2) GEL900 (GEL1,000 less virtually certain GEL100 discount).

Historical cost of an asset
test your understanding of variable consideration

Example 1, Scenario B:

On the basis of historical sales patterns that are consistent with the current economic environment and sales forecasts you estimate that there is a 75% probability that you will satisfy the threshold to qualify for the volume rebate.

What is the historical cost of each of the computers in your inventory at 31/12/2019? Choose one of:

1) GEL1,000 (list price actually paid in 2019);
2) GEL925 (GEL1,000 less 75% chance of GEL100 discount);
3) GEL900 (GEL1,000 less probable GEL100 discount); or
4) Another amount (specify…)

Historical cost of an asset
test your understanding of variable consideration

Example 1, Scenario C:

On the basis of historical sales patterns adjusted for the deteriorating the economic environment, consistently with sales forecasts you estimate that there is a 25% probability that you will satisfy the threshold to qualify for the volume rebate.

What is the historical cost of each of the computers in your inventory at 31/12/2019? Choose one of:

1) GEL1,000 (list price actually paid in 2019);
2) GEL975 (GEL1,000 less 25% chance of GEL100 discount);
3) GEL900 (GEL1,000 less GEL100 potential discount) ; or
4) Another amount (specify…).

Historical cost of an asset
test your understanding
(if needed, assume a discount rate of 10% per year)

Example 2 has five scenarios for buying a motor vehicle.

Example 2, Scenario A:

On 1 July 2019 you exchange (pay) GEL100,000 for a passenger motor vehicle which you receive on 1 July 2019.

What is the historical cost of the passenger motor vehicle?

Historical cost of an asset
test your understanding
(if needed, assume a discount rate of 10% per year)

Example 2, Scenario B:

On 1 July 2019 you exchange goods that you manufactured at a cost of GEL80,000 for a passenger motor vehicle which you receive on 1 July 2019. Had you paid cash for the vehicle you would have paid GEL100,000.

What is the historical cost of the passenger motor vehicle?

Choose 1 of: 1) GEL80,000; or 2) GEL100,000.

Historical cost of an asset
test your understanding
(if needed, assume a discount rate of 10% per year)

Example 2, Scenario C:

» On 1 July 2019 you exchange a promise to pay GEL121,000 on 30 June 2021 for a passenger motor vehicle which you receive on 1 July 2019

» On 30 June 2021 you pay GEL121,000 to settle the claim against you.

On 1 July 2019 what is the historical cost of the passenger motor vehicle?

Choose one of: 1) GEL100,000; or 2) GEL121,000.

Historical cost of an asset
test your understanding
(if needed, assume a discount rate of 10% per year)

Example 2, Scenario D:

» On 1 July 2019 you exchange (pay) GEL100,000 for a promise to receive a motor vehicle on 30 June 2021 (ie 2 years later).

» On 30 June 2021 you exchange the promise to receive the motor vehicle for the motor vehicle when the fair value of the motor vehicle is GEL150,000.

On 30 June 2021 what is the historical cost of the motor vehicle?

Choose one of: 1) GEL100,000; 2) GEL121,000; or 3) GEL150,000.

Historical cost of an asset
test your understanding
(if needed, assume a discount rate of 10% per year)

Example 2, Scenario E:

» On 1 July 2019 you exchange chemicals you manufactured at a historical cost of GEL80,000 (with a market value/fair value = GEL100,000) for a promise to receive a motor vehicle on 30 June 2021 (ie 2 years later).

» On 30 June 2021 you exchange the promise to receive the motor vehicle for the motor vehicle when the fair value of the motor vehicle is GEL150,000.

On 30 June 2021 what is the historical cost of the motor vehicle?

Choose one of: 1) GEL80,000; 2) GEL96,800; 3) GEL100,000; 4) GEL121,000; or 5) GEL150,000.

Historical cost of an asset (test your understanding)

example 3 consideration paid in advance of foreign currency denominated contracts

» On 01/01/2018 Reporting SME (functional currency GEL) contracts to import a computer system (to be classified as an item of PPE) for F$40 million. The contract must be settled by physical delivery of the computer system (and the prepayment is a non-monetary item).

