О.І. Лугова

ОБЛІК І ФІНАНСОВА ЗВІТНІСТЬ ЗА МІЖНАРОДНИМИ СТАНДАРТАМИ (ІНОЗЕМНОЮ МОВОЮ)

КУРС ЛЕКЦІЙ

МІНІСТЕРСТВО ОСВІТИ І НАУКИ УКРАЇНИ
МИКОЛАЇВСЬКИЙ НАЦІОНАЛЬНИЙ АГРАРНИЙ УНІВЕРСИТЕТ

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Обліково-фінансовий факультет

Кафедра обліку і оподаткування

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для здобувачів вищої освіти ступеня «магістр»
спеціальності 071 «Облік і оподаткування» денної форми навчання

Миколаїв
2017

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Курс лекцій призначений для підготовки здобувачів вищої освіти освітнього ступеня «магістр» спеціальності 071 «Облік і оподаткування».

Містить основні положення з дисципліни «Облік і фінансова звітність за міжнародними стандартами (іноземною мовою)». Розкриваються концептуальні засади на рівні міжнародних стандартів, а також розглядаються основні аспекти визнання, оцінки та відображення за вимогами міжнародних стандартів фінансової звітності необоротних і оборотних активів, власного капіталу, зобов'язань та формування фінансової звітності. Курс лекцій допоможе сформувати у здобувачів вищої освіти певну лексичну базу, виробити уміння та навички спілкуватися англійською мовою з фаху.

Може бути корисним також для спеціалістів з бухгалтерського обліку, викладачів та здобувачів вищої освіти, які бажають поглибити знання англійської мови за професійним спрямуванням.

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INTRODUCTION

International Financial Reporting Standards (IFRS) is a set of accounting standards developed by an independent, not-for-profit organization called the International Accounting Standards Board (IASB). The goal of IFRS is to provide a global framework for how public companies prepare and disclose their financial statements. IFRS provides general guidance for the preparation of financial statements, rather than setting rules for industry-specific reporting.

One major benefit of international standards is that they consider input from professionals and legal authorities around the world. This can create a set of ethical guidelines that do not favor one culture over another, as can be the case when a foreign company adheres to its own domestic ethical values.

International standards for accounting systems and the format of financial statements simplifies international investment decisions. Investors can compare the financial statements of companies following IFRS, regardless of the company's country of origin. Without standards, making comparisons becomes less reliable, as the information presented in financial statements is calculated using different methods. The adoption of international standards has allowed stock-trading exchanges to merge across continents and opened up a range of new investment opportunities to people all over the world.

Having an international standard is especially important for large companies that have subsidiaries in different countries. Adopting a single set of world-wide standards will simplify accounting procedures by allowing a company to use one reporting language throughout. A single standard will also provide investors and auditors with a cohesive view of finances.

Companies increasingly seek strategic partners, customers or suppliers in foreign countries. International accounting standards give companies a common financial language and understanding, making it easier for them to do business together. International standards also create an entirely new industry, international accounting consultation, creating new opportunities for entrepreneurs in any country.

1. DEVELOPMENT AND IMPLEMENTATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

1. The IFRS Foundation, its mission and structure

2. IFRS. Developing the Standards

3. The role and the benefits of IFRS

4. First-time adoption of IFRS

5. Chart of accounts

1. The IFRS Foundation, its mission and structure

Many of the largest companies in the world often do more of their business in foreign lands than in their home country. Companies now access not only their home capital markets for financing but others as well.

As this globalization takes place, companies are recognizing the need to have one set of financial reporting standards. For globalization to be efficient, what is reported for a transaction in Paris should be reported the same way in, New York, or London.

A revolution is therefore occurring in financial reporting. In the past, many countries used their own set of standards or followed standards set by larger countries, such as those in Europe or in the United States. However, that situation is changing rapidly.

A single set of rules, called International Financial Reporting Standards (IFRS), is now being used by over 150 countries.

IFRS began as an attempt to harmonize accounting across the European Union but the value of harmonization quickly made the concept attractive around the world.

They are sometimes still called by the original name of **International Accounting Standards** (IAS).

IAS were issued between 1973 and 2001 by the Board of the International Accounting Standards Committee (IASC).

The International Accounting Standards Committee (IASC) was founded in

June 1973 in London.

It was responsible for developing the **International Accounting Standards** and promoting the use and application of these standards.

The IASC was founded as a result of an agreement between accountancy bodies in the following countries: Australia, Canada, France, Germany Japan, Mexico, the Netherlands, the United Kingdom and Ireland, the USA.

The IASC had about 140 member bodies from 104 countries.

The International Accounting Standards Committee (IASC) was renamed as The International Accounting Standards Board (IASB) in April 2001.

During its first meeting the new Board adopted existing IAS and Standing Interpretations Committee standards (SICs).

The IASB has continued to develop standards calling the new standards **International Financial Reporting Standards** (**IFRS**).

Consequently the standards issued thereafter are known as IFRS. Therefore all the standards issued after 2001 are IFRS. The previous IAS are still valid but are being gradually superseded by new IFRS.

The IFRS Foundation is an independent, privately organised, not-for-profit organisation, operating to serve the public interest. The governance and due process are designed to keep the standard-setting independent from special interests while ensuring accountability to our stakeholders around the world.

Its main objectives include the development and promotion of the International Financial Reporting Standards (IFRSs) through the International Accounting Standards Board (IASB), which it oversees.

The mission of IFRS Foundation is to bring transparency, accountability and efficiency to financial markets around the world by developing IFRS. IFRS Foundation's work serves the public interest by fostering trust, growth and long-term financial stability in the global economy.

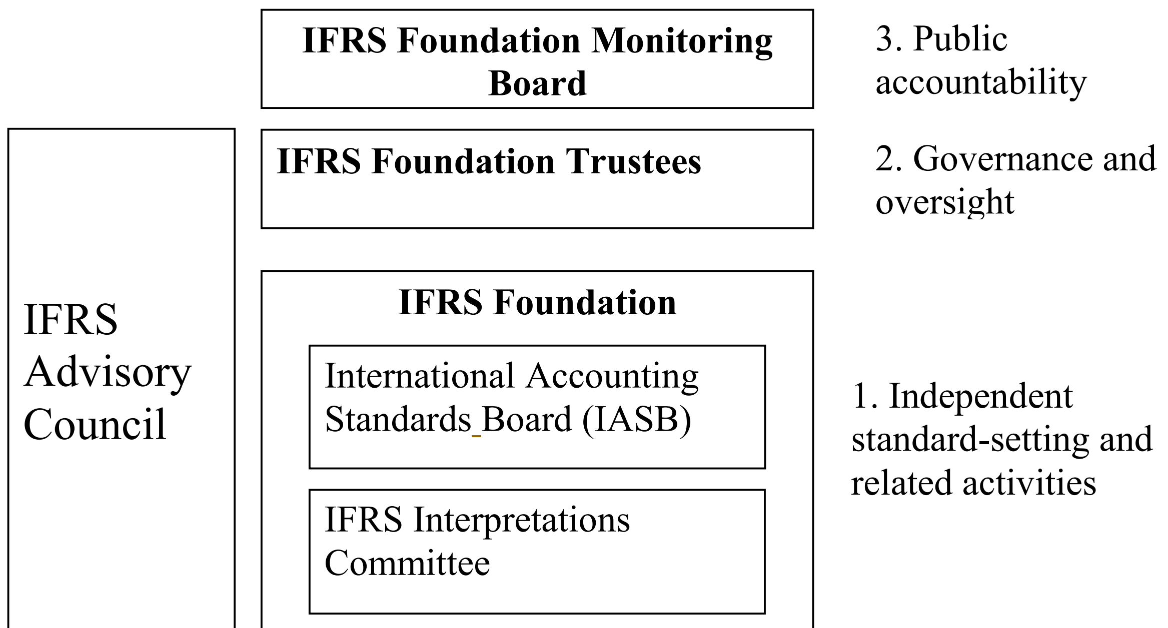
IFRS:

- bring **transparency** by enhancing the international comparability and quality of financial information, enabling investors and other market participants to

make informed economic decisions.

- strengthen **accountability** by reducing the information gap between the providers of capital and the people to whom they have entrusted their money. IFRS Standards provide information needed to hold management to account. As a source of globally comparable information, IFRS Standards are also of vital importance to regulators around the world.
- contribute to economic **efficiency** by helping investors to identify opportunities and risks across the world, thus improving capital allocation. Use of a single, trusted accounting language lowers the cost of capital and reduces international reporting costs for businesses.

The IFRS Foundation has a three-tier governance structure, based on an independent standard-setting Board of experts (International Accounting Standards Board), governed and overseen by Trustees from around the world (IFRS Foundation Trustees) who in turn are accountable to a monitoring board of public authorities (IFRS Foundation Monitoring Board).



The IFRS Advisory Council provides advice and counsel to the Trustees and the Board, whilst the Board also consults extensively with a range of other standing advisory bodies and consultative groups.

The governance and oversight of the activities undertaken by the IFRS Foundation and its standard-setting body rests with its Trustees, who are also

responsible for safeguarding the independence of the IASB and ensuring the financing of the organization.

At their January 2009 meeting the Trustees of the Foundation concluded the first part of the second Constitution Review, announcing the creation of a Monitoring Board and the expansion of the IASB to 16 members and giving more consideration to the geographical composition of the IASB.

The Trustees are publicly accountable to a Monitoring Board of public authorities.

The International Accounting Standards Board (IASB) is the independent standard-setting body of the IFRS Foundation.

Its members are responsible for the development and publication of IFRSs, and for approving **Interpretations of IFRSs** as developed by the **IFRS Interpretations Committee** (**the IFRIC**).

The International Accounting Standards Board (IASB) is an independent group of 16 experts with an appropriate mix of recent practical experience in setting accounting standards, in preparing, auditing, or using financial reports, and in accounting education.

The IASB was founded on April 1, 2001 as the successor to the International Accounting Standards Committee (IASC).

The **IFRS Interpretations Committee** is the interpretative body of the IASB.

IFRS Interpretations Committee replaced the former Standing Interpretations Committee (SIC) in March 2002.

SIC was the committee which made interpretations on IAS.

The IFRS Interpretations Committee comprises 14 voting members drawn from a variety of countries and professional backgrounds.

Its brief is to provide timely guidance on issues that arise in practice.

They are appointed by the Trustees of the IFRS Foundation.

The mandate of the Interpretations Committee is to review on a timely basis widespread accounting issues that have arisen within the context of current

IFRSs and to provide authoritative guidance **(IFRICs)** on those issues.

The Trustees promote the work of the International Accounting Standards Board (IASB)and the rigorous application of IFRSs but are not involved in any technical matters relating to the standards. This responsibility rests solely with the IASB.

Trustees are appointed for a renewable term of three years. Each Trustee is expected to have an understanding of, and be sensitive to, international issues relevant to the success of an international organisation responsible for the development of high quality global accounting standards for use in the world's capital markets and by other users.

Six of the Trustees must be selected from the Asia/Oceania region, six from Europe, six from North America, one from Africa, one from South America and two from the rest of the world.

The Monitoring Board was created in January 2009 with the aim of "providing a formal link between the Trustees and public authorities" in order to enhance the public accountability of the IFRS Foundation.

The Monitoring Board's main responsibilities are to ensure that the Trustees continue to discharge their duties as defined by the IFRS Foundation Constitution, as well as approving the appointment or reappointment of Trustees. The Monitoring Board meets the Trustees at least once a year, or more often if appropriate.

The Monitoring Board consists of capital markets authorities responsible for setting the form and content of financial reporting. Through the Monitoring Board, securities regulators that allow or require the use of IFRS in their jurisdictions will be able to more effectively carry out their mandates regarding investor protection, market integrity, and capital formation.

The IFRS Advisory Council is the formal advisory body to the IASB and the Trustees of the IFRS Foundation. It is comprised of a wide range of representatives from user groups, preparers, financial analysts, academics, auditors, regulators, professional accounting bodies and investor groups that are affected by

and interested in the IASB's work. Members of the Advisory Council are appointed by the Trustees. The Advisory Council normally meets three times a year for a period of two days.

2. IFRS. Developing the Standards

International Financial Reporting Standards (IFRSs) are Standards and Interpretations adopted by the International Accounting Standards Board (IASB). They comprise:

(a) International Financial Reporting Standards;

(b) International Accounting Standards; and

(c) Interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

List of International Financial Reporting Standards (IFRS)

№	International Financial Reporting Standards (IFRS)
1	First-time Adoption of IFRS
2	Share-based Payment
3	Business Combinations
4	Insurance Contracts
5	Non-current Assets Held for Sale and Discontinued Operations
6	Exploration for and Evaluation of Mineral Resources
7	Financial Instruments: Disclosures
8	Operating Segments
9	Financial Instruments
10	Consolidated Financial Statements
11	Joint Arrangements
12	Disclosure of Interests in Other Entities
13	Fair Value Measurement
14	Regulatory Deferral Accounts
15	Revenue from Contracts with Customers
16	Leases
17	Insurance Contracts

List of International Accounting Standards (IAS)

№	International Accounting Standards (IAS)
1	Presentation of Financial Statements
2	Inventories
7	Cash Flow Statements
8	Accounting Policies, Changes in Accounting Estimates and Errors
10	Events After the Balance Sheet Date
11	Construction Contracts

12	Income Taxes
16	Property, Plant & Equipment
17	Leases
18	Revenue
19	Employee Benefits
20	Accounting for Government Grants and Disclosure of Government Assistance
21	The Effects of Changes in Foreign Exchange Rates
23	Borrowing Costs
24	Related Party Disclosures
26	Accounting and Reporting by Retirement Benefit Plans
27	Consolidated and Separate Financial Statements
28	Investments in Associates
29	Financial Reporting in Hyperinflationary Economies
32	Financial Instruments: Presentation
33	Earnings per Share
34	Interim Financial Reporting
36	Impairment of Assets
37	Provisions, Contingent Liabilities and Contingent Assets
38	Intangible Assets
40	Investment Property
41	Agriculture

Interpretations of IFRS Interpretations Committee are known as IFRIC while the Interpretations of the Standing Interpretations Committee (SIC) were known as SIC.

List of Interpretations (before 2003)

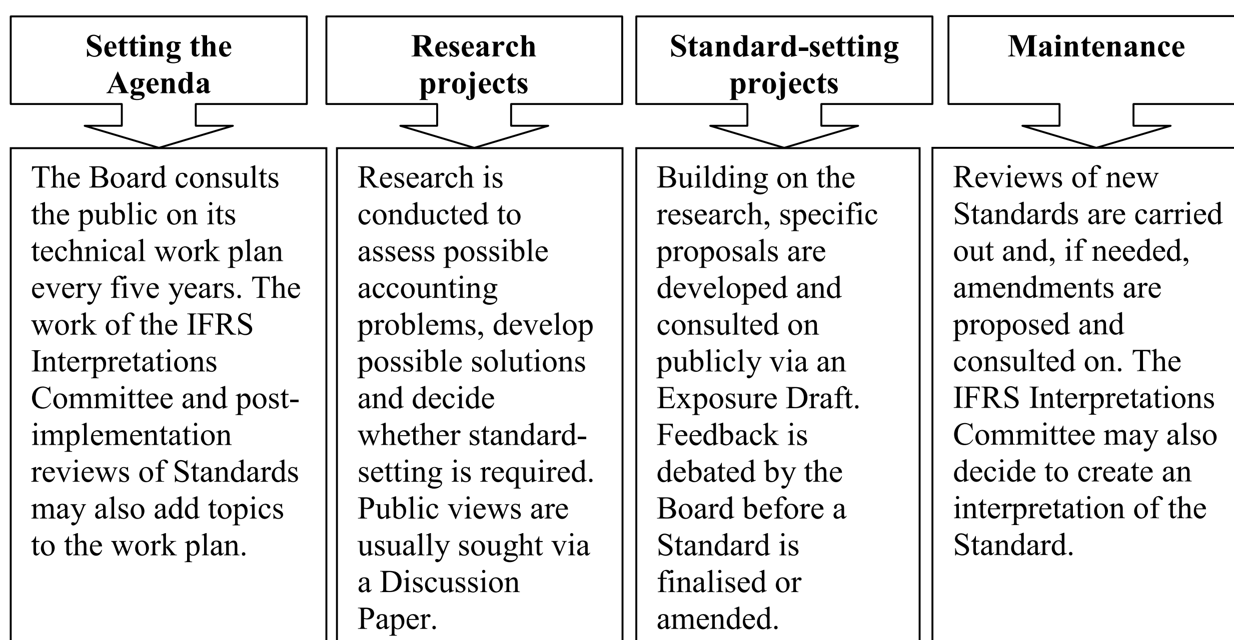
№	Standing Interpretations Committee of the IASC (SIC)
SIC 7	Introduction of the Euro
SIC 10	Government Assistance — No Specific Relation to Operating Activities
SIC 15	Operating Leases — Incentives
SIC 25	Iincome Taxes — Changes in the Tax Status of an Entity or its Shareholders
SIC 27	Evaluating the Substance of Transactions in the Legal Form of a Lease
SIC 29	Disclosure — Service Concession Arrangements
SIC 31	Revenue — Barter Transactions Involving Advertising Services
SIC 32	Intangible Assets — Website Costs

List of Interpretations (after 2003)

№	International Financial Reporting Interpretations Committee of the IASB (IFRIC)
IFRIC 1	Changes in Existing Decommissioning, Restoration and Similar Liabilities
IFRIC 2	Members' Shares in Cooperative Entities and Similar Instruments
IFRIC 4	Determining whether an Arrangement contains a Lease
IFRIC 5	Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
IFRIC 6	Liabilities arising from Participating in a Specific Market — Waste Electrical and Electronic Equipment

IFRIC 7	Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies
IFRIC 9	Reassessment of Embedded Derivatives
IFRIC 10	Interim Financial Reporting and Impairment
IFRIC 12	Service Concession Arrangements
IFRIC 13	Customer Loyalty Programmes
IFRIC 14	The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction
IFRIC 15	Agreements for the Construction of Real Estate
IFRIC 16	Hedges of a Net Investment in a Foreign Operation
IFRIC 17	Distributions of Non-cash Assets
IFRIC 18	Transfers of Assets from Customers
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments
IFRIC 20	Stripping Costs in the Production Phase of a Surface Mine
IFRIC 21	Levies
IFRIC 22	Foreign Currency Transactions and Advance Consideration
IFRIC 23	Uncertainty over Income Tax Treatments

The process for developing the Standards is highly transparent; every stage involves public consultation. The public can also access all Board papers and observe all Board meetings via our website or by attending the meetings.



Steps in the standard-setting process

The IFRS Foundation supports the implementation and application of the Standards, often working in collaboration with other organisations with responsibilities in this area. Activities include education support for newly-issued Standards, conferences and other education materials.

3. The role and the benefits of IFRS

International Financial Reporting Standards (**IFRS**) are designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries. They are a consequence of growing international shareholding and trade and are particularly important for companies that have dealings in several countries. They are progressively replacing the many different national accounting standards. The rules to be followed by accountants to maintain books of accounts which is comparable, understandable, reliable and relevant as per the users internal or external.

Currently, profiles are completed for 150 jurisdictions.

