

# Recognition and measurement risks in financial statements



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YOU HAVE THE ANSWER

- **IASB & IFRS**
- **Key notions**
- **Financial statements**
- **Recognition issues**
- **Measurement issues**

- **IASB**

- Created 1973 (IASC)
- Reorganised in 2001
- Administrative headquarter in London

- **IFRS**

- Until 2001 : 41 IAS published, still 30 are active
- Since 2002 : 13 IFRS published
- Interpretations (SIC, IFRIC)
- Dealing with Accounting and Reporting issues
- Transparent standard setting process

- **Europe**
  - **Manadatory since 2005 for group accounts of listed companies**
  - **Transition period until 2007 for certain companies**
  - **IFRS must be adopted by the EU to be applicable in member countries**
    - **Adoption process**
    - **No automatic adoption**
- **Adoption in more than 100 countries**
- **Convergence project with US standardsetter**

# Some key notions

- **True and fair view**
- **Principles based**
- **Substance over form**
- **Time value of money**

- **Balance sheet**
  - Financial position at closing date
- **Income statement and Statement of comprehensive income**
  - Economic performance of the accounting period
- **Statement of cash-flows**
  - Cash in- and outflows during the accounting period
- **Statement of changes in equity**
- **Notes**

# Balance sheet items

- **Assets**

- **Controlled by an entity as a result of past events**
- **Future economic benefits expected**

- **Liabilities**

- **Present obligation arising from a past event**
- **Settlement expected to result in an outflow of resources**

- **Equity**

- **Residual interest in the assets after deduction of liabilities**

# Recognition issues

- Internally generated intangible assets
- Leased assets
- Joint ventures
- Revenues



# Internally generated intangible assets

- **Development costs vs Research costs**
- **Conditions for recognition**
  - **Technical feasibility**
  - **Intention to complete**
  - **Ability to use or sell**
  - **Future economic benefits**
  - **Availability of resources**
  - **Ability to measure expenditure**

# Lease contracts

- **Finance lease vs Operating lease**
- **Criteria for distinction**
  - **Transfer of ownership**
  - **Bargain purchase option**
  - **Lease term for major part of economic life of the asset**
  - **Present value of lease payments amounts to substantially all of the fair value of the asset**
  - **Asset of specialised nature**

# Joint ventures

- **Entity controlled together with one or more partner(s)**
- **Recognition of assets and liabilities proportionally?**
  - **If so, assets and liabilities are recognised that are not existing as such and not controlled by the parent**

**= Proportional consolidation method**

# Revenues

- **Transfer to the buyer of the significant risks and rewards of ownership of goods or service rendered**
- **Issues**
  - **Sale and buy-back agreements**
  - **Customer loyalty programs**
  - **Guarantee services**

# Measurement issues

- Initial recognition
- Useful life
- Depreciation/Amortization method
- Cost model vs. Fair value model
- Impairment
- Pension obligations and other provisions

# Initial recognition

- **Definition of acquisition cost**

**Example: Cost of an A380**

- **Scope of production cost for internally generated assets**

- **Direct cost?**
- **Indirect cost?**

**Example: Development cost**

- **Useful life maybe definite, indefinite or unlimited**
  - **Decision taken for some categories of assets by entity (ex. brands)**
- **Useful life may vary from one entity to another for the same assets:**

**Example Aircrafts : AF-KLM 20 years, LH 12 years, EJ 23 years**

# Depreciation method

- **Straight line**
- **Double decline**
- **Variable**
- **Residual value ?**



- **Fair value**

- **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**
- **Three levels**
  - **1: unadjusted quoted prices in active markets for identical assets and liabilities**
  - **2: other observable inputs not included in 1**
  - **3: unobservable inputs including the entity's own data**

# Cost vs. Fair value

- **In case of fair value accounting : no depreciation but annual update of fair value – difference in net profit/loss or comprehensive income**
- **Fair value is mandatory for most of the financial instruments and optional for tangible assets**
- **Example Investment property of Unibail-Rodamco**
  - 2009 : -2138 Mio. €**
  - 2010 : +1695 Mio. €**

# Impairment test

- **Annually (indefinite useful life) or if indications**
- **Identification of Recoverable amount, ie. Value in use or Fair value less cost to sell**
- **Calculation of value in use requires assumptions about future benefits**
- **Identification of Cash-generating units**

**Example : Car project in car manufacturing industry**

# Pension obligations

- **Defined contribution plan vs. Defined benefit plan**
- **Defined benefit plans require assumptions about**
  - **Increase of salaries**
  - **Expected life (mortality)**
  - **Return of plan assets**
  - **Inflation**
  - ...

**Example Daimler 2010: Present value of pension obligation 17 684 Mio. €**

# Other provisions

- **Examples:**
  - **Warranties**
  - **Decontamination**
  - **Onerous contracts**
  - **Legal obligations**
  - **Court cases**
  - **...**
- **Best estimate of probability and amount**

**Thank you!**

**Questions ?**

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