Date	Spot 1F$ =	In accordance with the contract…
01/01/2018	GEL20	Reporting SME pays 25% of the purchase price
01/07/2018	GEL25	Reporting SME pays 50% of the purchase price
01/08/2018	GEL26	Reporting SME gets control over computer system
31/12/2018	GEL30	
01/01/2019	GEL29	Reporting SME pays 25% of the purchase price.

Historical cost of an asset (test your understanding)

example 3 consideration paid in advance of foreign currency denominated contracts (continued)

What is the historical cost of the computer system? Choose one of:

Date	Alternative 1	Alternative 2	Alternative 3	Alternative 4	Alternative 5
01/01/2018	GEL200 (ie €10m x GEL20)	GEL200 (ie €10m x GEL20)	GEL200 (ie €10m x GEL20)		
01/07/2018	GEL500 (€20m x GEL25)	GEL500 (€20m x GEL25)	GEL500 (€20m x GEL25)		
01/08/2018	GEL260 (ie €10m x GEL26)			GEL1,040m (ie €40m x GEL26)	
31/12/2018		GEL300 (ie €10m x GEL30)			GEL1,200m (ie €40m x GEL30)
01/01/2019			GEL290 (ie €10m x GEL29)		
Total	**GEL960 million**	**GEL1,000 million**	**GEL990 million**	**GEL1,040 million**	**GEL1,200 million**

Fair value of an asset
the concept

» The fair value of an asset is:

- » the price that would be received to sell an asset (exit price)
- » in an orderly transaction (not a forced sale)
- » between market participants (market-based view)
- » at the measurement date (current price) (see IFRS 13 *Fair Value Measurement*)

» The fair value of an asset is:

- » the amount for which the asset could be exchanged between knowledgeable, willing parties in an arm's length transaction (The Glossary of Terms in the IFRS for SMEs)
  - » for application guidance see paragraphs 11.27 to 11.32

» Market participant perspective: consequently, the entity's intention to hold an asset is not relevant when measuring fair value.

Comparing cost model, revaluation model and fair value model
reporting performance: asset consumed entirely through use

» 1 January 2011 you pay GEL1 million and gain control of a building

- » estimated useful life = 40 years
- » depreciation method = straight-line
- » nil residual value

» 31 December 2018: fair value = GEL1.2 million

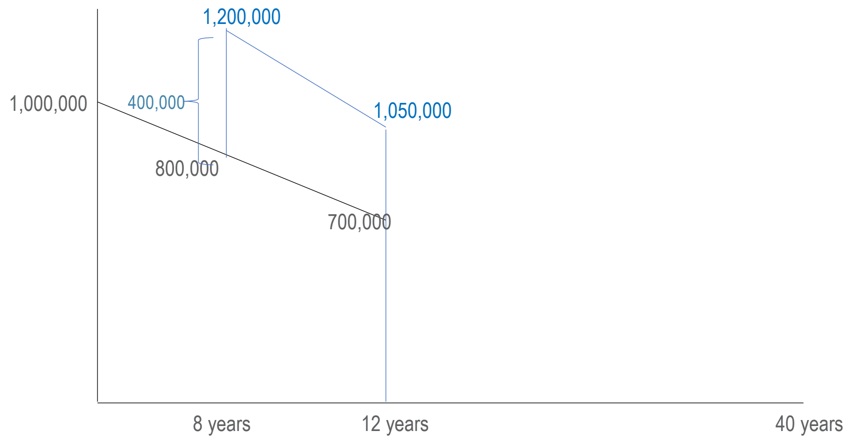
» 31 December 2026: fair value (= recoverable amount) = GEL300,000

» 31 December 2034 fair value (= recoverable amount) GEL800,000.

Plot in a graph the carrying amount of the asset over its useful life using each of the three measurement model for non-financial assets.

Prepare a table that compares financial performance over the entire life of the asset using each of the three models.