Afghanistan	Albania	Angola	Anguilla	Antigua and Barbuda	Argentina
Armenia	Australia	Austria	Azerbaijan	Bahamas	Bahrain
Bangladesh	Barbados	Belarus	Belgium	Belize	Bermuda
Bhutan	Bolivia	Bosnia and Herzegovina	Botswana	Brazil	Brunei Darussalam
Bulgaria	Cambodia	Canada	Cayman Islands	Chile	China
Colombia	Costa Rica	Croatia	Cyprus	Czech Republic	Denmark
Dominica	Dominican Republic	Ecuador	Egypt	El Salvador	Estonia
European Union	Fiji	Finland	France	Gambia	Georgia
Germany	Ghana	Greece	Grenada	Guatemala	Guinea-Bissau
Guyana	Honduras	Hong Kong SAR	Hungary	Iceland	India
Indonesia	Iran	Iraq	Ireland	Israel	Italy
Jamaica	Japan	Jordan	Kazakhstan	Kenya	Kosovo
Kuwait	Latvia	Lesotho	Liberia	Liechtenstein	Lithuania
Luxembourg	Macao	Macedonia	Madagascar	Malawi	Malaysia
Maldives	Malta	Mauritius	Mexico	Moldova	Mongolia
Montenegro	Montserrat	Myanmar	Namibia	Nepal	Netherlands
New Zealand	Nicaragua	Niger	Nigeria	Norway	Oman

Pakistan	Palestine	Panama	Paraguay	Peru	Philippines
Poland	Portugal	Qatar	Romania	Russia	Rwanda
Saudi Arabia	Serbia	Sierra Leone	Singapore	Slovakia	Slovenia
South Africa	South Korea	Spain	Sri Lanka	St Kitts and Nevis	St Lucia
St Vincent and the Grenadines	Suriname	Swaziland	Sweden	Switzerland	Syria
Chinese Taipei	Tanzania	Thailand	Timor-Leste	Trinidad and Tobago	Turkey
Uganda	Ukraine	United Arab Emirates	United Kingdom	United States	Uruguay
Uzbekistan	Venezuela	Vietnam	Yemen	Zambia	Zimbabwe

Global application of IFRS will make the comparison of financial statements easier for foreign investors which is advantageous for companies to attract investors.

It is generally expected that IFRS adoption worldwide will be beneficial to investors and other users of financial statements, by reducing the costs of comparing alternative investments and increasing the quality of information.

Companies are also expected to benefit, as investors will be more willing to provide financing.

Companies that have high levels of international activities are among the group that would benefit from a switch to IFRS.

Companies that are involved in foreign activities and investing benefit from the switch due to the increased comparability of a set accounting standard.

It offers accounting professionals more opportunities in any part of the world if same accounting practices prevail throughout the world.

Today, everything in the world comes closer than ever before. Things are harmonizing and people learn to think and act global.

And indeed, you can see that in every step you make—you can shop the same items anywhere in the world, you can get the same food in McDonalds anywhere in the world, you can even fly anywhere in the world in less than 24 hours.

Accounting and financial reporting are no exception. This is where IFRS has its own spot—it will serve as unified set of principles for financial reporting anywhere in the world.

4. First-time adoption of IFRS

Date of transition to IFRSs The beginning of the earliest period for which an entity presents full comparative information under IFRSs in its **first IFRS financial statements**

First IFRS financial statements The first annual financial statements in which an entity adopts **International Financial Reporting Standards (IFRSs)**, by an explicit and unreserved statement of compliance with IFRSs.

First-time adopter An entity that presents its **first IFRS financial statements**.

5. Chart of accounts

To keep a company's financial data organized, accountants developed a system that sorts transactions into records called **accounts**.

Because every business transaction affects *at least two* accounts, our accounting system is known as a **double-entry** system.

Although the system is referred to as double-entry, a transaction may involve more than two accounts.

When a company's accounting system is set up, the accounts most likely to be affected by the company's transactions are identified and listed out. This list is referred to as the company's **chart of accounts**.

A chart of accounts is a listing of the names of the **accounts** that a company has identified and made available for recording transactions in its general ledger.

Within the chart of accounts you will find that the accounts are typically listed in the following order:

Balance sheet accounts	Assets Liabilities Owner's (Stockholders') Equity
Income statement accounts	Operating Revenues Operating Expenses Non-operating Revenues and Gains Non-operating Expenses and Losses

Depending on the size of a company and the complexity of its business operations, the chart of accounts may list as few as thirty accounts or as many as thousands. A company has the flexibility of tailoring its chart of accounts to best meet its needs.

Each account in the chart of accounts is typically assigned a name and a unique number by which it can be identified. (Software for some small businesses may not require account numbers.) Account numbers are often five or more digits in length with each digit representing a division of the company, the department, the type of account, etc.

2. PROPERTY, PLANT AND EQUIPMENT. INVESTMENT PROPERTY

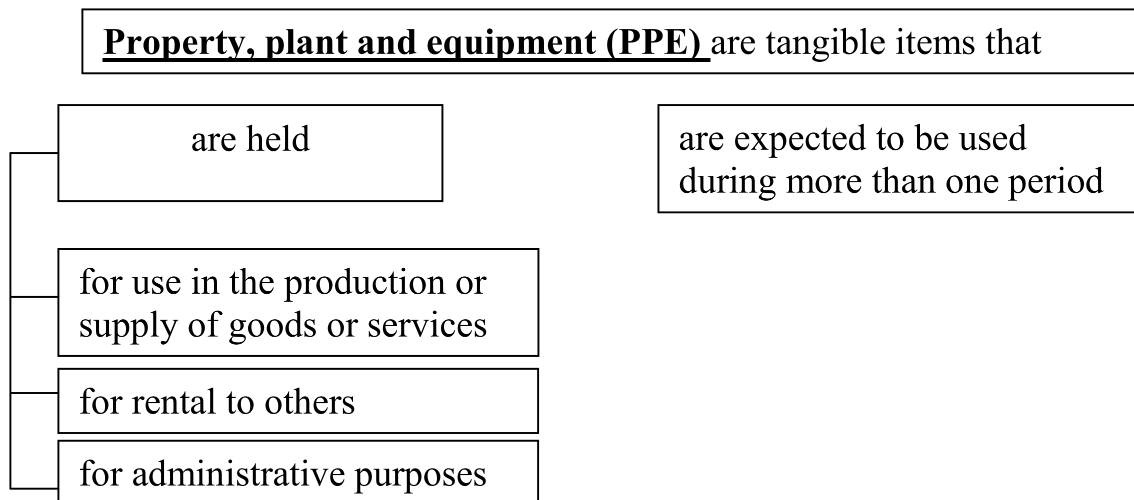
1. **Recognition of PPE**
2. **Measurement of PPE**
3. **Depreciation**
4. **Derecognition of PPE**
5. **Disclosure of PPE in the financial statements**
6. **Investment Property**

1. Recognition of PPE

Property, plant and equipment are tangible items that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period.



A class of property, plant and equipment is a grouping of assets of a similar nature and use in an entity's operations. The following are examples of separate classes:

(a) land;

(b) land and buildings;

(c) machinery;

(d) ships;

(e) aircraft;

(f) motor vehicles;

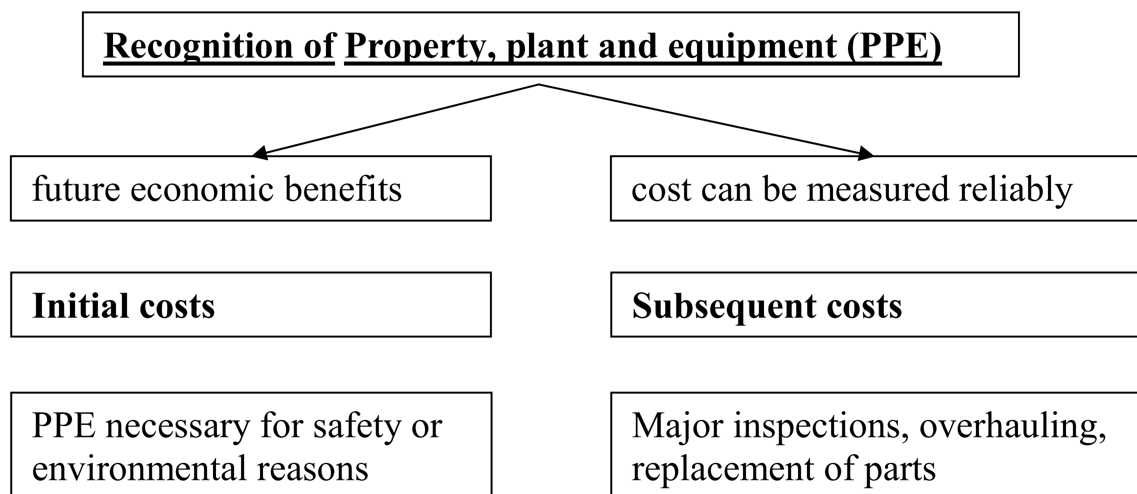
(g) furniture and fixtures; and

(h) office equipment.

IAS 16 states that the cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

- it is probable that future economic benefits associated with the item will flow to the entity; and
- the cost of the item can be measured reliably.

This recognition principle shall be applied to all costs at the time they are incurred, both **incurred initially** to acquire or construct an item of property, plant and equipment and **incurred subsequently after recognition** to add to, replace part of or service it.



Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, eg IFRS 2 Share-based Payment.

Initial costs

Some items of property, plant and equipment might be necessary to acquire for safety or environmental reasons. Although they do not directly increase the future economic benefits, they might be inevitable to obtain future economic

benefits from other assets and therefore, should be recognized as an asset. For example, water cleaning station might be necessary in order to proceed with some chemical processes within chemical manufacturer.

Subsequent costs

Day-to-day servicing of the item shall be recognized in profit or loss as incurred, because they just maintain (not enhance) item's capacity to bring future economic benefits.

However, some parts of the item of property, plant and equipment may require replacement at regular intervals, for example, aircraft interiors. In such a case, an entity derecognizes carrying amount of older part and recognizes the cost of new part into the carrying amount of the item. The same applies to major inspections for faults, overhauling and similar items.

2. Measurement of PPE

Initial Measurement

An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its **cost.**

The cost of an item of property, plant and equipment comprises:

1. its **purchase price** including import duties, non-refundable purchase taxes, after deducting trade discounts and rebates
2. any **costs directly attributable** to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Examples of these costs are: costs of site preparation, professional fees, initial delivery and handling, installation and assembly, etc.,
3. the initial estimate of **the costs of dismantling and removing the item and restoring the site**on which it is located.

The cost of an item of property, plant and equipment is the **cash price equivalent** at the recognition date.

If payment is **deferred** beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognized as **interest** over the

period of credit (unless such interest is capitalized in accordance with IAS 23).

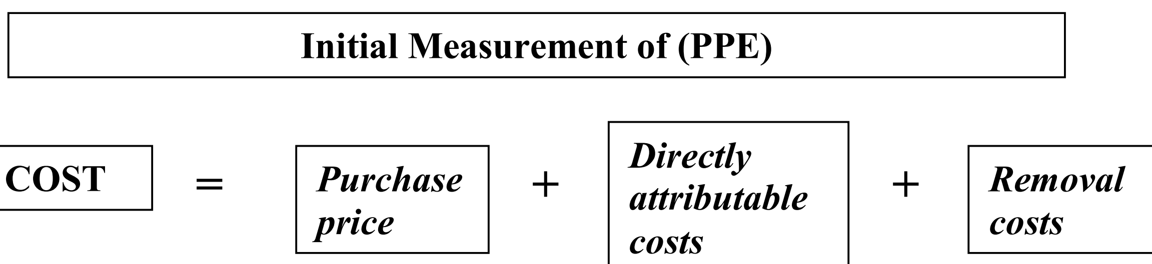
If an asset is acquired in exchange for another non-monetary asset, the cost will be measured at the fair value unless

(a) the exchange transaction lacks commercial substance or

(b) the fair value of neither the asset received nor the asset given up is reliably measurable.

If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

Initial Measurement of (PPE)



The cost of an item of property, plant and equipment is the ***cash price equivalent*** at the recognition date.

If an asset is acquired in exchange for another non-monetary asset, the cost will be measured at the **fair value**

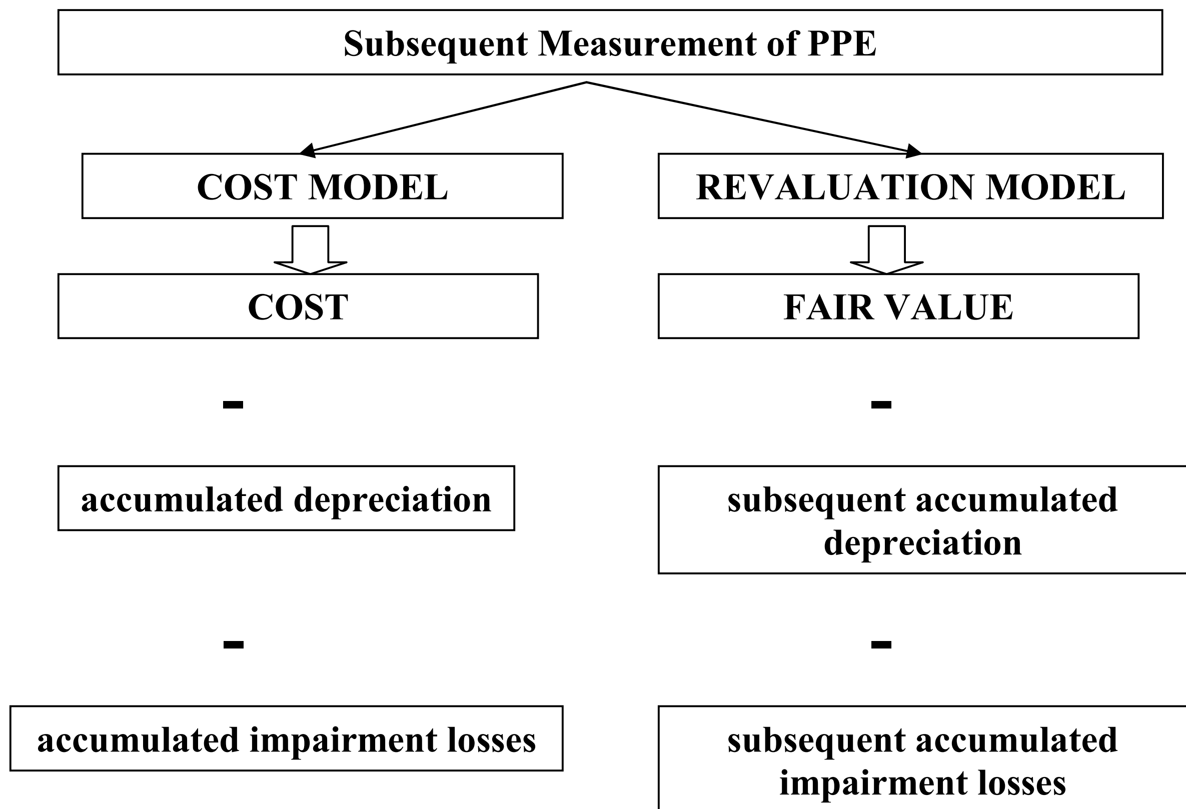
Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

Subsequent Measurement

An entity may choose 2 accounting models for its property plant and equipment:

1. **Cost model** An entity shall carry an asset at its ***cost less any accumulated depreciation and any accumulated impairment losses***.

2. **Revaluation model** An entity shall carry an asset at a ***revalued amount***. Revalued amount is its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses.



An **impairment loss** is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use.

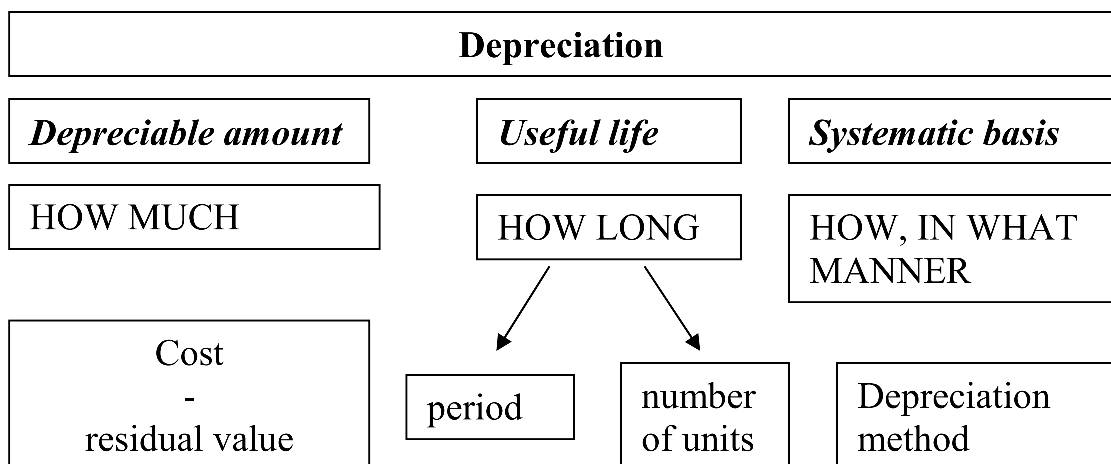
An entity shall revalue its assets with sufficient regularity so that the carrying amount does not differ materially from its fair value at the end of the reporting period.

If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.

3. Depreciation

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

The items of PPE are usually depreciated in order to maintain matching principle – as they are in operation for more than 1 year, they assist in producing the revenues in more than 1 year and therefore, their cost shall be spread among those years in order to match the revenue they help to produce.



When dealing with the depreciation please do have 3 basic things in mind:

- ***Depreciable amount*** is simply HOW MUCH you are going to depreciate. It is the cost of an asset, or other amount substituted for cost, less its residual value.
- ***Depreciation period*** is simply HOW LONG you are going to depreciate and it is basically asset's **useful life**.

Useful life is:

(a) the period over which an asset is expected to be available for use by an entity; or

(b) the number of production or similar units expected to be obtained from the asset by an entity.

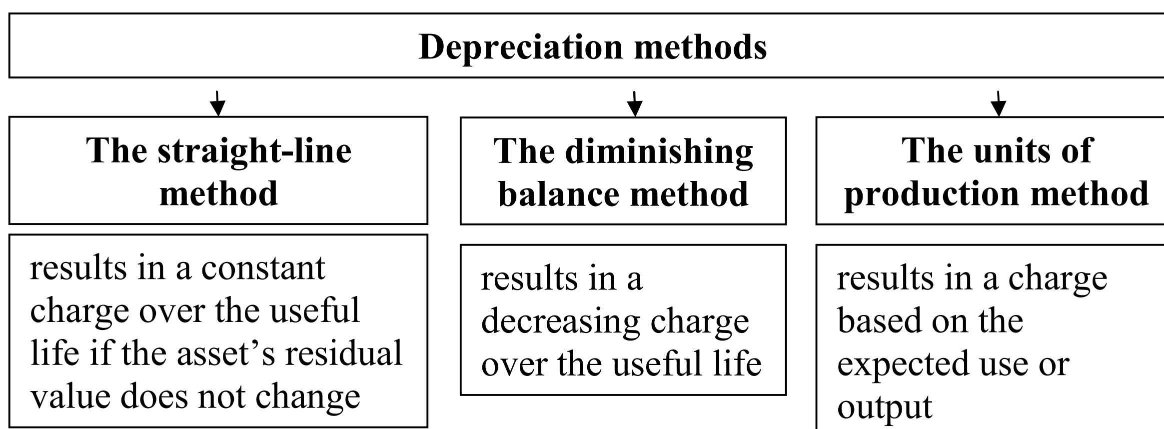
IFRS16 lists several factors that shall be considered when establishing item's useful life: expected usage of the item, expected physical wear and tear, technical or commercial obsolescence of the item, and legal or other limits on the use of the asset. Useful life and asset's residual value (input to depreciable amount) shall be reviewed ***at least at the end of each financial year.*** If there is a change in the expectations comparing to previous estimates, then change shall be accounted for as a change in an accounting estimate in line with IAS 8 (no restatement of previous periods).

- ***Depreciation method*** is simply HOW, IN WHAT MANNER you are going to depreciate.

The depreciation method used shall reflect the pattern in which the asset's

future economic benefits are expected to be consumed by the entity.

A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life.



The entity selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits.

The depreciation charge for each period shall be recognised in profit or loss unless it is included in the carrying amount of another asset.

Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

For example, aircraft interior cost might be depreciated separately from the remaining airplane cost.

Carrying amount is the amount at which an asset is recognised after deducting any accumulated depreciation and accumulated impairment losses.

The **residual value** of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

4. Derecognition of PPE

The carrying amount of an item of property, plant and equipment shall be derecognised:

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.

Derecognition of PPE

on disposal

no future economic benefits are expected

gain or ***loss***

= net disposal proceeds - the carrying amount

Gain or ***loss are*** included in Profit or Loss, but not as Revenue

The gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognised. Gains shall not be classified as revenue.

The gain or loss arising from the derecognition of an item of PPE shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

5. Disclosure of PPE in the financial statements

The financial statements shall disclose, for each class of PPE:

(a) the measurement bases used for determining the gross carrying amount;

(b) the depreciation methods used;

(c) the useful lives or the depreciation rates used;

(d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and

(e) a reconciliation of the carrying amount at the beginning and end of the period showing:

(i) additions;

(ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with IFRS 5 and other disposals;

(iii) acquisitions through business combinations;

(iv) increases or decreases resulting from revaluations under paragraphs 31, 39 and 40 and from impairment losses recognised or reversed in other comprehensive income in accordance with IAS 36;

(v) impairment losses recognised in profit or loss in accordance with IAS 36;

(vi) impairment losses reversed in profit or loss in accordance with IAS 36;

(vii) depreciation;

(viii) the net exchange differences arising on the translation of the financial statements from the functional currency into a different presentation currency, including the translation of a foreign operation into the presentation currency of the reporting entity; and

(ix) other changes.

The financial statements shall also disclose:

(a) the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;

(b) the amount of expenditures recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;

(c) the amount of contractual commitments for the acquisition of property, plant and equipment; and

(d) if it is not disclosed separately in the statement of comprehensive income, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss.

6. Investment Property

Investment property is property (land or a building—or part of a building—or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

(a) use in the production or supply of goods or services or for administrative purposes; or

(b) sale in the ordinary course of business.

An investment property shall be measured initially at its cost. Transaction costs shall be included in the initial measurement.

Transfers to, or from, investment property shall be made when, and only when, there is a change in use, evidenced by:

(a) commencement of owner-occupation, for a transfer from investment property to owner-occupied property;

(b) commencement of development with a view to sale, for a transfer from investment property to inventories;

(c) end of owner-occupation, for a transfer from owner-occupied property to investment property; or

(d) commencement of an operating lease to another party, for a transfer from inventories to investment property.

3. INTANGIBLE ASSETS

1. The definition, recognition and types of intangible assets

2. Sources and measurement of intangible assets

3. Amortization and disposal of intangible assets

4. Disclosure of intangible assets in the financial statements

1. The definition, recognition and types of intangible assets

An **intangible asset** is an identifiable non-monetary asset without physical substance.

Intangible assets are assets that lack physical existence and are not financial instruments.

Intangible assets are usually classified as non-current (long-term) assets because they produce benefits over several years. They are valuable because they provide rights and privileges to their owners.

An asset is a resource that is controlled by the entity as a result of past events (for example, purchase or self-creation) and from which future economic benefits (inflows of cash or other assets) are expected. Thus, the three critical attributes of an intangible asset are:

- identifiability
- control (power to obtain benefits from the asset)
- future economic benefits (such as revenues or reduced future costs)

An intangible asset meets the **identfiability criterion** when:

- it is separable, that is it can be separated or divided from the entity and sold, transferred, licensed or exchanged, either individually or together with a related contract, asset or liability: or
- arises from contractual or other legal rights, whether or not those rights are transferable or separable from the entity or from other rights and obligations.

The criteria for **recognition** of an intangible asset are that:

- it meets the definition of an intangible asset;

- it is probable that future economic benefits attributable to the asset will flow to the entity; and
- the asset's cost can be reliably measured.

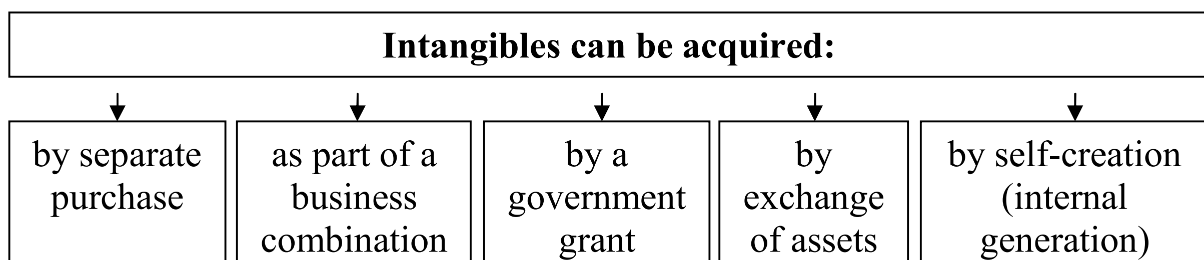
Control exists where an entity has the power to obtain the future economic benefits from an underlying resource and to restrict the access of others to those benefits.

Control is usually evidenced by legally enforceable contractual or other rights, such as legal title or a licence. In the absence of legal rights, it is more difficult to demonstrate control. The entity may be able to control the future economic benefits in some other way, for example control over the benefits of know-how may be attained through secrecy.

Examples of possible intangible assets include:

✓ computer software
✓ patents
✓ copyrights
✓ motion picture films
✓ customer lists
✓ mortgage servicing rights
✓ licenses
✓ import quotas
✓ franchises
✓ customer and supplier relationships
✓ marketing rights

2. Sources and measurement of intangible assets



Intangible assets acquired separately or as part of a business combination

The probability recognition criterion is always satisfied when intangible assets are acquired separately or as part of a business combination. This is because the price paid reflects expectations about the probability that the future economic benefits of the asset will flow to the entity.

IFRS 3, 'Business combinations', contains an illustrative list of items acquired in a business combination that meet the definition of an intangible asset. The summarised list is as follows:

- Marketing-related intangible assets, including trademarks, internet domain names and newspaper mastheads.
- Customer-related intangible assets, including customer lists, order backlogs, customer contracts and non-contractual customer relationships.
- Artistic-related intangible assets, including copyrights for plays, books and musical works.
- Contract-based intangible assets, including licence agreements, management contracts and broadcasting rights.
- Technology-based intangible assets, including patented technology, databases and trade secrets such as secret formulas, processes or recipes.

Internally generated intangible assets

There will always be difficulties with identifying internally generated intangible assets and in distinguishing the expected future economic benefits that might be attributable to the internally generated intangible assets from those expected from the business as a whole.

Research and development

The process of generating an intangible asset is divided into a research phase and a development phase.

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

Development is 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 commencement of commercial production or use. Development is more closely related to the earnings process than research.

Non-qualifying expenditure

Costs that are indistinguishable from the costs of developing the business as a whole should be expensed as incurred and include start up, training, advertising and promotion costs, relocation and reorganisation costs.

Initial measurement

Intangible assets should be measured initially at cost.

Separately acquired intangible assets

The cost of a separately acquired intangible asset comprises the purchase price, including import duties and non-refundable purchase taxes after deducting trade discounts and rebates. Directly attributable costs of preparing the asset for its intended use are also included. The cost can usually be measured reliably, particularly when the purchase consideration is in the form of cash or other monetary assets.

Intangible assets acquired as part of a business combination

The cost of an intangible asset that is acquired as part of a business combination is represented by the asset's fair value at the acquisition date.
Internally-generated intangible assets

The cost of internally-generated intangibles should include all directly attributable costs incurred in the creation of the asset from the date on which the asset first met the recognition criteria

Examples of directly attributable costs include the costs of materials and services used or consumed in generating the asset, employment costs of those directly involved in creating the asset, depreciation of relevant property, plant and equipment, amortisation of patents and licences utilised in creating the asset legal fees and registration fees. The costs capitalised should also include borrowing costs where relevant.

Intangible assets acquired by way of government grant

An intangible asset may sometimes be acquired free of charge or for a nominal amount, by way of government grant. Intangible assets such as these may be recognised either at fair value or nominal value.

Exchange of intangible assets

An intangible asset acquired in exchange for a non-monetary asset or for a combination of monetary and non-monetary assets should be measured at fair value, unless the exchange transaction lacks commercial substance or the fair value of neither the asset given up nor the asset received can be reliably measured. If the intangible asset is not measured at fair value, it is measured at the carrying amount of the asset given up.

Subsequent expenditure

The nature of many intangible assets is that there are often no additions to the asset or replacements to parts of it. Therefore, most subsequent expenditure is likely to be incurred to maintain the asset and will not usually meet the criteria for recognition as an asset. Moreover, it is often difficult to attribute subsequent expenditure to a particular intangible asset rather than to the business as a whole. For this reason, most subsequent expenditure will not qualify as an asset and will be expensed as incurred. Subsequent expenditure on intangible assets is only capitalised in rare circumstances.

Subsequent expenditure on acquired research and development is expensed as incurred until the project meets the criteria for recognition. Once the criteria are met all subsequent expenditure is capitalised

Measurement subsequent to initial recognition

Subsequent to initial recognition, an entity may choose to adopt the cost or revaluation model as its accounting policy if the asset is traded in an active market.

Under the cost model the intangible asset is carried at cost less any accumulated amortisation and impairment losses.

Under the revaluation model the intangible asset is carried at a revalued amount. This amount is the asset's fair value (the active market price) at the date of valuation less subsequent accumulated amortisation and impairment losses.

3. Amortization and disposal of intangible assets

Useful life for an intangible asset is the period over which the asset is expected to be available for use by an entity or the number of production or similar units expected to be obtained from the asset by an entity.

Intangible assets are classified **based on useful life**.

- **Indefinite life:** no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity.
- **Finite life:** a limited period of benefit to the entity.

Amortisation – intangibles with finite lives

Where an intangible asset has a finite useful life its depreciable amount should be amortised on a systematic basis over that life.

The amortisation method should reflect the pattern of consumption of the economic benefits expected from the asset or, if the pattern cannot be reliably determined, the entity should apply the straight-line method of amortisation. Amortisation is recorded in the income statement, unless it is permitted or required to be included in the carrying amount of another asset.

A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include straight-line method, the diminishing balance method and the unit of production method.

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

Derecognition of intangible assets

Where an intangible asset is disposed of or where no future economic benefits are expected from its use or disposal it should be derecognised.

Gains and losses arising on derecognition should be calculated as the difference between the asset's net disposal proceeds and its carrying amount and

should be recognised in the income statement.

4. Disclosure of intangible assets in the financial statements

For each class of intangible asset, disclose:

- ✓ useful life or amortisation rate
- ✓ amortisation method
- ✓ gross carrying amount
- ✓ accumulated amortisation and impairment losses
- ✓ line items in the income statement in which amortisation is included
- ✓ reconciliation of the carrying amount at the beginning and the end of the period showing:
- ✓ additions (business combinations separately)
- ✓ assets held for sale
- ✓ retirements and other disposals
- ✓ revaluations
- ✓ impairments
- ✓ reversals of impairments
- ✓ amortisation
- ✓ foreign exchange differences
- ✓ other changes
- ✓ basis for determining that an intangible has an indefinite life
- ✓ description and carrying amount of individually material intangible assets
- ✓ certain special disclosures about intangible assets acquired by way of government grants
- ✓ information about intangible assets whose title is restricted
- ✓ contractual commitments to acquire intangible assets

Additional disclosures are required about:

- intangible assets carried at revalued amounts
- the amount of research and development expenditure recognised as an expense in the current period.

4. INVENTORIES

1. **Definitions and measurement of inventories**
2. **Inventory Costing Methods**
3. **Perpetual and Periodic Inventory Systems**
4. **Recognition as an expense**
5. **Disclosure of inventories in the financial statements**

1. Definitions and measurement of inventories

Inventories are assets:

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

The term inventory refers to the stock of goods which the business holds in a variety of forms:

- Raw materials for use in a subsequent manufacturing process.
- Work in progress, partly manufactured goods.
- Finished goods, completed goods ready for sale to customers.
- Finished goods which the business has bought for resale to customers.

A manufacturer may hold three categories of inventory:

- raw materials
- work in progress
- finished goods

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.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Inventories shall be measured at the lower of (1) and (2)

(1) Cost

(2) Net realisable value.

The **cost of inventories** shall comprise

all costs of purchase,

costs of conversion

and other costs incurred in bringing the inventories to their present location and condition.

The **costs of purchase** of inventories comprise

the purchase price,

import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities),

and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services.

Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

The **costs of conversion** of inventories include costs directly related to the units of production, such as direct labour.

They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods.

Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration.

Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include non-production overheads or the costs of designing products for specific customers in the cost of inventories.

Net realisable value is:

(1) net amount expected to realise

(2) from selling inventories

(3) during ordinary course of business

Net realisable value is entity-specific.

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.

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. This is simply the expected revenue from the sale of inventory after deducting any further costs that are necessary in order to sell the inventory.

Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:

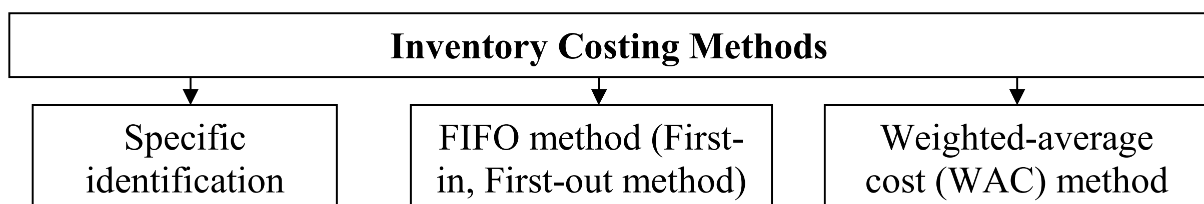
(a) abnormal amounts of wasted materials, labour or other production costs;

(b) storage costs, unless those costs are necessary in the production process before a further production stage;

(c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and

(d) selling costs.

2. Inventory Costing Methods



The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs.

In all other cases the cost of inventories should be measured using either the

- FIFO method (First-in, First-out method)
- Weighted-average cost (WAC) method

An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified.

The **First-In, First-Out (FIFO) method** assumes that goods are used in the order in which they are purchased.

In other words, it assumes that **the first goods purchased are the first used** (in a manufacturing concern) **or sold** (in a merchandising concern). The inventory remaining must therefore represent the most recent purchases.

In all cases where FIFO is used, the inventory and cost of goods sold would be the same at the end of the month whether a perpetual or periodic system is used.

This is true because the same costs will always be first in and, therefore, first out.

This is true whether cost of goods sold is computed as goods are sold throughout the accounting period (the perpetual system) or as a residual at the end of the accounting period (the periodic system).

One objective of FIFO is to approximate the physical flow of goods.

When the physical flow of goods is actually first-in, first-out, the FIFO method closely approximates specific identification. At the same time, it does not permit manipulation of income because the enterprise is not free to pick a certain cost item to be charged to expense.

Another advantage of the FIFO method is that the ending inventory is close to current cost. Because the first goods in are the first goods out, the ending inventory amount will be composed of the most recent purchases.

This is particularly true where the inventory turnover is rapid. This approach generally provides a reasonable approximation of replacement cost on the balance sheet when price changes have not occurred since the most recent purchases.

The basic disadvantage of the FIFO method is that current costs are not matched against current revenues on the income statement. The oldest costs are

charged against the more current revenue, which can lead to distortions in gross profit and net income.

FIFO assumes that the first items put on the shelf are the first items sold, so your oldest goods are sold first. This system is generally used by companies whose inventory is perishable or subject to quick obsolescence. If prices go up, FIFO will give you a lower cost of goods sold because you are using your older, cheaper goods first. Your bottom line will look better to your investors, if you have any, but your tax liability will be higher because you have higher profit. A positive about the FIFO method is that it represents recent purchases and, as such, more accurately reflects replacement costs.

The use of the **average cost methods** is usually justified on the basis of practical rather than conceptual reasons. These methods are simple to apply and objective. They are not as subject to income manipulation as some of the other inventory pricing methods.

In addition, proponents of the average cost methods argue that it is often impossible to measure a specific physical flow of inventory and therefore it is better to cost items on an average-price basis. This argument is particularly persuasive when the inventory involved is relatively homogeneous in nature.

IAS 2 allows two different methods to be used for valuing inventory:

1. First in, first out (FIFO). This assumes that the first items to be bought will be the first to be used, although this may not be the physical distribution of the goods. Thus, remaining inventory valuation will always be the value of the most recently purchased items.

2. Average cost (AVCO). Under this method a new average value (usually the weighted average using the number of items bought) is calculated each time a new delivery of inventory is acquired.

IAS does not allow for inventory to be valued using the Last in, first out (LIFO) method.

Similarly, inventories which are similar in nature and use to the company will use the same valuation method. Only where inventories are different in nature

or use can a different valuation method be used.

Once a suitable method of valuation has been adopted by a company then it should continue to use that method unless there are good reasons why a change should be made. This is in line with the **CONSISTENCY** concept.

Valuing Raw Materials

A comparison is made between the cost of the raw materials (applying either FIFO or AVCO) and their realisable value.

Valuing Work in Progress and Finished Goods

IAS 2 requires that the valuation of these two items includes not only their raw or direct material content, but also includes an element for direct labour, direct expenses and production overheads.

The cost of these two items therefore consists of:

- direct materials
- direct labour
- direct expenses
- production overheads, these are costs to bring the product to its present location and condition
- Other overheads which may be applicable to bring the product to its present location and condition

The cost of these two items excludes:

- abnormal waste in the production process
- storage costs
- selling costs
- administration costs not related to production.

3. Perpetual and Periodic Inventory Systems

Perpetual inventory system and periodic inventory systems are the two systems of keeping records of inventory.

Perpetual inventory system updates inventory accounts after each purchase or sale.

Inventory subsidiary ledger is updated after each transaction

Inventory quantities are updated continuously.

Periodic inventory system records inventory purchase or sale in "Purchases" account.

"Purchases" account is updated continuously, however, "Inventory" account is updated on a periodic basis, at the end of each accounting period (e.g., monthly, quarterly)

Inventory subsidiary ledger is not updated after each purchase or sale of inventory.

Inventory quantities are not updated continuously.

Inventory quantities are updated on a periodic basis.

4. Recognition as an expense

When inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories shall be recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, shall be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.

5. Disclosure of inventories in the financial statements

The financial statements shall disclose:

(a) the accounting policies adopted in measuring inventories, including the cost formula used;

(b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity;

(c) the carrying amount of inventories carried at fair value less costs to sell;

(d) the amount of inventories recognised as an expense during the period;

(e) the amount of any write-down of inventories recognised as an expense in the period in accordance with paragraph 34;

(f) the amount of any reversal of any write-down that is recognised as a reduction in the amount of inventories recognised as expense in the period in accordance with paragraph 34;

(g) the circumstances or events that led to the reversal of a write-down of inventories in accordance with paragraph 34; and

(h) the carrying amount of inventories pledged as security for liabilities.

5. BIOLOGICAL ASSETS

1. The definition and types of biological assets

2. Recognition and measurement of biological assets

3. Disclosure of biological assets in the financial statements

1. The definition and types of biological assets

Agricultural activity is the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.

Examples of agricultural activity include:

- Raising livestock, fish or poultry
- Stud farms (for example, breeding horses or cattle)
- Forestry
- Cultivating vineyards, orchards or plantations
- Floriculture

A **biological asset** is a living animal or plant.

Biological assets include the following:

- Sheep, pigs, beef cattle, poultry and fish;
- Dairy cows;
- Trees in a forest;
- Plants for harvest (for example, wheat and vegetables);
- Trees, plants and bushes from which agricultural produce is harvested (for example, fruit trees, vines and tea bushes).

A **group of biological assets** is an aggregation of similar living animals or plants.

Biological transformation comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset.

Biological transformation is a natural change in a biological asset.

It includes growth of living animals or plants, reduction in output due to age

or disease and the production of new biological assets through a managed reproductive programme.

Agricultural produce is the harvested product of the entity's biological assets.

Harvest is the detachment of produce from a biological asset or the cessation of a biological asset's life processes.

The table below provides examples of biological assets, agricultural produce, and products that are the result of processing after harvest:

Biological assets	**Agricultural produce**	**Products that are the result of processing after harvest**
Sheep	Wool	Yarn, carpet
Trees in a plantation forest	Felled trees	Logs, lumber
Plants	Cotton	Thread, clothing
	Harvested cane	Sugar
Dairy cattle	Milk	Cheese
Pigs	Carcass	Sausages, cured hams
Bushes	Leaf	Tea, cured tobacco
Vines	Grapes	Wine
Fruit trees	Picked fruit	Processed fruit

An **active market** is a market where all the following conditions exist:

(a) the items traded within the market are homogeneous;

(b) willing buyers and sellers can normally be found at any time; and

(c) prices are available to the public.