Comparing cost model, revaluation model and fair value model reporting performance: asset partly consumed through use and then sold



Assume Entity sold the building on 31/12/2022 for GEL 1,050,000

Comparing cost model, revaluation model and fair value model what do you think?

» **Which model best reflects the economics of the building over time?**

1) cost model; or
2) revaluation model; or
3) fair value model.

» **Which model provides the most decision-useful information for primary user resource allocation decision making?**

1) cost model; or
2) revaluation model; or
3) fair value model.

Comparing cost model, revaluation model and fair value model what do you think?

» **Which model gives management more flexibility in reporting profit or loss for the period?**

1) cost model; or
2) revaluation model; or
3) fair value model.

» **Which model reports least profit over the life of the asset?**

1) cost model; or
2) revaluation model; or
3) fair value model.

Revenue

Scope

» Section 23 covers revenue from:
  » sale of goods
  » rendering of services
  » construction contracts
  » use of an entity's assets by others:
    » interest
    » royalties
    » dividends received

» But some specialised revenue is dealt with in other sections of IFRS for SMEs:
  » Leases (Section 20)
  » Financial instruments (Sections 11 and 12)
  » Associates and joint ventures (Sections 14 and 15)
  » Investment property (Section 16)
  » Agriculture (Section 34)

Test your understanding

MotorHead operates a chain of car dealerships selling new and used cars and renting cars to customers under short-term leases.

In 2019 MotorHead closed a retail outlet and sold the land and building.

Which of the following income is not in the scope of Section 23?

Choose one of:

1) sales of new cars;
2) sales of used cars;
3) rentals; or
4) sale of retail outlet (land and building).

Revenue from the sale of goods example

Reporting SME sells goods for GEL90 to Reseller who sells them to EndCustomer for GEL100.

Reporting SME accept returns from Reseller.

What is the timing and amount of revenue that must recognised by:

- **Reporting SME; and**
- **Reseller?**

Sale through an intermediary example: principle and agent

Reporting SME sells goods for GEL100 through Intermediary who gets a commission of GEL10.

Reporting SME owns the goods until sold to end users and is responsible for defects and returns from end users.

What is the timing and amount of revenue that must recognised by:

- **Reporting SME; and**
- **Intermediary?**

Measurement

- Revenue is measured at the fair value of consideration received or receivable.
  - Net of trade discounts, prompt settlement discounts, volume rebates.
  - Does not include amounts collected on behalf of others, such as:
    - sales tax (value added tax)
    - amounts collected while acting as an agent rather than principal seller (ie for an agent only the commission is revenue)

Measurement deferred revenue

- If deferral is normal credit terms in the industry, revenue = contract amount (ie no discounting)
- But if deferral constitutes a financing transaction, revenue = present value of all expected receipts. Discount rate is either:
  - prevailing rate for similar instrument; or
  - 'implicit' interest rate that discounts cash flows to current cash sale price.

Measurement
example: deferred revenue

On 01/01/2019 Reporting SME sells goods with a carrying amount of GEL750,000 for GEL1,210,000, payment due on 31/12/2020 'interest free' when the current cash price would have been GEL1,000,000.

What is the timing and amount of revenue that Reporting SME recognises this sale transaction?

Measurement
exchange of goods

- Measurement hierarchy for revenue recognised on an exchange of dissimilar goods/services that has commercial substance:
  - Fair value of goods/services received (adjusted for any cash transferred)
  - Fair value of goods/services given up (adjusted for any cash transferred)
  - If neither of above can be measured reliably, then revenue = carrying amount of asset given up (adjusted for any cash transferred)

Measurement
multiple element sales

Normally, MotorHead sells car for GEL10,000,000 and offers 3-year service contract for an extra charge of GEL400,000.

On 01/01/2019, as a promotion, MotorHead includes **3-year service** as part of sale of a car for total price GEL10,200,000.

How much revenue must MotorHead recognize in 2019?

Measurement
multiple element sales: customer loyalty points

» Sale of goods/services with customer loyalty awards:
  » Allocate fair value of the consideration received to:
    (a) the main sale; and
    (b) award credits based on fair value.
  » Award credits are a liability (deferred revenue) until redeemed.