2. Recognition and measurement of biological assets

An entity shall recognise a biological asset or agricultural produce when, and only when:

(a) the entity controls the asset as a result of past events;

(b) it is probable that future economic benefits associated with the asset will flow to the entity; and

(c) the fair value or cost of the asset can be measured reliably.

In agricultural activity, control may be evidenced by, for example, legal ownership of cattle and the branding or otherwise marking of the cattle on acquisition, birth, or weaning. The future benefits are normally assessed by measuring the significant physical attributes.

A biological asset shall be measured on initial recognition and at the end of each reporting period at its fair value less costs to sell, except limited circumstances (for the case described in paragraph 30 where the fair value cannot be measured reliably).

There are two occasions where the standard permits departure from current fair value:

at the early stage of an asset's life;

and when fair value cannot be measured reliably on initial recognition.

Agricultural produce harvested from an entity's biological assets shall be measured at its fair value less costs to sell at the point of harvest. Such measurement is the cost at that date when applying IAS 2 *Inventories* or another applicable Standard.

Carrying amount is the amount at which an asset is recognised in the statement of financial position.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

The fair value of an asset is based on its present location and condition. As a result, for example, the fair value of cattle at a farm is the price for the cattle in the relevant market less the transport and other costs of getting the cattle to that market.

The fair value hierarchy may be summarised as follows:

• Price for the asset in an active market.

• Recent transaction price for the asset if there is no active market.

• Market prices for similar assets, adjusted for the points of difference.

• Sector benchmarks.

• Present value of the future cash flows expected to be generated from the asset.

Contract prices are not necessarily relevant in determining fair value, because fair value reflects the current market in which a willing buyer and seller would enter into a transaction.

At the date a contract is signed between willing parties, the contract price would be the best estimate of the future market price and would therefore be a relevant price to use in a cash flow model. At a later date, historical contract prices may bear no relevance to the current fair value of the biological asset itself. Therefore, the fair value of a biological asset or its agricultural produce is not influenced by the existence of a contract unless the contract prices represent current market prices.

In some cases, a contract for the sale of a biological asset or agricultural produce may be an onerous contract, as defined in IAS 37, 'Provisons, contingent liabilities and contingent assets', and would be measured in accordance with that standard. The existence of an onerous contract does not affect the fair value of the biological asset.

Costs to sell are the incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes.

Costs to sell are the incremental costs incurred in selling the asset.

They include commissions paid to brokers and dealers, transfer taxes and duties and fees paid to regulatory agencies or commodity exchanges.

Costs to sell do not include the cost of transporting the asset to market (as this is included in its fair value) or income taxes and finance costs.

The sale of agricultural produce is clearly revenue as defined by IAS 18 «Revenue».

Revenue comprises the fair value of the consideration received or receivable only for the sale of agricultural produce and/or biological assets. It is stated net of sales taxes, rebates and discounts.

IAS 18 specifically scopes out revenue arising from changes in fair value and initial gains and losses for agricultural assets and produce. Fair value gains are income in accordance with the Framework; fair value losses are expenses. Fair value gains may be shown as part of total income but separately from revenue.

Income under IAS 41 can be classified into:

• Initial gain or loss on biological assets.

• Changes in fair value less costs to sell of biological assets.

• Initial gain or loss on agricultural produce.

Initial losses on biological assets typically arise when a biological asset is purchased.

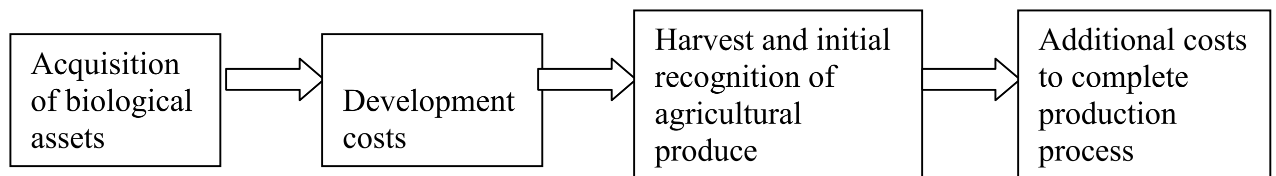
The cost of the biological asset is often higher than the fair value less costs to sell, as the latter represents an exit price, and transaction expenses therefore create a loss. Initial gains on biological assets arise when new biological assets are generated – for example, when a calf or a piglet is born.

Changes in fair value less costs to sell of biological assets represent the difference in value from period to period, normally on an aggregated basis. It is therefore sometimes difficult to distinguish from the initial gain due to procreation. The value typically increases due to growth, procreation and higher prices, but may decrease due to degeneration, sickness and lower prices.

Initial gains or losses on agricultural produce represents the difference between the change in carrying value of the biological assets due to harvest and the fair value less costs to sell of the harvested agricultural produce. It reflects the last stage of the value creation of the biological process, and the harvested produce is transferred to inventory.

There may be further costs involved in preparing the inventory for market.

The different stages in the accounting life of a biological asset are shown in the simple diagram below.



IAS 41 requires all gains and losses arising under the standard to be disclosed on an aggregated basis [IAS 41 para 40]. It should be noted that the standard does not require or encourage disaggregating the gain or loss. Further, disaggregating gains and losses arising from initial recognition and changes during the year may be impracticable.

A gain or loss arising on initial recognition of a biological asset at fair value less costs to sell and from a change in fair value less costs to sell of a biological asset shall be included in profit or loss for the period in which it arises.

A loss may arise on initial recognition of a biological asset, because costs to sell are deducted in determining fair value less costs to sell of a biological asset. A gain may arise on initial recognition of a biological asset, such as when a calf is born.

A gain or loss arising on initial recognition of agricultural produce at fair value less costs to sell shall be included in profit or loss for the period in which it arises.

There is a presumption that fair value can be measured reliably for a biological asset. However, that presumption can be rebutted only on initial recognition for a biological asset for which market-determined prices or values are not available and for which alternative estimates of fair value are determined to be clearly unreliable. In such a case, that biological asset shall be measured at its cost less any accumulated depreciation and any accumulated impairment losses. Once the fair value of such a biological asset becomes reliably measurable, an entity shall measure it at its fair value less costs to sell. Once a non-current biological asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale) in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*, it is presumed that fair value

can be measured reliably.

3. Disclosure of biological assets in the financial statements

An entity shall disclose the aggregate gain or loss arising during the current period on initial recognition of biological assets and agricultural produce and from the change in fair value less costs to sell of biological assets.

An entity shall provide a description of each group of biological assets.

If not disclosed elsewhere in information published with the financial statements, an entity shall describe:

(a) the nature of its activities involving each group of biological assets; and

(b) non-financial measures or estimates of the physical quantities of:

(i) each group of the entity's biological assets at the end of the period; and

(ii) output of agricultural produce during the period.

An entity shall disclose the methods and significant assumptions applied in determining the fair value of each group of agricultural produce at the point of harvest and each group of biological assets.

An entity shall disclose the fair value less costs to sell of agricultural produce harvested during the period, determined at the point of harvest.

An entity shall disclose:

(a) the existence and carrying amounts of biological assets whose title is restricted, and the carrying amounts of biological assets pledged as security for liabilities;

(b) the amount of commitments for the development or acquisition of biological assets; and

(c) financial risk management strategies related to agricultural activity.

An entity shall present a reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period. The reconciliation shall include:

(a) the gain or loss arising from changes in fair value less costs to sell;

(b) increases due to purchases;

(c) decreases attributable to sales and biological assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5;

(d) decreases due to harvest;

(e) increases resulting from business combinations;

(f) net exchange differences arising on the translation of financial statements into a different presentation currency, and on the translation of a foreign operation into the presentation currency of the reporting entity; and

(g) other changes.

If an entity measures biological assets at their cost less any accumulated depreciation and any accumulated impairment losses (see paragraph 30) at the end of the period, the entity shall disclose for such biological assets:

(a) a description of the biological assets;

(b) an explanation of why fair value cannot be measured reliably;

(c) if possible, the range of estimates within which fair value is highly likely to lie;

(d) the depreciation method used;

(e) the useful lives or the depreciation rates used; and

(f) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.

If, during the current period, an entity measures biological assets at their cost less any accumulated depreciation and any accumulated impairment losses (see paragraph 30), an entity shall disclose any gain or loss recognised on disposal of such biological assets and the reconciliation required by paragraph 50 shall disclose amounts related to such biological assets separately. In addition, the reconciliation shall include the following amounts included in profit or loss related to those biological assets:

(a) impairment losses;

(b) reversals of impairment losses; and

(c) depreciation.

If the fair value of biological assets previously measured at their cost less any accumulated depreciation and any accumulated impairment losses becomes reliably measurable during the current period, an entity shall disclose for those biological assets:

(a) a description of the biological assets;

(b) an explanation of why fair value has become reliably measurable; and

(c) the effect of the change.

6. CASH AND CASH EQUIVALENTS

1. The definition and recognition of cash and cash equivalents

2. Accounting for the movement of cash and cash equivalents

3. Disclosure of cash and cash equivalents in the financial statements

1. The definition and recognition of cash and cash equivalents

Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

The term **cash and cash equivalents** includes: currency, coins, checks received but not yet deposited, checking accounts, petty cash, savings accounts, money market accounts, and short-term, highly liquid investments with a maturity of three months or less at the time of purchase.

The items included as cash and cash equivalents must also be unrestricted.

2. Accounting for the movement of cash and cash equivalents

Cash flows are inflows and outflows of cash and cash equivalents.

Business activities can be divided into three (3) groups:

- Operating activities
- Investing activities
- Financing activities

Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.

Operating activities are day-to-day business activities of a company which determine the company's net income (loss).

Operating activities are business activities associated with the primary purpose of a business.

Examples of operating activities are listed in the table below:

Business	Operating Activities
Manufacturing	Manufacturing and selling goods
Retail	Buying and re-selling goods
Service	Selling and providing services

Operating activities involve transactions that create revenues and expenses and thus are used to determine net income (loss).

In other words, operating activities are principal revenue producing activities.

The results of operating activities are reported in the operating income section of the **income statement** and in the operating cash flows section of the **statement of cash flows**.

Balance sheet also reflects some of the results of operations (e.g., working capital, long-term assets, and liabilities).

For example, the statement of cash flows classifies cash receipts and payments as operating, investing, and financing activities. Typical cash receipts and payments within the operating activities category are provided below:

Operating cash receipts (inflows):

- Revenue from the sale of goods and services
- Interest income (i.e., return on loans)
- Dividends income (i.e., return on equity securities)
- Royalties, fees, commissions, and other revenue

Operating cash payments (outflows):

- Payments to employees for services
- Payments to suppliers for inventory
- Payments to lenders for interest
- Payments to government for taxes
- Payments to others for operating expenses (e.g., insurance premiums)

Important to note, **some cash flows related to financing and investing activities** (e.g., interest, dividend)**are reported as operating activities** on the

statement of cash flows **when these items involve income determination** (i.e., are reported in the income statement). For example, even though loan proceeds and repayment involve financing activities, interest expense is reported as an operating activity because interest expense is reported in the income statement.

Operating cash flows and a company's net income (loss) are seldom equal due to the depreciation and amortization expense, changes in current assets and current liability accounts, etc.

It is important to evaluate operating cash flows when analyzing an entity's going concern because a**company often depends on its operating cash flows to meet its cash flow needs**.

Negative operating cash flows, combined with cash inflows from investing (e.g., selling assets) and financing activities (e.g., borrowing), may indicate a serious financial problem. On the other hand, **positive operating cash flows** combined with negative investing cash flows indicate goods financial performance and growth. An excess in operating cash flows can be used for financial purposes (e.g., pay dividends, repurchase stock, repay debt) and growth (e.g., buy assets).

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Investing activities are identified with changes in a corporation's long-term assets.

Examples of investing activities include the *acquisition* (purchase) of long-term investments, equipment used in the business, a building used in the business, and so on.

Investing activities also include the *sale* of long-term investments and the sale of long-term assets that had been used in the business.

In general **investing activities involve purchasing and disposing assets necessary for business operations**. Different businesses need to acquire different types of assets such as land, property, plant, equipment, patents, copyrights, cash, accounts receivable, etc.

Investing activities is one of the ways to acquire assets.

Cash flows from investing activities are usually reported in the second section of the statement of cash flows. Typical investing cash flows are presented below.

Cash inflows from investing activities:

- Selling fixed assets
- Selling intangible assets
- Selling investments
- Collecting principal on loans made to other entities*

(*) Collecting interest payments on loans made to other entities is reported as an operating activity because interest revenue involves income determination.

Cash outflows from investing activities:

- Payments to purchase fixed assets
- Payments to purchase intangible assets
- Payments to purchase investments (i.e., equity securities of other entities)
- Making loans to other entities

<u>**Financing activities**</u> are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

Financing activities are business activities that involve issuing and paying off debt, issuing preferred and common stock, paying cash dividends, and acquiring treasury stock

In other words, in general **financing activities involve obtaining funds to start and operate a business**. Such activities reflect the relationship between the company and its **lenders** (e.g. bank) and **owners** (e.g., shareholders).

For instance, issuing bonds and repaying the debt is a financing activity that involves creditors while paying cash dividends is a financing activity that involves owners.

Cash flows from financing activities are usually reported in the third section of the statement of cash flows. Typical financing cash flows are presented below.

Cash inflows from financing activities:

- Issuing notes payable
- Issuing bonds
- Issuing preferred and common stock

Cash outflows from financing activities:

- Repaying debt (i.e., principal)*
- Paying cash dividends**
- Buying treasury stock

(*) Interest expense payments on debt are reported as an operating activity because interest expense involves income determination.

(**) Paying cash dividends is not an operating activity because cash dividends do not represent an expense. Cash dividends reduce retained earnings and thus represent a financing activity.

Noncash investing and financing activities

There are investing and financing activities that do not affect cash flows. For example, retiring long-term debt by issuing common stock is a noncash financing activity. Other example of noncash investing and financing activities include: acquiring land by issuing common stock, purchasing a building by issuing a note payable, acquiring equipment in exchange for land, etc.

Because noncash investing and financing activities *indirectly* affect cash flows, they are **reported in a separate section of the statement of cash flows**.

Important noncash investing and financing activities provide valuable information about overall investing and financing activities of an entity and must be reported either:

- **At the bottom of the statement of cash flows**, or
- **In the notes to the financial statements**.

Usually noncash investing and financing activities are reported in a separate section at the bottom of the statement of cash flows. This section lists important noncash investing and financing activities and offsets these transactions against each other.

In other words, **noncash financing/investing "outflows"** **offset** **financing/investing cash "inflows",** and vice versa. As the result, cash is not affected.

Examples:

- Financing cash "outflow" from retiring debt is offset by financing cash "inflow" from issuing stock.
- Investing cash "outflow" from acquiring land is offset by financing cash "inflow" from issuing stock.
- Investing cash "outflow" from acquiring equipment is offset by investing cash "inflow" from selling land.

The above-listed examples are summarized in the table below.

"Outflow"	**"Inflow"**
Retiring debt by issuing common stock	
Retiring debt: financing cash "outflow"	Issuing common stock: financing cash "inflow"
Acquiring land by issuing common stock	
Acquiring land: investing cash "outflow"	Issuing common stock: financing cash "inflow"
Acquiring equipment in exchange for land	
Acquiring equipment: investing cash "outflow"	Selling land: investing cash "inflow"

3. Disclosure of cash and cash equivalents in the financial statements

The amount of cash and cash equivalents will be reported on the balance sheet as the first item in the listing of current assets.

The change in the amount of cash and cash equivalents during an accounting period is explained by the statement of cash flows.

A change in this balance sheet category	...is reported in this section of the cash flow statement
Current Assets (other than Cash)	Operating Activities
Current Liabilities	Operating Activities
Long-term Assets	Investing Activities
Long-term Liabilities	Financing Activities
Stockholders' Equity	Financing Activities

The statement of cash flows shall report cash flows during the period classified by operating, investing and financing activities.

The purpose of the *cash flow statement* or *statement of cash flows* is to provide information about a company's gross receipts and gross payments for a specified period of time.

The gross receipts and gross payments will be reported in the cash flow statement according to one of the following classifications: operating activities, investing activities, and financing activities. The net change from these three classifications should equal the change in a company's *cash and cash equivalents* during the reporting period. For instance, the cash flow statement for the calendar year 2013 will report the causes of the change in a company's *cash and cash equivalents* between its balance sheets of December 31, 2012 and December 31, 2013.

In addition to the cash amounts being reported as operating, investing, and financing activities, the cash flow statement must disclose other information, including the amount of interest paid, the amount of income taxes paid, and any significant investing and financing activities which did not require the use of cash.

The statement of cash flows is to be distributed along with a company's income statement and balance sheet.

Format of the Statement of Cash Flows

The statement of cash flows has four distinct sections:

1. Cash involving **operating activities**
2. Cash involving **investing activities**
3. Cash involving **financing activities**
4. Supplemental information.

Cash flows from operating activities are primarily derived from the principal revenue-producing activities of the entity. Therefore, they generally result from the transactions and other events that enter into the determination of profit or loss. Examples of cash flows from operating activities are:

(a) cash receipts from the sale of goods and the rendering of services;

(b) cash receipts from royalties, fees, commissions and other revenue;

(c) cash payments to suppliers for goods and services;

(d) cash payments to and on behalf of employees;

(e) cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits;

(f) cash payments or refunds of income taxes unless they can be specifically identified with financing and investing activities; and

(g) cash receipts and payments from contracts held for dealing or trading purposes.

1. Cash Provided From or Used By Operating Activities

This section of the cash flow statement reports the company's net income and then converts it from the accrual basis to the cash basis by using the changes in the balances of current asset and current liability accounts, such as:

Accounts Receivable	Notes Payable (generally due within one year)
Inventory	Accounts Payable
Supplies	Wages Payable
Prepaid Insurance	Payroll Taxes Payable
Other Current Assets	Interest Payable
	Income Taxes Payable
	Unearned Revenues
	Other Current Liabilities

In addition to using the changes in current assets and current liabilities, the operating activities section has adjustments for depreciation expense and for the gains and losses on the sale of long-term assets.

Investing activities

The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which expenditures have been made for resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are:

(a) cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalised

development costs and self-constructed property, plant and equipment;

(b) cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;

(c) cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);

(d) cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

(e) cash advances and loans made to other parties (other than advances and loans made by a financial institution);

(f) cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a financial institution);

(g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and

(h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge of an identifiable position the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

2. Cash Provided From or Used By Investing Activities

This section of the cash flow statement reports *changes* in the balances of *long-term asset* accounts, such as:

Long-term Investments

Land

Buildings

Equipment

Furniture & Fixtures

Vehicles

In short, investing activities involve the purchase and/or sale of long-term investments and PPE.

Financing activities

The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the entity. Examples of cash flows arising from financing activities are:

(a) cash proceeds from issuing shares or other equity instruments;

(b) cash payments to owners to acquire or redeem the entity's shares;

(c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short or long-term borrowings;

(d) cash repayments of amounts borrowed; and

(e) cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

3. Cash Provided From or Used By Financing Activities

This section of the cash flow statement reports *changes* in balances of the *long-term liability* and *stockholders' equity* accounts, such as:

Notes Payable (generally due after one year)

Bonds Payable

Deferred Income Taxes

Preferred Stock

Paid-in Capital in Excess of Par-Preferred Stock

Common Stock

Paid-in Capital in Excess of Par-Common Stock

Paid-in Capital from Treasury Stock

Retained Earnings

Treasury Stock

In short, financing activities involve the issuance and/or the repurchase of a company's own bonds or stock. Dividend payments are also reported in this

section.

4. Supplemental Information

This section of the cash flow statement discloses the amount of interest and income taxes paid. Also reported are significant exchanges not involving cash. For example, the exchange of company stock for company bonds would be reported in this section.

the general assumptions:

- When an asset (other than cash) increases, the Cash account *decreases*.
- When an asset (other than cash) decreases, the Cash account *increases*.
- When a liability increases, the Cash account *increases*.
- When a liability decreases, the Cash account *decreases*.
- When owner's equity increases, the Cash account *increases*.
- When owner's equity decreases, the Cash account *decreases*.

For a change in assets (other than cash)—the change in the Cash account is in the *opposite* direction.

For a change in liabilities and owner's equity—the change in the Cash account is in the *same* direction.

An entity shall report cash flows from operating activities using either:

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

An entity shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 22 and 24 are reported on a net basis.

Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:

(a) cash receipts and payments on behalf of customers when the cash flows reflect the activities of the customer rather than those of the entity; and

(b) cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.

Cash flows arising from transactions in a foreign currency shall be recorded in an entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

The cash flows of a foreign subsidiary shall be translated at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.

7. ACCOUNTS RECEIVABLE. REVENUES

1.Accounts Receivable and Bad Debts Expense

2. Measurement of Revenues

3. Recognition of Revenues

4. Disclosure

1. Accounts Receivable and Bad Debts Expense

Accounts receivable is a current asset that reports the amount a company's customers owe the company for goods or services provided on credit.

Under accrual accounting, a company credits a revenue account and debits Accounts Receivable (the amount due from customers) when billing customers.

When an account receivable is collected, the accountant debits Cash and credits Accounts Receivable.

Under the **accrual basis of accounting** a sale *on credit* will:

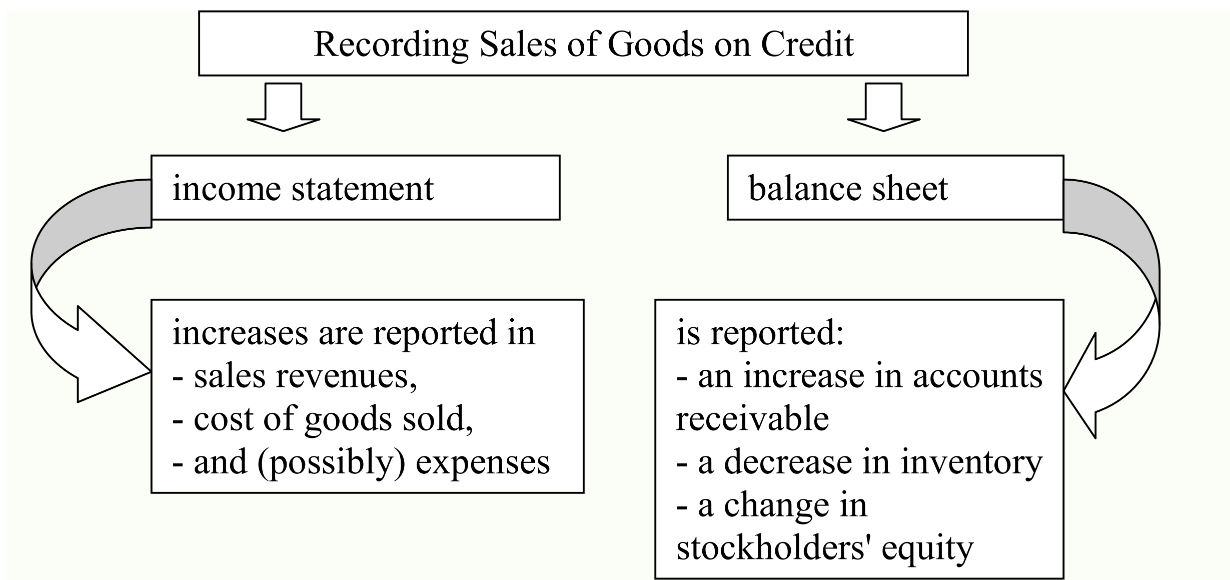
1. Increase sales or sales revenues, which are reported on the income statement, and
2. Increase the amount due from customers, which is reported as accounts receivable—an asset reported on the balance sheet.

Recording Sales of Goods on Credit

When a company sells goods on credit, it reports the transaction on both its income statement and its balance sheet.

On the income statement, increases are reported in sales revenues, cost of goods sold, and (possibly) expenses.

On the balance sheet, an increase is reported in accounts receivable, a decrease is reported in inventory, and a change is reported in stockholders' equity for the amount of the net income earned on the sale.



A company that extends credit to a customer faces the risk of not collecting the account receivable. If a loss does occur from extending credit, it is reported as an operating expense, such as bad debts expense.

There are two ways of reporting losses from credit sales.

One is the *direct write-off method*. Under this approach, the company does not anticipate any loss.

The asset Accounts Receivable is reported at its full amount and no expense is reported until it is known with certainty that a customer will not pay the amount owed.

This method is not encouraged by accountants, because it may be overstating assets and net income.

The preferred way to report losses from credit sales is to anticipate that some receivables will not be collected. This approach is the *allowance method*. It gets it name because of the contra account to Accounts Receivable entitled Allowance for Doubtful Accounts.

The credit balance in the allowance account works to value the accounts receivable at their approximate net realizable amount. Under the allowance method, the bad debts expense and the credit to the allowance account is reported closer to the time of the sale—thus providing a better matching with revenues. Under the allowance method the accounts receivable are reported at a more realistic and conservative amount.

If a buyer does not pay the amount it owes, the seller will report:

1. A credit loss or bad debts expense on its income statement, and
2. A reduction of accounts receivable on its balance sheet.

To assist in the managing of accounts receivables, an aging of the accounts receivable is prepared. An aging sorts the customers' balances by how long the customers have owed the open invoice amounts.

Sales on credit involve credit terms such as "net 10 days" or "net 30 days" or "2/10, net 30" and others. Net 30 days means there is no discount allowed from the amount on the sales invoice. If the credit term is "2/10, net 30" the customer can remit 2% less than the invoice amount if the customer pays within 10 days. Otherwise the full amount is due in 30 days.

2. Measurement of Revenues

Revenues are the amounts that a business earns from selling goods or providing services to its customers.

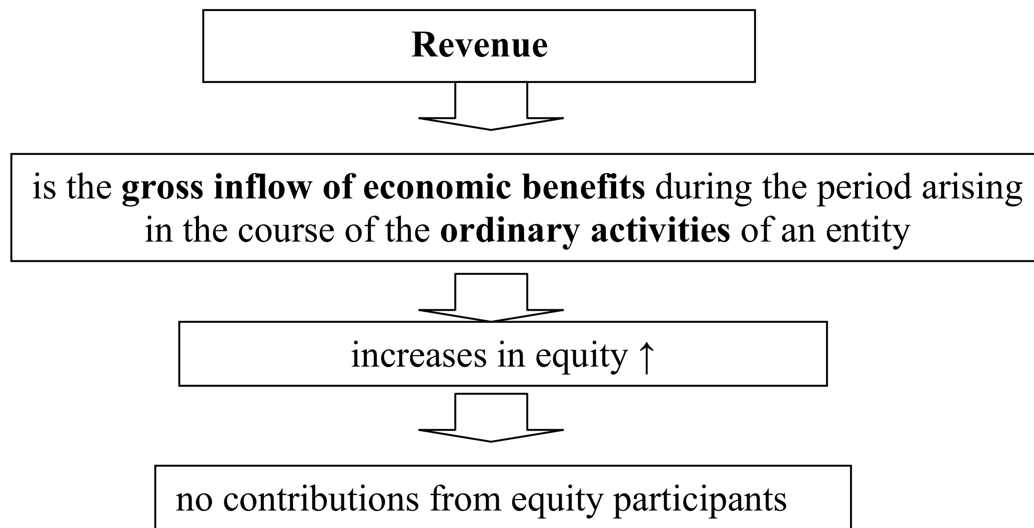
For example, a retailer's revenues will include its sales of merchandise, a law firm's revenues will include the fees it earns from providing legal services to its clients, and a bank's revenues will include the interest that it earns on the loans to borrowers.

Under the accrual method of accounting, revenues are reported on the income statement for the period when the revenues were *earned* (not the period when the cash is received).

This means that revenues can occur before the cash is received, after the cash is received, or at the same time that the cash is received.

Hence, *revenues* are different from *cash receipts*.

Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.

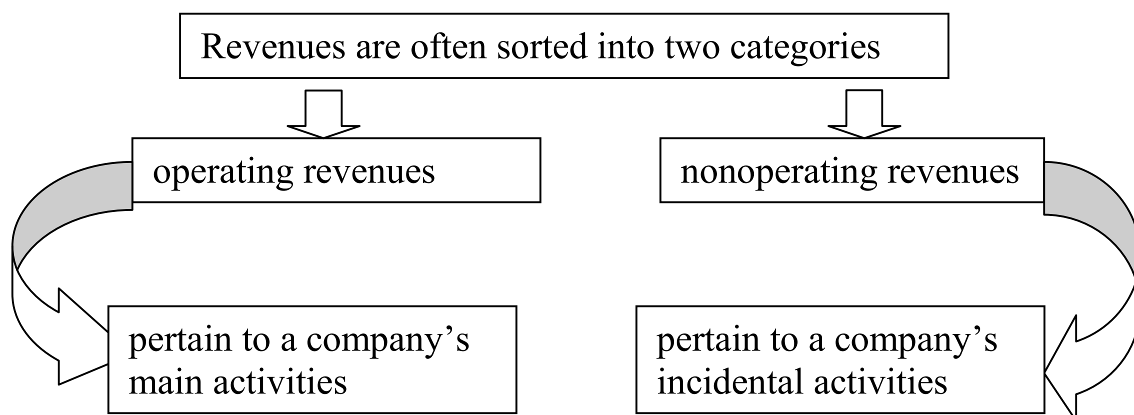


Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

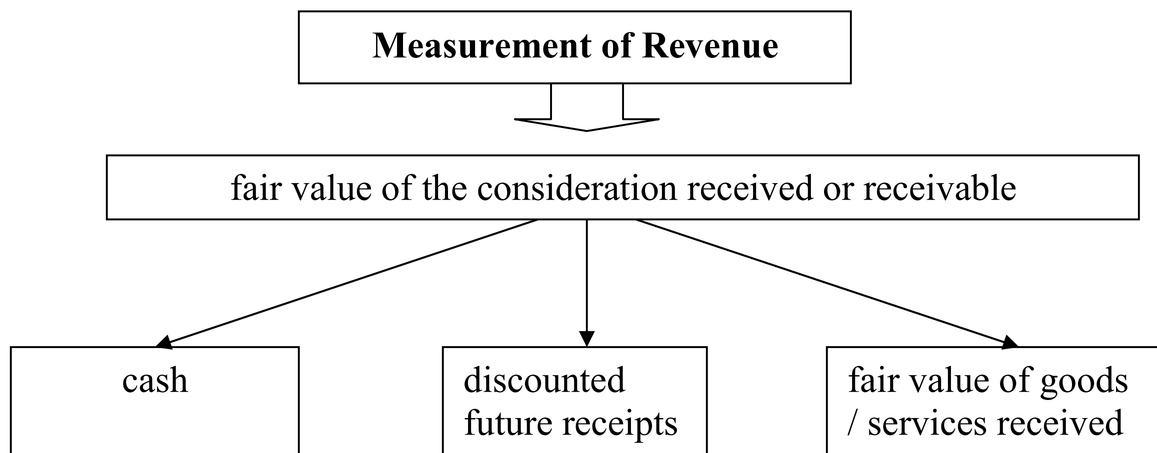
Revenues are often sorted into two categories: operating revenues and nonoperating revenues.

Operating revenues pertain to a company's main activities. For instance, a retailer's operating revenues could include sales of merchandise, sales of extended warranties, and repair revenues.

Nonoperating revenues pertain to a company's incidental activities. This means that a retailer's nonoperating revenues will include the interest and the rent that it earns on its investments.



Revenue shall be measured at the fair value of the consideration received or receivable.



Any trade discounts or rebates shall be deducted and revenue is measured net of these items.

When the cash inflow is ***deferred*** or postponed to future, then the fair value of consideration received might be less than its nominal amount. In this case, the fair value of consideration received is determined by ***discounting future cash flows*** to their present value using the ***imputed rate of interest***.

With regard to exchanges of goods or services (barter transactions):

- When goods or services are of a ***similar nature***, then the exchange is not regarded as a transaction revenue generating and ***the revenue cannot be recognized***.
- When goods or services are of a ***dissimilar nature***, then the exchange is regarded as a transaction revenue generating and ***the revenue is recognized*** in amount of fair value of goods/services received (adjusted by the amount of any cash transferred).

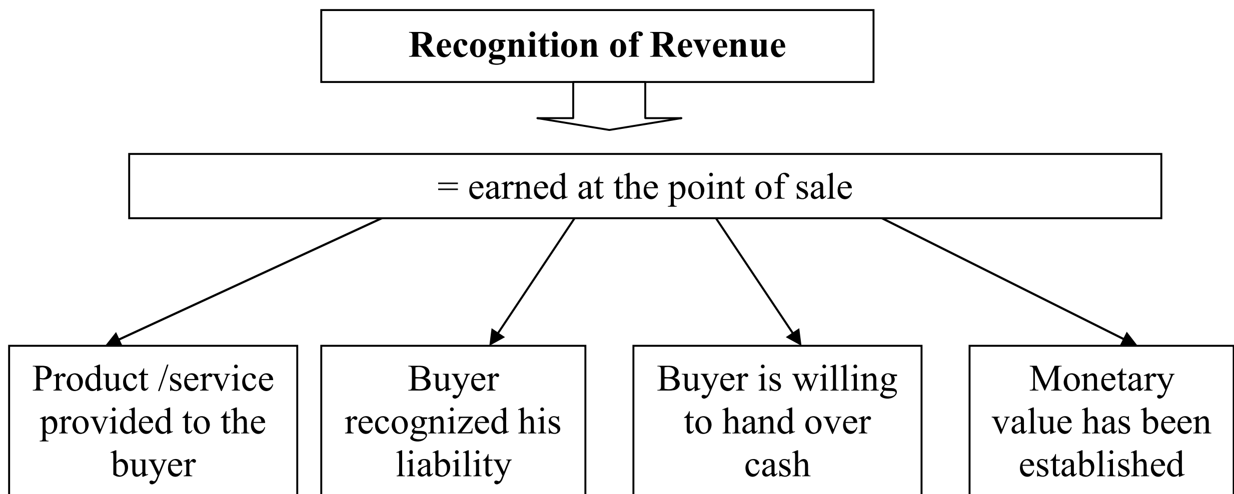
3. Recognition of Revenues

IAS 18 «Revenue» shall be applied in accounting for revenue arising from the following transactions and events:

(a) the sale of goods;

(b) the rendering of services; and

(c) the use by others of entity assets yielding interest, royalties and dividends.



Revenue from the sale of goods shall be recognised when all the following conditions have been satisfied:

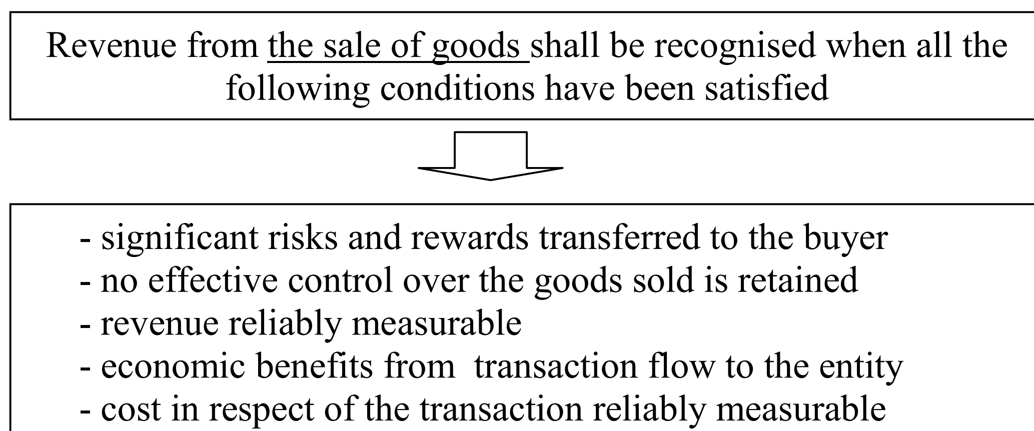
(a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;

(b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;

(c) the amount of revenue can be measured reliably;

(d) it is probable that the economic benefits associated with the transaction will flow to the entity; and

(e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.



IAS 18 sets in its Appendix the practical guidance on recognition of revenue from various situations when selling goods.

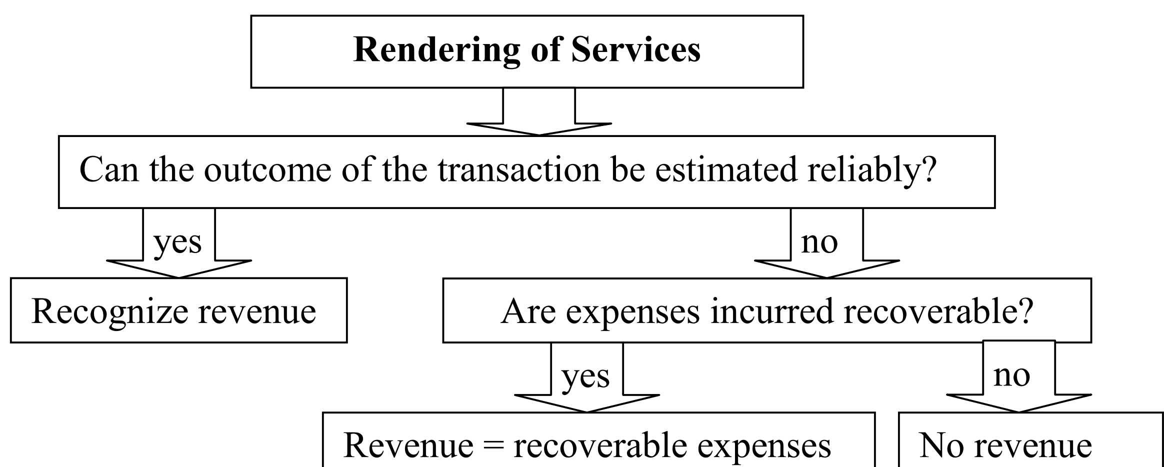
Transaction	Revenue Recognition
Bill and Hold Sales	When the buyer takes title.
Goods Shipped Subject to Conditions	
– installation & inspection	When the buyer accepts delivery and installation & inspection is completed.
– on approval	When the buyer formally accepts the shipment
– with limited right of return	When the goods were delivered and time for return lapsed.
– consignment sales	After the buyer sells goods to the final customer.
– cash on delivery sales	When delivery is made and cash is received by the seller.
Lay Away Sales	When the delivery is made.
Sale and Repurchase Agreements	Look out for financing arrangement – not revenue.
Subscriptions to Publications	In line with the period over which the items are dispatched.

Rendering of services

When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the stage of completion of the transaction at the end of the reporting period.

Here, can the outcome of the transaction be estimated reliably?

- If yes, then the revenue can be recognized by the reference to the stage of completion of the transaction at the end of the reporting period.
- If not, then the revenue can be recognized only to the extent of the expenses recognized that are recoverable.