Revenue from providing services

Recognise revenue from providing services (including construction services) using:

» stage of completion when the **outcome** of the transaction **can be estimated reliably**.

» cost recovery method when **outcome cannot be estimated reliably.**

Revenue from providing services stage of completion method

» The **outcome** of the transaction **can be estimated reliably** when:

  » amount of revenue is measurable reliably;

  » collection is probable;

  » stage of completion at reporting date can be estimated reliably; and

  » costs incurred and future costs can be measured reliably.

» If a contract will probably result in a loss, immediately recognise an expense and a provision liability for the onerousness of the contract.

Revenue from providing services
examples

How much revenue must be recognize in the year ended 31/12/2019 in respect of each of the contracts below entered into on 01/01/2019?

Example 1: Security firm receives GEL10,000 to respond to alarms for 2-year period.

Example 2: Law firm fees are contingent on winning the case, otherwise nothing. Outcome unknown. Costs are incurred.

Example 3: Contractor enters into GEL10,000,000 fixed price, 3-year construction contract;

- » incurs GEL800,000 contract costs; and
- » is unable to estimate reliably the expected costs to complete but overall loss on contract is unlikely and collectability is highly probable.

Revenue from providing services
example 4

» Entity has a fixed price contract to **construct a road** for the government that becomes onerous.

	Original estimates	2019	2020	2021
Revenue	**2,000,000**	**2,000,000**	**2,000,000**	**2,000,000**
Costs incurred	-	200,000	1,100,000	2,100,000
Estimated future costs	1,000,000	800,000	1,100,000	-
Total expected costs	**1,000,000**	**1,000,000**	**2,200,000**	**2,100,000**

Revenue from providing services
example 5

Entity has a **fixed price contract to construct a bridge** using new technologies but cannot initially determine the outcome of the contract.

	Original estimates	2019	2020	2021
Revenue	**2,000,000**	**2,000,000**	**2,000,000**	**2,000,000**
Costs incurred	**-**	200,000	750,000	1,200,000
Estimated future costs	**?**	?	250,000	-
Total expected costs	**?**	**?**	**1,000,000**	**1,200,000**

Revenue from interest, royalties and dividends

Assuming collectability and measurement reliability recognise:

» interest using the effective interest method

» royalties on an accrual basis in accordance with the substance of the relevant agreement

» dividends when the right to receive payment is established

GeorgianFarm mini-case study

GeorgianFarm case study

» GeorgianFarm has farmed pears, raspberries and tomatoes on farmland in rural Georgia that 15 years ago it purchased in exchange for 10 000 GEL per hectare.

» Today GeorgianFarm generates cash inflows by:

  » selling the produce that it harvests from its pear trees, raspberry plants and tomato vines; and

  » selling fruit juice that it extracts at its juicing plant from harvested tomatoes and raspberries that fail strict the Russian Federation fresh fruit marketing standards for the 'extra class' fresh fruit table-market.

GeorgianFarm case study (continued)

» **Pears:** fruit is first harvested from a pear tree when it is about 4 years old. However, the initial harvest yields little fruit (about 10 kilogram). The fruit yield increases steadily each year as the tree matures peaking at about 150 kilograms of fruit per tree. GeorgianFarm fells its pear trees when their fruit yield deteriorates irrevocably (usually when the tree is about 70 years old). The wood harvested from the felled trees is sold to the furniture industry.

» By storing pears it harvests from its orchards in its purpose built refrigerated storage facility, GeorgianFarm supplies harvested pears to the Russian and Georgian fresh produce markets for up to eight months after harvest.

GeorgianFarm case study (continued)

» **Raspberries:** are harvested from plants that when maintained well, bear fruit indefinitely. Following the harvest each year, GeorgianFarm removes (prunes) the two-year-old canes leaving only the one-year-old canes to bear fruit in the next season. The removed canes are worthless.

» **Tomatoes:** are harvested from vines that each year GeorgianFarm grows from seed. Each year the vines wither and die after harvest.