The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

(a) the amount of revenue can be measured reliably;

(b) it is probable that the economic benefits associated with the transaction will flow to the entity;

(c) the stage of completion of the transaction at the end of the reporting period can be measured reliably; and

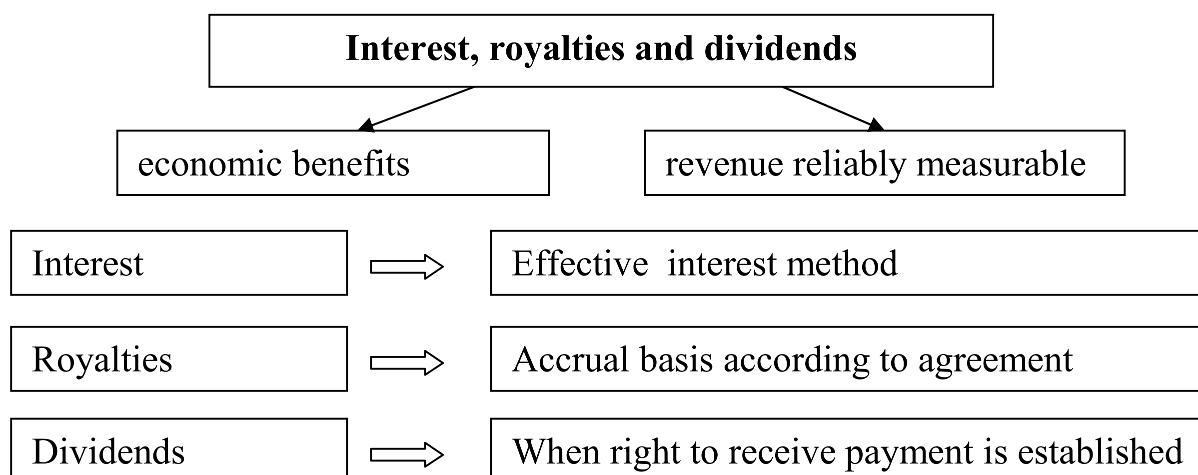
(d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue shall be recognised only to the extent of the expenses recognised that are recoverable.

IAS 18 sets in its Appendix the practical guidance on recognition of revenue from various situations when rendering services.

Transaction	**Revenue Recognition**
Installation Fees	With reference to the stage of completion.
Servicing Fees	If subsequent services are included, then defer the revenue for the subsequent services.
Advertising Commissions	
– Media Commissions	When the related advertisement appears before the public.
– Production Commissions	With reference to the stage of completion.
Insurance Agency Commissions	
– Agent Renders Further Services	Defer over the period during which the policy is in force.
– Agent Does Not Render Further Services	At the date of policy commencement or renewal.
Financial Services	
– Integral Part of Effective Interest Rate	Based on the classification of the related financial instrument
– Earned As Services Are Provided	When related service is provided.
– Earned On Execution of Significant Act	When related significant act has been completed.
Admission Fees	When the event takes place or allocate proportionally to individual events.
Tuition Fees	Over the period of instruction.
Initiation, Entrance, Membership Fees	

– No additional services provided	Immediately when membership starts.
– Additional services provided	Defer over the membership period on some reasonable basis.
Franchise Fees	On the basis reflecting the purpose for which the fees are charged.
Fees from Development of Customized Software	With reference to the stage of completion, including the post-delivery service support stage.



Revenue arising from the use by others of entity assets yielding interest, royalties and dividends shall be recognised on the bases set out in paragraph 30 when:

(a) it is probable that the economic benefits associated with the transaction will flow to the entity; and

(b) the amount of the revenue can be measured reliably.

Revenue shall be recognised on the following bases:

(a) interest shall be recognised using the effective interest method as set out in IAS 39, paragraphs 9 and AG5–AG8;

(b) royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement; and

(c) dividends shall be recognised when the shareholder's right to receive payment is established.

4. Disclosure

An entity shall disclose:

(a) the accounting policies adopted for the recognition of revenue, including

the methods adopted to determine the stage of completion of transactions involving the rendering of services;

(b) the amount of each significant category of revenue recognised during the period, including revenue arising from:

(i) the sale of goods;

(ii) the rendering of services;

(iii) interest;

(iv) royalties;

(v) dividends; and

(c) the amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

8. SHAREHOLDERS' EQUITY

1. Common stock

2. Preferred stock

3. Treasury stock

4. Additional paid-up capital

5. Accumulated other comprehensive income

6. Retained earnings

1. Common stock

Shareholders' equity represents the interest of a company's shareholders in the net assets of the company. According to the accounting equation:

Shareholders' equity = Assets − Liabilities

On a balance sheet, there is separate section for shareholders' equity which includes its components such as

common stock,

preferred stock,

treasury stock

additional paid-up capital,

accumulated other comprehensive income,

retained earnings.

Common stock represents the legal capital of the company.

Common stock is a component of shareholder equity on a company's balance sheet which represents the interest of the company's owners.

Unlike a sole proprietorship or a partnership (in which the capital is contributed by one or a limited number of people), companies are normally owned by hundreds and thousands of people. The share capital of companies is divided into large numbers of shares called common shares. A common share is evidence of ownership in a company and represents a right to its net assets. It makes transfer of ownership easy and is the prime reason for popularity of companies as a form of business.

Par value of common stock

A company normally assigns a value called par value = *face value* to a share of its common stock and mentions it in the legal document. For example, the par value of a share of Microsoft is $0.00000625. However, it is not mandatory for a company to assign a par value. For example, Apples Inc. has no par value assigned to its shares.

Stated value of a common stock

Stated value is a value attached to a share of common stock with no par value. Stated value per share is used to determine the legal capital of the company for accounting purposes.

Issuance of Shares of Stock

When companies need more capital, they issue new shares to investers. Usually, the shares are issued in exchange of cash or cash equivalants but they may be issued in exchange of other assets such as property, plant and equipment. The investor receives share certificates as evidance of contribution towards the capital of the company.

The journal entries to record the issuance of stocks depends on whether the shares have been issued at par value or not.

Issuance of Par Value Stock

Par value shares are those which have a face value assigned to them. Such shares may be issued at par, above par or below par.

When par value shares are issued exactly at par, cash is debited and common stock or preferred stock account is credited.

In case of issuance above par, cash account is debited for the total cash received by the company, common stock or preferred stock is credited for the par value multiplied by number shares issued and additional paid-in capital account is credited for the excess of cash received over the par value mulitplied by number of shares issued.

When par value shares are issued below par, cash is debited for the actual amount recieved, common stock or preferred stock is credited for the total par

value and discount on capital is debited for the excess of total par value over cash recieved.

The discount on capital is part of shareholders' equity and it appears as a deduction from other equity accounts on balance sheet.

Issuance of No Par Stock

Issuance of shares having no par value is recorded by debiting cash and crediting common stock or prefered stock. However if board of directors of the company assigns a value to shares orally, such value is called stated value and the journal entries will be similar to par value stock.

2. Preferred stock

Preferred stock is a sort of share capital which has a preferred right to dividends.

Preferred stock is a type of stock issued by a business that usually pays a fixed dividend prior to any distributions to the holders of the common stock of the business.

This payment is usually cumulative, so any delayed prior payments must be paid to the preferred stock holders before distributions can be made to the holders of common stock.

However, the holders of preferred stock usually gain this advantage in exchange for giving up their right to share in any additional earnings generated by the company, which limits the amount by which the shares can change in value over time.

There are three main types of stock transactions, which are:

- The sale of stock for cash
- Stock issued in exchange for non-cash assets or services
- The repurchase of stock

3. Treasury stock

Treasury stock arises when the board of directors ***board of directors*** —elects

to have a company buy back shares from shareholders.

This purchase reduces the amount of outstanding stock on the open market.

Treasury stock is contra-equity account which means that it appears as a deduction from other shareholders' equity accounts and it represents the cost of the company's investment in its own share stock.

The most common treasury stock accounting method is the cost method.

The other method is called the par value method.

Treasury Stock — Cost Method

Cost method is one of the two methods of accounting for treasury stock, the stock which has been bought back by the issuing company itself.

Under the cost method, the purchase of treasury stock is recorded by debiting treasury stock account by the actual cost of purchase.

The cost method ignores the par value of the shares and the amount received from investors when the shares were originally issued.

Treasury Stock — Par Value Method

Par value method of accounting for treasury stock is one of the two techniques of accounting to record the purchase and resale of treasury stock. Treasury stock refers to shares which have been bought by the issuing company itself.

Under par value method, purchase of treasury stock is recorded by debiting treasury stock by the total par value of the shares. Cash account is credited for the actual amount paid to purchase the treasury stock. Any additional paid-in capital or discount on capital relating to treasury shares is cancelled by a debit or credit respectively.

At this point, if the sum of credit side of the journal entry is less than the sum of debit side, additional paid-in capital account will be *credited* for the difference.

Alternatively if the sum of credit side exceeds the sum of debit side of the journal entry, the difference will be *debited* to additional paid-in capital account up to the available balance and the rest, if any, will be debited to retained earnings

account.

4. Additional paid-up capital

Additional paid-up capital represents the cash contributed by the shareholders of the company in excess of the legal capital of the company i.e. the common stock.

5. Accumulated other comprehensive income

Accumulated other comprehensive income represents the credits or debits in shareholders' equity which are other than those related to transactions with shareholders, for example credit for revaluation surplus, credits and debits related to translation reserve, changes in fair value of available for sale investments, etc.

6. Retained earnings

Retained earnings = retained profit = Retained Income represent the total earnings of the company retained by the company for reinvestment.

It equals the retained earnings of last period plus net income for the period minus dividends paid during the period.

A company either pays out its earnings for a period or it retains it to fuel internal growth. Retained earnings is the equity account which hold those accumulated retained earnings.

Retained earnings is affected by net income for the period, dividends paid out during the period, etc. Other adjustments to retained earnings include adjustment related to changes in accounting policies and estimates, etc.

Retained earnings statement report changes in retained earnings in a period.

9. LIABILITIES AND EMPLOYEE BENEFITS

1. Liabilities

2. Employee benefits

1. Liabilities

A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

In simple words, liability is an obligation of the entity to transfer cash or other resources to another party.

Liability could for instance be a bank loan, which obligates the entity to pay loan installments over the duration of the loan to the bank along with the associated interest cost. Alternatively, an entity's liability could be a trade payable arising from the purchase of goods from a supplier on credit.

Liabilities may be classified into *Current* and *Non-Current*. The distinction is made on the basis of time period within which the liability is expected to be settled by the entity.

Current Liability is one which the entity expects to pay off within one year from the reporting date.

Non-Current Liability is one which the entity expects to settle after one year from the reporting date.

Following are examples the common types of liabilities along with their usual classifications.

Liability	Classification
Long Term Bank Loan	Non-current
Bank Overdraft	current
Short Term Bank Loan	current
Trade Payables	current
Debenture	Non-current
Tax Payble	Current

The following recognition criteria to be met before a liability could be shown on the face of a financial statement:

1. The outflow of resources embodying economic benefits (such as cash) from the entity is probable.

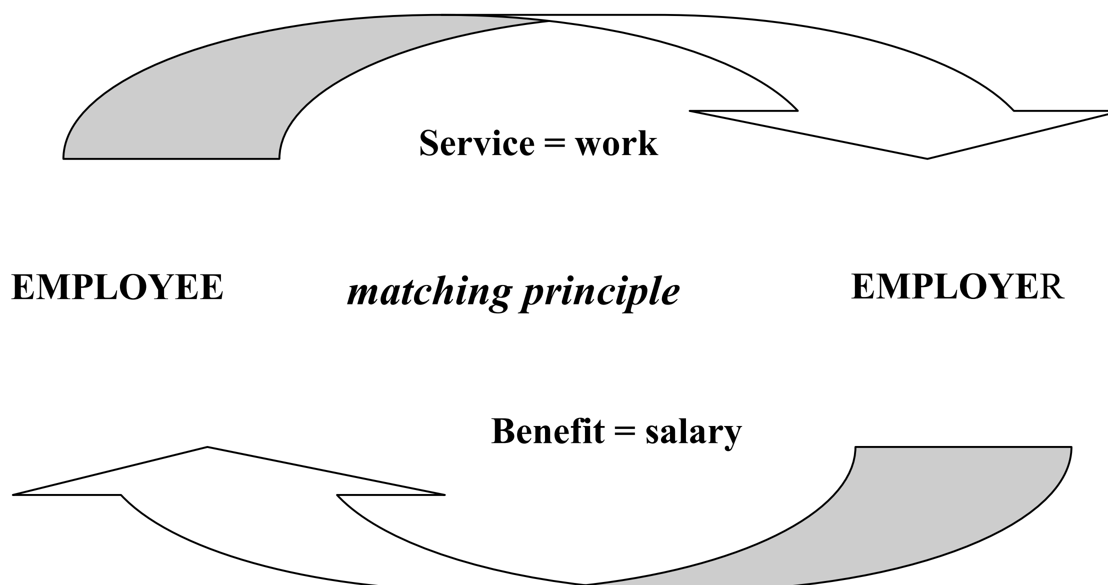
2. The cost / value of the obligation can be measured reliably.

2. Employee benefits

The main objective of IAS 19 is to prescribe the accounting and disclosure for employee benefits. IAS 19 requires and entity to recognize:

- ***a liability*** when an employee has provided service in exchange for employee benefits to be paid in the future; and
- ***an expense*** when the entity consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

That's the clear demonstration of ***matching principle*** — to recognize an expense in the period when matching revenue is recognized.



Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees.

Multi-employer plans are defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:

(a) pool the assets contributed by various entities that are not under common control; and

(b) use those assets to provide benefits to employees of more than one entity,

on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.

Vested employee benefits are employee benefits that are not conditional on future employment.

The *present value of a 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.

Current service cost is the increase in the present value of a defined benefit obligation resulting from employee service in the current period.

Interest cost is the increase during a period in the present value of a defined benefit obligation which arises because the benefits are one period closer to settlement.

Plan assets comprise:

(a) assets held by a long-term employee benefit fund; and

(b) qualifying insurance policies.

Assets held by a long-term employee benefit fund are assets (other than non-transferable financial instruments issued by the reporting entity) that:

(a) are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and

(b) are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:

(i) the remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or

(ii) the assets are returned to the reporting entity to reimburse it for employee benefits already paid.

A qualifying insurance policy is an insurance policy* issued by an insurer that is not a related party (as defined in IAS 24 *Related Party Disclosures*) of the reporting entity, if the proceeds of the policy:

(a) can be used only to pay or fund employee benefits under a defined

benefit plan; and

(b) are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:

(i) the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or

(ii) the proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.

Fair value is the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.

The *return on plan assets* is interest, dividends and other revenue derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less any costs of administering the plan (other than those included in the actuarial assumptions used to measure the defined benefit obligation) and less any tax payable by the plan itself.

Actuarial gains and losses comprise:

(a) experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and

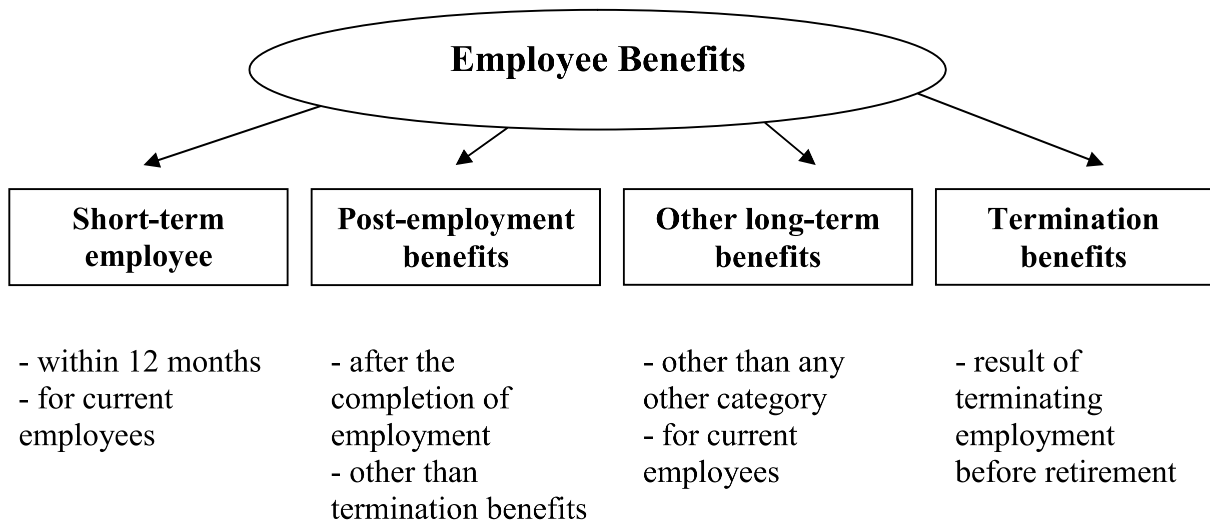
(b) the effects of changes in actuarial assumptions.

Past service cost is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (when benefits are introduced or changed so that the present value of the defined benefit obligation increases) or negative (when existing benefits are changed so that the present value of the defined benefit obligation decreases).

<u>IAS 19 classifies employee benefits into 4 main categories:</u>

- ***Short-term employee benefits*** = employee benefits (other than termination benefits) that are expected to be settled wholly before twelve months after the end of the annual reporting period in which the employees render the related service.

- ***Post-employment benefits*** = employee benefits (other than termination benefits and short-term employee benefits) that are payable after the completion of employment.
- ***Other long-term benefits*** = all employee benefits other than short-term employee benefits, post-employment benefits and termination benefits.
- ***Termination benefits*** = employee benefits provided in exchange for the termination of an employee's employment as a result of either:
    - (a) an entity's decision to terminate an employee's employment before the normal retirement date; or
    - (b) an employee's decision to accept an offer of benefits in exchange for the termination of employment.



Short-term employee benefits are employee benefits (other than termination benefits) that are due to be settled within twelve months after the end of the period in which the employees render the related service.

<u>Short-term employee</u> benefits include items such as:

(a) wages, salaries and social security contributions;

(b) short-term compensated absences (such as paid annual leave and paid sick leave) where the compensation for the absences is due to be settled within twelve months after the end of the period in which the employees render the related employee service;

(c) profit-sharing and bonuses payable within twelve months after the end of the period in which the employees render the related service; and

(d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Short-term employee benefits include all the following items (if payable within 12 months after the end of the reporting period):

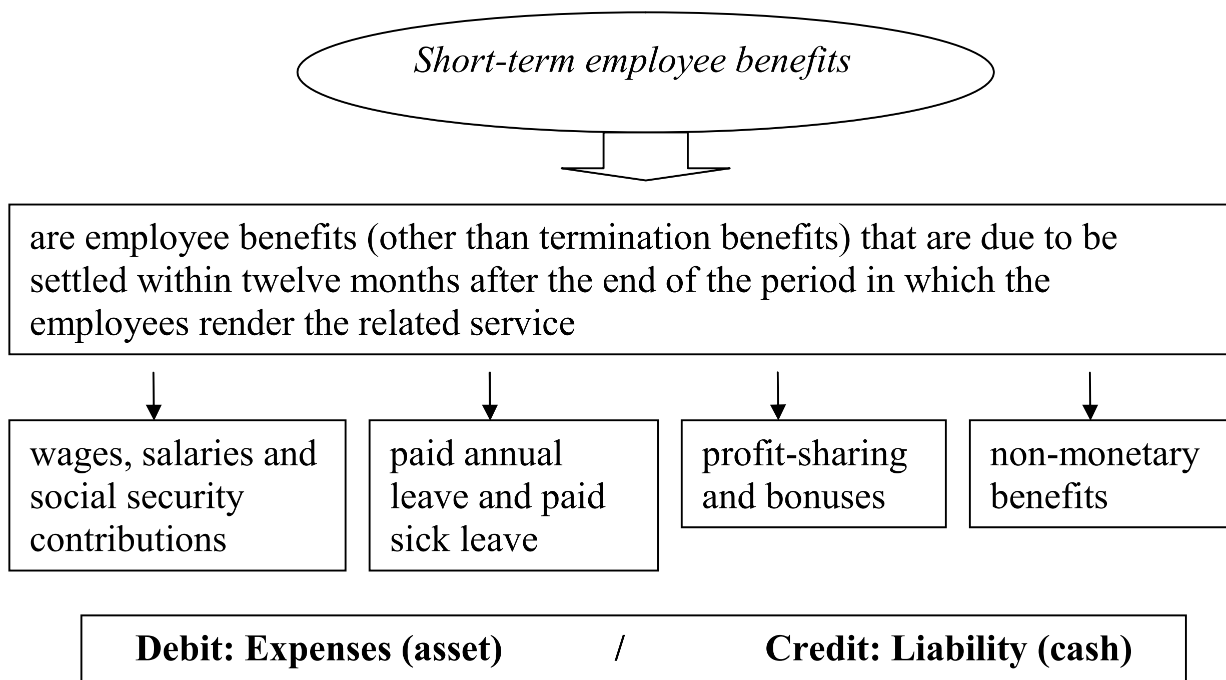
- wages, salaries and social security contributions;
- paid annual leave and paid sick leave;
- profit-sharing and bonuses; and
- non-monetary benefits (such as medical care, housing, cars and free or subsidized goods for current employees).