GeorgianFarm case study (continued)
Question 1

Which Section of the IFRS for SMEs applies to each of GeorgianFarm's:

» farmland;

» living plants;

» harvested produce;

» pear refrigeration facility; and

» fruit juicing plant?

GeorgianFarm case study (continued)
Question 2

Which accounting policy alternatives are available to GeorgianFarm to account for each of:

» farmland;

» living plants;

» harvested produce;

» pear refrigeration facility; and

» fruit juicing plant?

GeorgianFarm case study (continued)
Question 3

Which of the accounting policy alternatives you identified (in answering Question 2 above) would provide the most relevant information to primary users of its financial information, about each of:

» Farmland, pear refrigeration facility and fruit juicing plant;

» living plants; and

» harvested produce?

GeorgianFarm case study (continued)
Question 4

In a future financial reporting period (say 2022) could GeorgianFarm voluntarily change its accounting policy for any of:

» farmland;

» living plants;

» harvested produce;

» pear refrigeration facility; and

» fruit juicing plant?

GeorgianFarm case study (continued)
Question 5A farmland accounting judgements

If no indications of impairment, what judgements would GeorgianFarm make to account (in its 31 December 2019 financial statements) for its farmland?

GeorgianFarm case study (continued)
Question 5B living plants accounting judgements

If no indications of impairment, what judgements would GeorgianFarm make to account (in its 31 December 2019 financial statements) for its living plants?

» Separate undue cost or effort judgements in determining whether to recognise the plants and, if so, the applicable measurement model.
   » **If fair value less costs to sell:** judgements in measuring the fair value of the pear trees, raspberry plants and tomato vines (fruit trees)
   » **If cost model:** judgements in measuring:
      » historical cost;
      » depreciation; and
      » impairment testing (ie identifying and assessing impairment indicators. (Note: if impairment had been indicated: significant judgements in measuring fair value less costs to sell and value in use).

GeorgianFarm case study (continued)
Question 5B living plants accounting judgements (continued)

When on contemplating the initial recognition of its living plants, would management conclude that neither the fair value nor the costs of its living plants can be measured reliably without **undue cost or effort**?

Analysis:

» Who is expected to use the financial statements?

» What are the benefits to the expected users of having the cost or fair value information? And could their decisions be affected by not having the cost or fair value information?

» What **incremental** cost (for example, valuers' fees) or effort (for example, endeavours by employees) would be required to determine cost or fair value of the living plants?

Concluding question: do the incremental costs or efforts of measuring cost or fair value of its living plants **substantially** exceed the benefits that those who are expected to use GeorgianFarm's financial statements would receive from having the information?

GeorgianFarm case study (continued)
Question 5B living plants accounting judgements (continued)

When after initial recognition of its living plants, would management conclude that the fair value of a living plants is not readily determinable without **undue cost or effort**?

Analysis:

» Who is expected to use the financial statements?

» What are the benefits to the expected users of having the fair value information? And could their decisions be affected by not having the fair value information?

» What **incremental** cost (for example, valuers' fees) or effort (for example, endeavours by employees) would be required to determine fair value of the living plants?

Concluding question: do the incremental costs or efforts of measuring fair value of its living plants **substantially** exceed the benefits that those who are expected to use GeorgianFarm's financial statements would receive from having the information?

GeorgianFarm case study (continued)
Question 5C harvested produce accounting judgements

What judgements would GeorgianFarm make to account (in its 31 December 2019 financial statements) for its harvested produce?

GeorgianFarm case study (continued)
Question 5D pear refrigeration facility and fruit juicing plant accounting judgements

If unimpaired, what judgements would GeorgianFarm make to account (in its 31 December 2019 financial statements) for its pear refrigeration facility and fruit juicing plant?

GeorgianFarm case study (continued)
Question 5E impairment judgements

Assuming that at 31/12/2019 there are indications of impairment, what judgements would GeorgianFarm make to test its assets for impairment?

» farmland;

» living plants;

» harvested produce;

» pear refrigeration facility; and

» fruit juicing plant?

THANK YOU for actively participating in the session!