The entity shall recognize short-term employee benefits as ***an expense*** to profit or loss (unless another IFRS requires or permits the inclusion of the benefits in the cost of an asset).

The expense shall be recognized in the ***undiscounted amount of short-term employee benefits*** expected to be paid in exchange for employee's service rendered during an accounting period.

The accounting entry is as follows:

Debit: Expenses (asset) / Credit: Liability (cash)

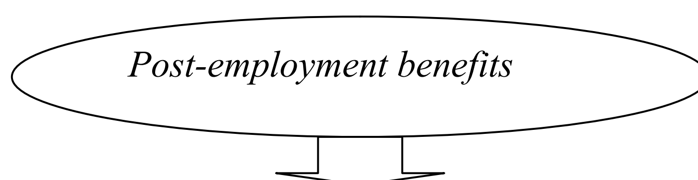


Short-term paid absences: Expected cost of short-term paid absences shall be recognized when the employees render service that increases their entitlement to

future paid absences (in the case of ***accumulating*** paid absences); or when the absences occur (in the case of ***non-accumulating*** paid absences).

Profit sharing and bonuses: An entity shall recognize the expected cost of profit-sharing and bonus payments when the entity has a ***present legal or constructive obligation*** to make such payments as a result of past events; and a ***reliable estimate*** of the obligation can be made. A present obligation exists when, and only when, the entity has no realistic alternative but to make the payments.

Post-employment benefits are employee benefits (other than termination benefits) which are payable after the completion of employment.



are employee benefits (other than termination benefits) which are payable after the completion of employment

Post-Employment Benefits

Post-employment benefits include items such as various pensions, retirement benefits, post-employment life insurance and post-employment medical care.

Post-employment benefits include, for example:

(a) retirement benefits, such as pensions; and

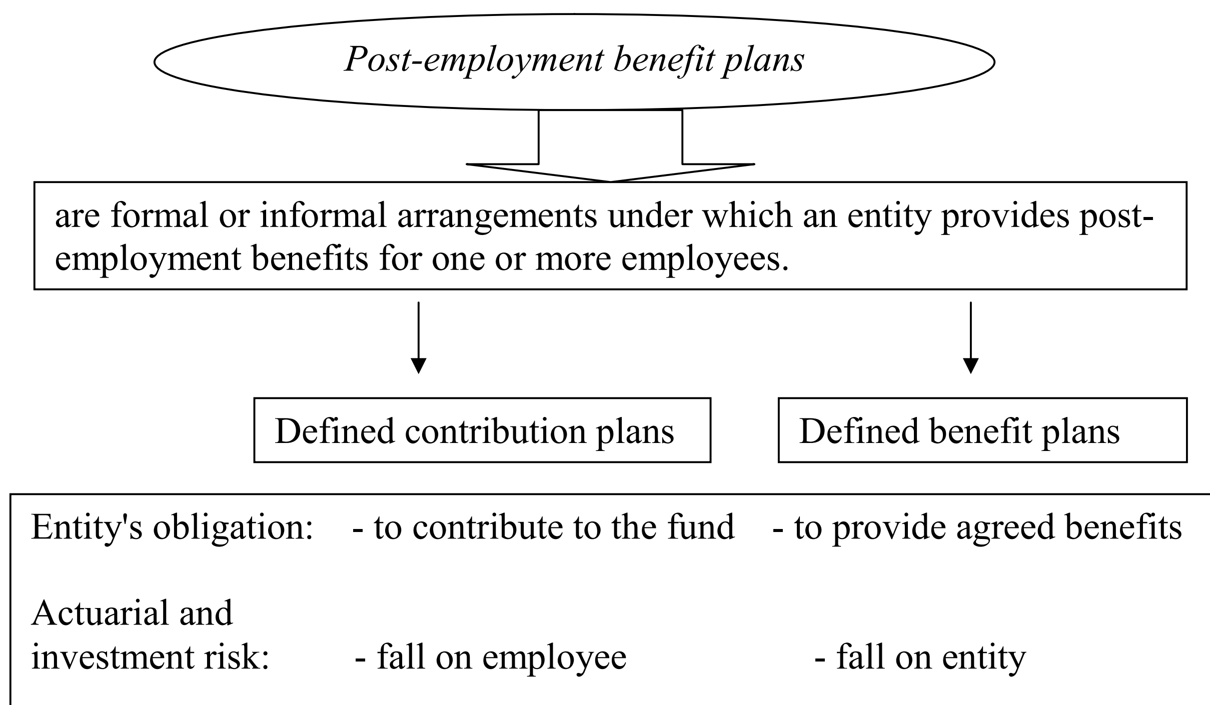
(b) other post-employment benefits, such as post-employment life insurance and post-employment medical care.

Post-employment benefit plans are formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.

There are 2 basic types of post-employment benefits:

- Defined contribution plans
- Defined benefit plans

It is absolutely crucial to know the difference between the two and to classify your post-employment benefit correctly, as the accounting treatment is totally different for each of them.



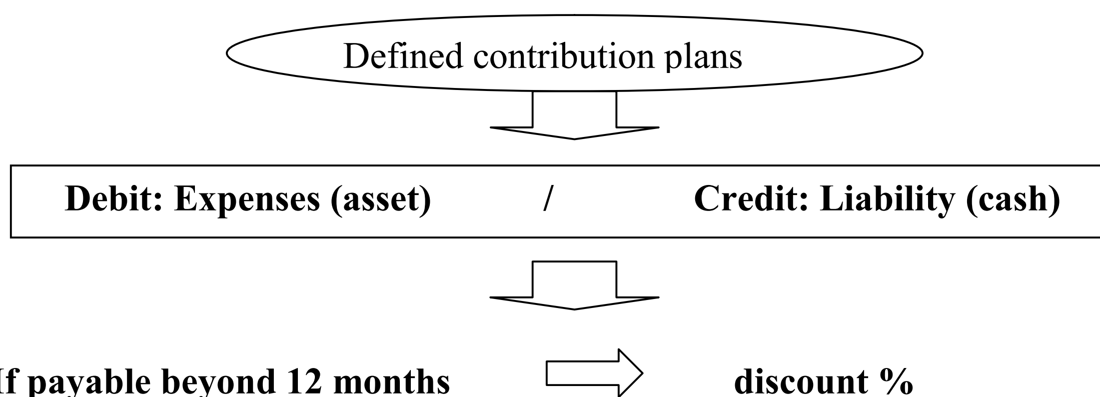
Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

The employer shall recognize contributions payable to a defined contribution plan ***as an expense*** to profit or loss (unless another IFRS requires or permits the inclusion of the benefits in the cost of an asset).

When the contributions are ***not expected to be settled wholly before twelve*** **months** after the end of the reporting period, they shall be discounted.

The accounting entry is as follows:

DEBIT: Expenses for employee benefits (profit or loss) or Cost of another asset (statement of FP)	/	CREDIT: Liability or accrued expenses or cash if paid



If payable beyond 12 months ⇨ discount %

Defined benefit plans are post-employment benefit plans other than defined contribution plans.

Under defined benefit plan, the employer has the obligation to pay specified amount of benefits according to the plan to the employee and all investment and actuarial risk thus fall on the entity.

The employers shall perform the following steps in order to account for the defined benefit plan:

Step 1: Determine Deficit or Surplus

Deficit or surplus is a difference between the present value of defined benefit obligation and fair value of plan assets as at the end of the reporting period. In order to determine it, the entity must:

- Estimate the ***ultimate cost of a benefit***.
- The entity must use ***projected unit credit method*** to estimate how much the employees have earned for their work in the current and prior periods, to attribute the benefit to the periods of service and to incorporate estimates about demographic and financial variables ("actuarial assumptions") into calculations.
- ***Discount the benefit*** in order to determine the present value of the defined benefit obligation and the current service cost.
- ***Deduct the fair value of any plan assets*** from the present value of the defined benefit obligation.

Step 2: Determine amount in the statement of financial position

Although there is quite enough numbers involved in accounting for defined benefit plan, IAS 19 requires to present them as 1 single amount in the statement of

financial position – ***the net defined benefit liability (asset)***, which is basically deficit or surplus calculated in the step 1, but adjusted for the effect of asset ceiling.

Asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

Step 3: Determine amount in the profit or loss

The entity shall present the following amounts to profit or loss:

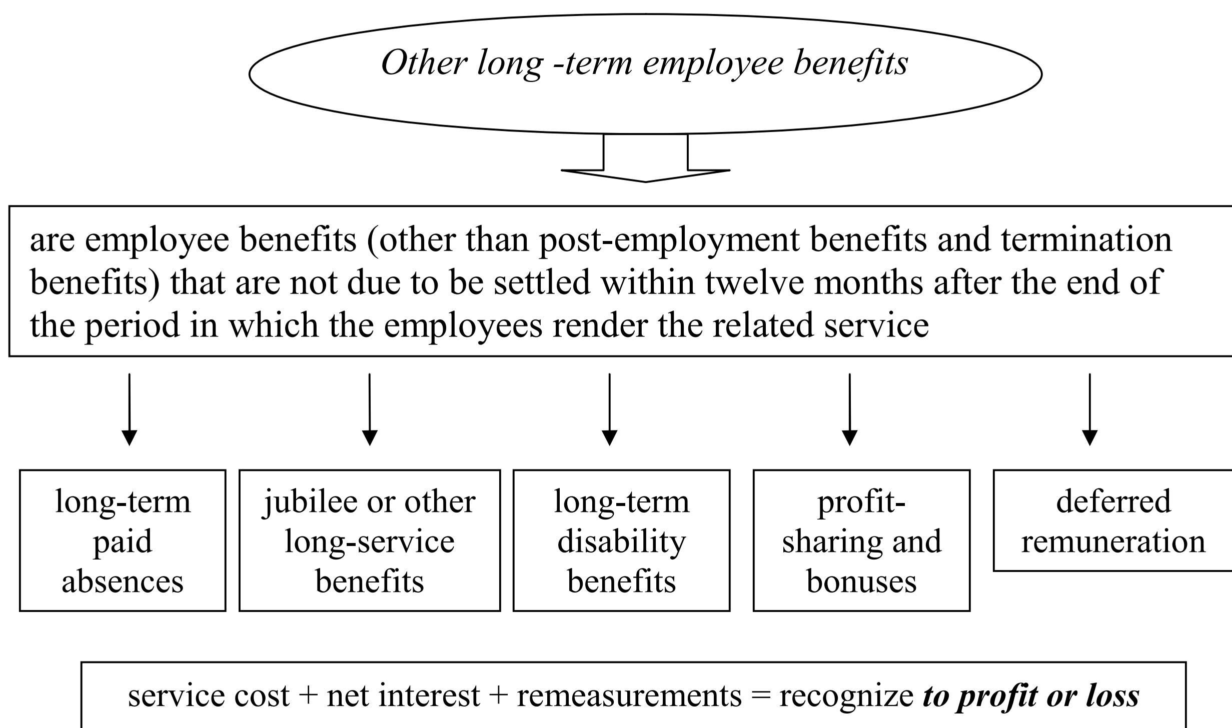
- ***Current service cost*** = the increase in the present value of the defined benefit obligation resulting from employee service in the current period;
- ***Any past service cost*** = the change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment or a curtailment
- ***Any gain or loss on settlement***
- ***Net interest on the net defined benefit liability (asset)*** = the change in the net defined benefit liability (asset) during the period due to passage of time ("unwinding the discount")

Step 4: Determine remeasurements in other comprehensive income

The entity shall present the following remeasurements to other comprehensive income:

- ***Actuarial gains and losses*** = the changes in the present value of the defined benefit obligation resulting from experience adjustments or the effects of changes in actuarial assumptions
- Return on plan assets, excluding amounts included in net interest on the net defined benefit liability (asset)
- Any change in the effect of the asset ceiling.

Other long-term employee benefits are employee benefits (other than post-employment benefits and termination benefits) that are not due to be settled within twelve months after the end of the period in which the employees render the related service.



Other long-term employee benefits include, for example:

(a) long-term compensated absences such as long-service or sabbatical leave;

(b) jubilee or other long-service benefits;

(c) long-term disability benefits;

(d) profit-sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related service; and

(e) deferred compensation paid twelve months or more after the end of the period in which it is earned.

As other long-term benefits are not subject to so much uncertainty as defined benefit plans, the accounting treatment is a bit easier.

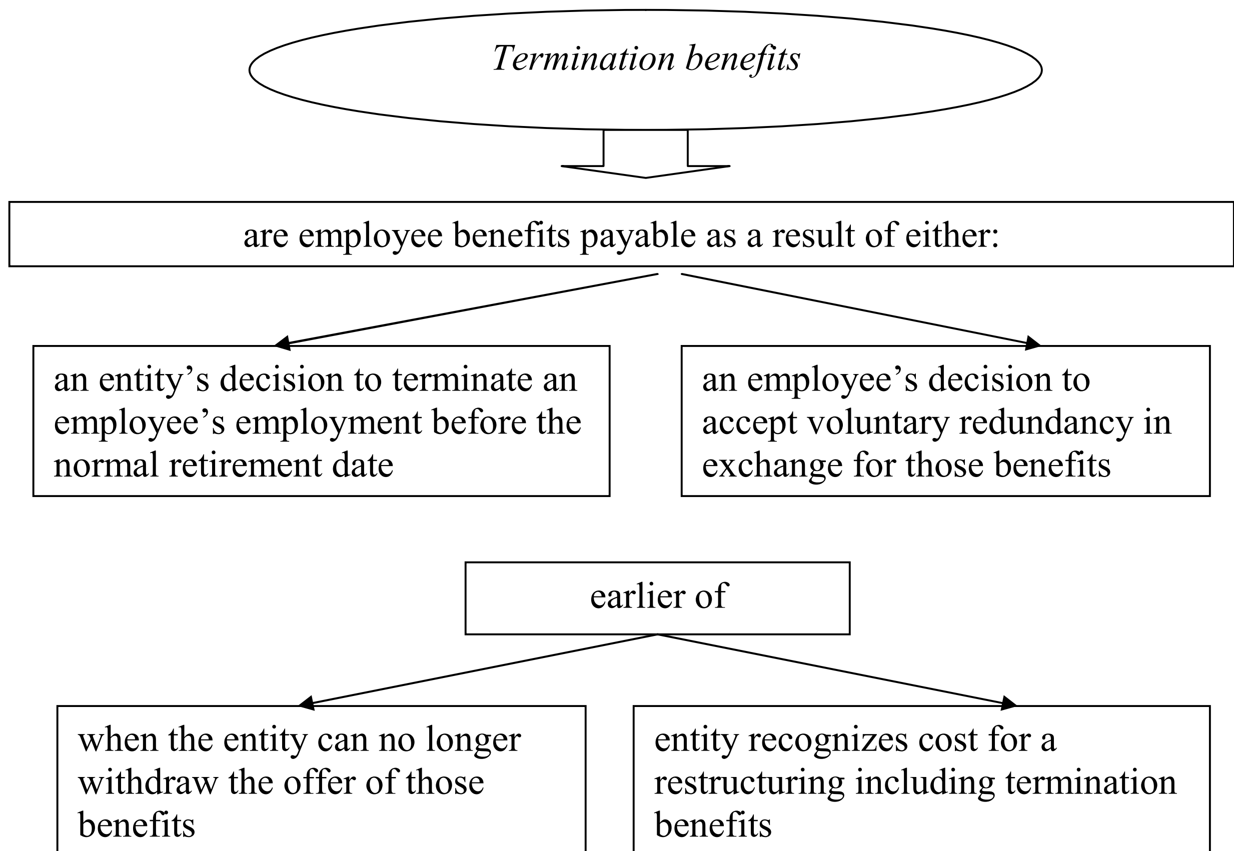
However, the entity should perform the same steps as I have described at defined benefit plans. The only difference is that all items such as service cost, net interest on the net defined benefit liability (asset) and remeasurements of the net defined benefit liability (asset) are presented ***in the profit or loss*** – so nothing goes to other comprehensive income.

Termination benefits are employee benefits payable as a result of either:

(a) an entity's decision to terminate an employee's employment before the

normal retirement date; or

(b) an employee’s decision to accept voluntary redundancy in exchange for those benefits.



Termination benefits

Termination benefits represent quite a different cup of tea than the previous 3 categories. Why? Because they are not provided in exchange for the service of the employee; instead, they are provided ***in exchange for the termination*** of employment.

However, be careful here, because the termination benefit sometimes includes the benefit for BOTH the termination of employment AND the service of employee at the same time.

For example, a company closes one of its production plants and offers the bonus of 1 000 USD to all employees who will be laid off. But because this company needs qualified people to perform the closure, it offers the bonus of 3 000 USD to each employee who stays with the company until the closure is completed.

In this small example, the bonus of 1 000 USD paid to all fired employees

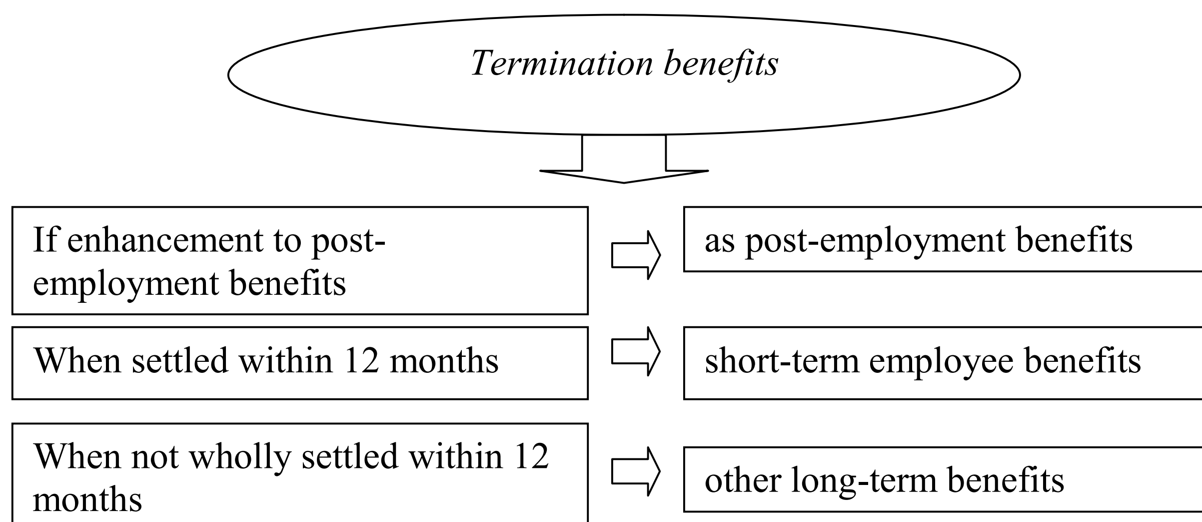
represents ***termination benefit*** and additional 2 000 USD paid to all employees who stay until the closure is completed represents ***the benefit for the employee's service***, mostly classified as ***other long-term benefit in line with IAS 19***.

The primary question here is ***WHEN*** to recognize the liability and expense for termination benefits. It is at the earlier of:

- when the company can no longer withdraw the offer of those benefits (either the termination plan exists or employee accepts the offer of benefits) and
- when the company recognizes cost for a restructuring (IAS 37) and involves the payment of termination benefits.

The next question is ***HOW*** to recognize termination benefits. This depends on the specific terms of the benefits:

- if the termination benefits ***are expected*** to be settled wholly before 12 months after the end of the reporting period, then we should apply the requirements for ***short-term employee benefits*** (so recognize it as an expense to profit or loss on undiscounted basis)
- if the termination benefits ***are not expected*** to be settled wholly before 12 months after the end of the reporting period, then we should apply the requirements for ***other long-term employee benefits*** (so recognize it as an expense to profit or loss on undiscounted basis)



10. CONCEPTS THAT UNDERLIE THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

1. Purpose and Status of the Framework

2. Qualitative Characteristics of Useful Financial Information

3. The Elements of Financial Statements

4. Basic Assumptions, Accounting Principles and Constraints

5. Recognition of the Elements of Financial Statements

6. Measurement of the Elements of Financial Statements

7. Concepts of Capital and Capital Maintenance

1. Purpose and Status of the Framework

The Conceptual Framework for the Financial Reporting (IFRS Framework) serves as a pillar on which the whole IFRS stand.

The IFRS Framework describes the basic concepts that underlie the preparation and presentation of financial statements for external users.

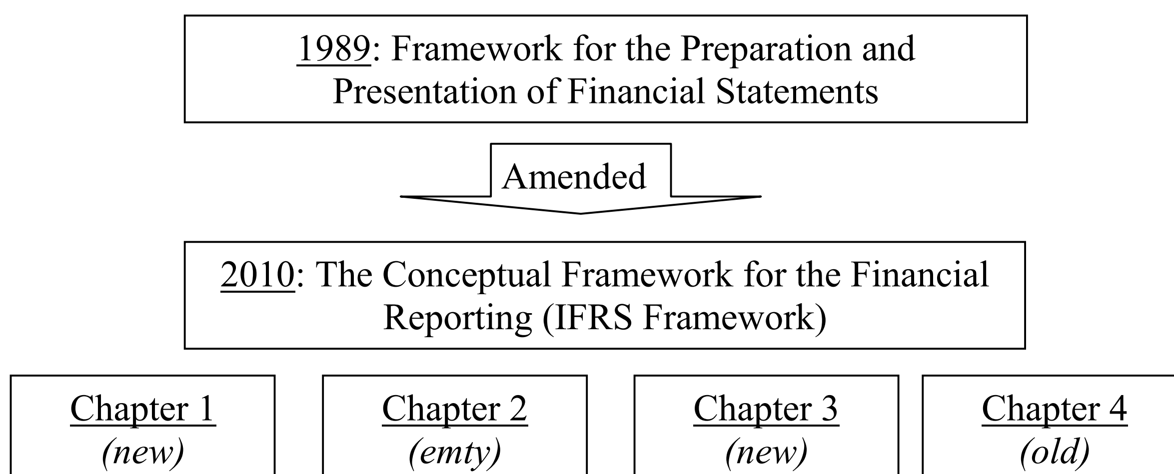
The IFRS Framework serves as a guide to the Board in developing future IFRSs and as a guide to resolving accounting issues that are not addressed directly in an International Accounting Standard or International Financial Reporting Standard or Interpretation.

The IFRS Framework underwent certain changes over past years. Previously, it was called "Framework for the Preparation and Presentation of Financial Statements". Currently, it is a kind of a mix—new text approved in September 2010 plus old text that is to be replaced in the future.

History of the Framework:

April 1989	*Framework for the Preparation and Presentation of Financial Statements* (the Framework) was approved by the IASC Board
July 1989	Framework was published
April 2001	Framework adopted by the IASB.
September 2010	*Conceptual Framework for Financial Reporting 2010* (the IFRS Framework) approved by the IASB

The IFRS Framework itself is not a standard, but it is still very important though, as gives the users some guidance of how the financial statements shall be prepared.



The **IFRS Framework** deals with:

(a) the objective of financial reporting;

(b) the qualitative characteristics of useful financial information;

(c) the definition, recognition and measurement of the elements from which financial statements are constructed; and

(d) concepts of capital and capital maintenance.

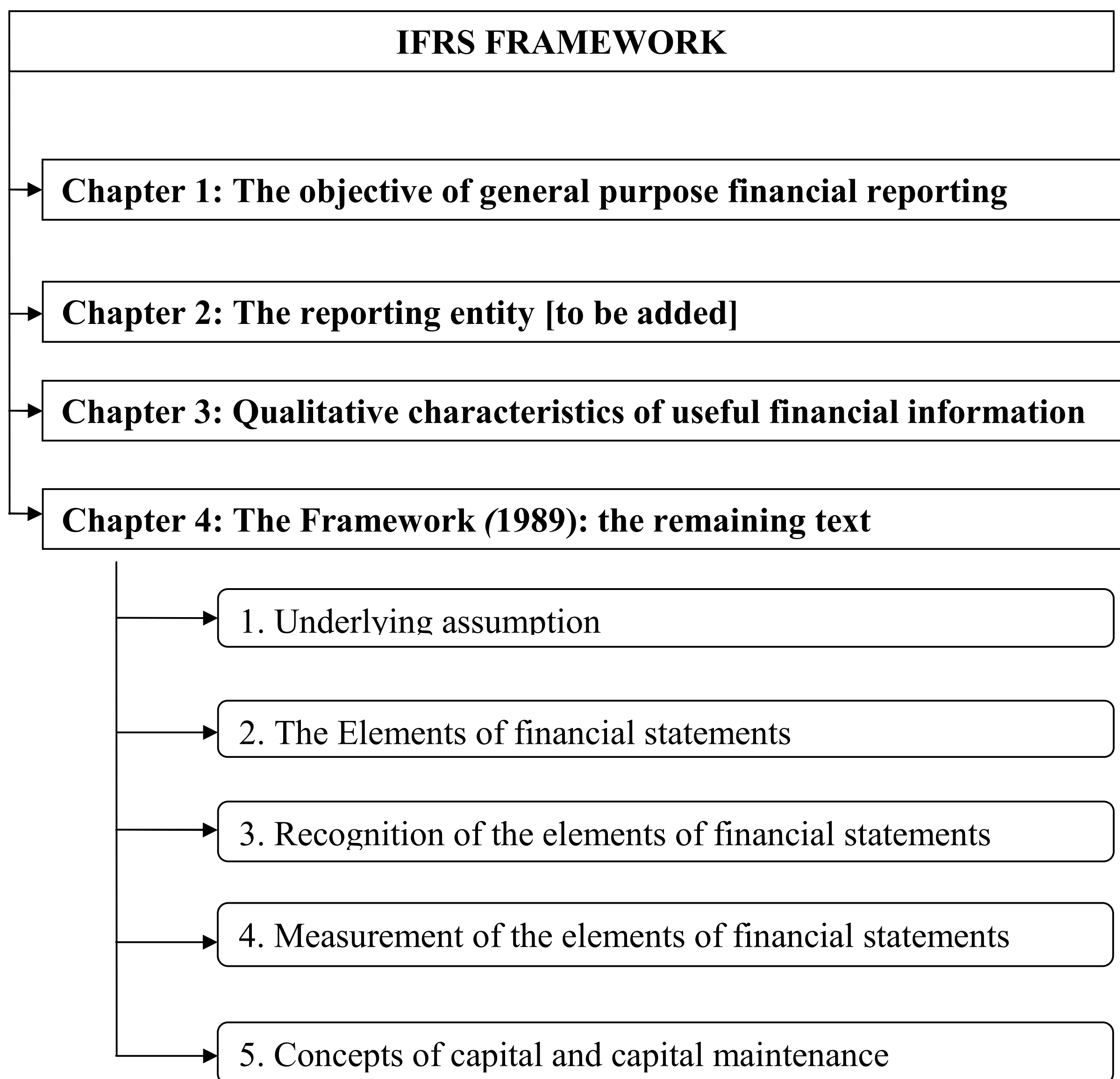
IFRS Framework consists of 4 chapters:

Chapter 1 explains who needs information about entity's financial situation and why—investors, lenders, creditors, but also other parties. Financial statements shall provide information about a reporting entity's economic resources and claims, plus their changes.

Chapter 2 is empty and will be inserted in the later process of updates.

Chapter 3 describes 2 types of characteristics for financial information to be useful:

Chapter 4 contains the original text of "old" IFRS Framework before any changes. As IASB adds new text, relevant paragraphs in this older text will be deleted and replaced by the new Chapters. It has 5 main parts.



2. Qualitative Characteristics of Useful Financial Information

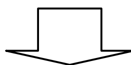
Financial information presented in financial statements has several qualities that make it useful for the users.

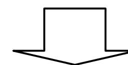
These qualities are outlined in Chapter 3 of the IFRS Framework. Conceptual Framework categorizes these into fundamental qualitative characteristics and enhancing qualitative characteristics.

Financial information is useful when it is *relevant* and *represents faithfully* what it purports to represent.

The usefulness of financial information is enhanced if it is *comparable*, *verifiable*, *timely* and *understandable*.

Qualitative characteristics of useful financial information





Fundamental

- ✓ Relevance
- ✓ Faithful representation

Enhancing

- ✓ Comparability
- ✓ Verifiability
- ✓ Timeliness
- ✓ Understandability

The fundamental qualitative characteristics:

Relevance – financial information is regarded as relevant if it is capable of influencing the decisions of users.

Faithful representation – this means that financial information must be complete, neutral and free from error.

The enhancing qualitative characteristics:

Comparability – it should be possible to compare an entity over time and with similar information about other entities.

Verifiability – if information can be verified (e.g. through an audit) this provides assurance to the users that it is both credible and reliable.

Timeliness – information should be provided to users within a timescale suitable for their decision making purposes.

Understandability – information should be understandable to those that might want to review and use it. This can be facilitated through appropriate classification, characterisation and presentation of information.

3. The Elements of Financial Statements

The main purpose of financial statements is to provide financial information to the users to assist them in their economic decisions.

In order to enhance the quality of information in financial statements, business transactions are grouped in different classes or categories on the basis of

their economic characteristics. The broad classes or categories are called **elements of financial statements**.

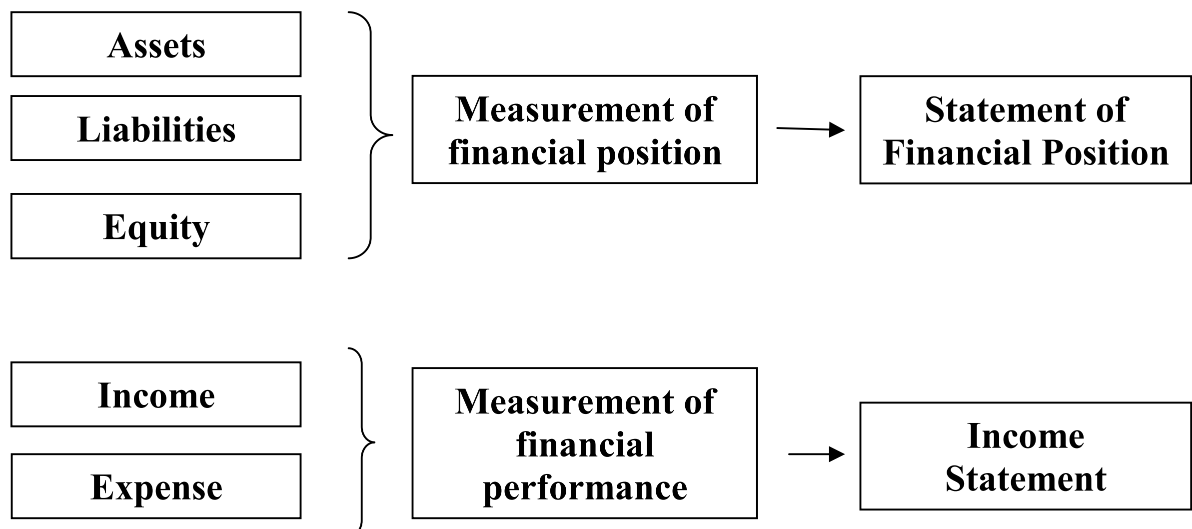
The elements of financial statements are broad classes that group various transactions and items info financial statements.

In Framework there are in total FIVE elements of financial statements mentioned which are as follows:

1. Assets
2. Liabilities
3. Equity
4. Income
5. Expense

The elements directly related to the measurement of financial position of the entity are **assets, liabilities** and **equity**. These elements are presented in the **Statement of Financial Position** which was previously known as Balance Sheet.

The elements directly related to the measurement of financial performance of the entity are **income** and **expense.** These elements are presented in the **Income Statement**.



An asset is 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.

In simple words, asset is something which a business owns or controls to benefit from its use in some way. It may be something which directly generates

revenue for the entity (e.g. a machine, inventory) or it may be something which supports the primary operations of the organization (e.g. office building).

Assets may be classified into Current and Non-Current.

The distinction is made on the basis of time period in which the economic benefits from the asset will flow to the entity.

Current Assets are ones that an entity expects to use within one-year time from the reporting date.

Non-Current Assets are those whose benefits are expected to last more than one year from the reporting date.

A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.

In simple words, liability is an obligation of the entity to transfer cash or other resources to another party. Liability could for instance be a bank loan, which obligates the entity to pay loan installments over the duration of the loan to the bank along with the associated interest cost. Alternatively, an entity's liability could be a trade payable arising from the purchase of goods from a supplier on credit.

Liabilities may be classified into Current and Non-Current.

The distinction is made on the basis of time period within which the liability is expected to be settled by the entity.

Current Liability is one which the entity expects to pay off within one year from the reporting date.

Non-Current Liability is one which the entity expects to settle after one year from the reporting date.

Equity is the residual interest in the assets of the entity after deducting all the liabilities.

Equity is what the owners of an entity have invested in an enterprise. It represents what the business owes to its owners. It is also a reflection of the capital left in the business after assets of the entity are used to pay off any outstanding

liabilities.

Equity therefore includes share capital contributed by the shareholders along with any profits or surpluses retained in the entity. This is what the owners take home in the event of liquidation of the entity.

The Accounting Equation may further explain the meaning of equity:

Assets - Liabilities = Equity

This illustrates that equity is the owner's interest in the Net Assets of an entity.

Rearranging переставлять, передвигать the above equation, we have

Assets = Equity + Liabilities

Assets of an entity have to be financed in some way. Either by debt (Liability) or by share capital and retained profits (Equity). Hence, equity may be viewed as a type of liability an entity has towards its owners in respect of the assets they financed.

Examples of Equity recognized in the financial statements include the following:

- Ordinary Share Capital
- Preference Share Capital
- Retained Earnings
- Revaluation Surpluses

Profit is frequently used as a measure of performance or as the basis for other measures, such as return on investment or earnings per share.

The elements directly related to the measurement of profit are income and expenses.

Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

Income is therefore an increase in the net assets of the entity during an accounting period except for such increases caused by the contributions from

owners.

The first part of the definition is quite easy to understand as income must logically result in an increase in the net assets (equity) of the entity such as by the inflow of cash or other assets. However, net assets of an entity may increase simply by further capital investment by its owners even though such increase in net assets cannot be regarded as income. This is the significance of the latter part of the definition of income.

There are two types of income:

- Sale Revenue: Income earned in the ordinary course of business activities of the entity;
- Gains: Income that does not arise from the core основной operations of the entity.

For instance, sale revenue of a business whose main aim is to sell biscuits is income generated from selling biscuits. If the business sells one of its factory machines, income from the transaction would be classified as a gain rather than sale revenue.

Following are common sources of incomes recognized in the financial statements:

- Sale revenue generated from the sale of a commodity.
- Interest received on a bank deposit.
- Dividend earned on entity's investments.
- Rentals received on property leased by the entity.
- Gain on re-valuation of company assets.

Expenses are the decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Expense is simply a decrease in the net assets of the entity over an accounting period except for such decreases caused by the distributions to the owners.

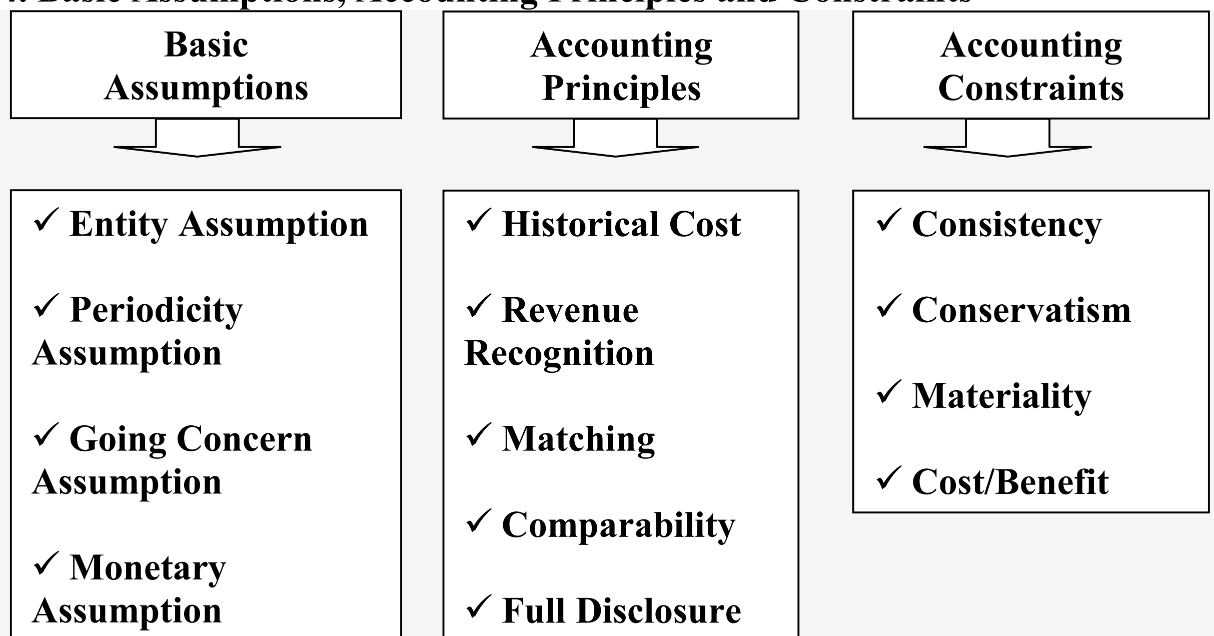
The first aspect of the definition is quite easy to grasp as the incurring of an expense must reduce the net assets of the company. For instance, payment of a company's utility bills reduces cash.

However, net assets of an entity may also decrease as a result of payment of dividends to shareholders or drawings by owners of a business, both of which are distributions of profits rather than expense. This is the significance значение, смысл of the latter part of the definition of expense.

Following is a list of common types of expenses recognized in the financial statements:

- Salaries and wages
- Utility expenses
- Cost of goods sold
- Administration expenses
- Finance costs
- Depreciation
- Impairment losses

4. Basic Assumptions, Accounting Principles and Constraints



Accounting Underlying Assumptions - Basis for Generally Accepted Accounting Principles (GAAP)

Entity Assumption - the transactions and balances of a business entity are to be accounted for separately from its owners. The business entity is therefore considered to be distinct from its owners for the purpose of accounting

Periodicity Assumption- divide economic activities into time periods for reporting.

Going Concern Assumption - the company will remain in business and will carry out existing commitments kəˈmɪtmənts обязательство. Assets will be used to bring future benefit and liabilities will be paid.

The IFRS Framework states that the going concern assumption is an underlying assumption.

Monetary Assumption - Measurement and Financial statements show only measurable activities. Financial statements must be reported in the national monetary unit (i.e., U.S. dollars for U.S. companies).

No adjustments are made for inflation or deflation.

Accounting Principles:

Historical Cost - Assets and Liabilities are recorded at cost.

Cost is the best estimate of fair value at the time the transaction occurs.

Revenue Recognition: Show revenues on the income statement when:

- the earnings process процесс; is judged to be complete or virtually complete (you do not owe the customer anything else)
- there is reasonable certainty as to the collectibility of cash (you believe you will be paid)

Accrual Basis of Accounting:

Revenues are recorded when earned and expenses are recorded when incurred.

When the cash is received or paid DOES NOT Matte

Matching - expenses incurred should be matched with revenues earned for the same period.

Comparability - allows users to identify similarities and differences

1) one year to the next

2) one company to another

A format for financial statements is required. It shows trends over time.

Full Disclosure - all relevant accounting information must be disclosed повинна бути розкрита to users.

1) the “notes to the financial statements” are required

2) the “notes to the financial statements” discuss details that are not shown on the financial statements

Accounting Constraints:

Consistency - use the same accounting policies and procedures from one period to the next (FASB gives choices of how things can be reported and once you choose a method you keep using it)

Materiality - the amount is big enough to make a difference in the decision of a reasonable person.

Conservatism - when estimating, present the lowest asset value, the highest liability amount, and the lowest net income position

1) recognize losses as soon as you know about them

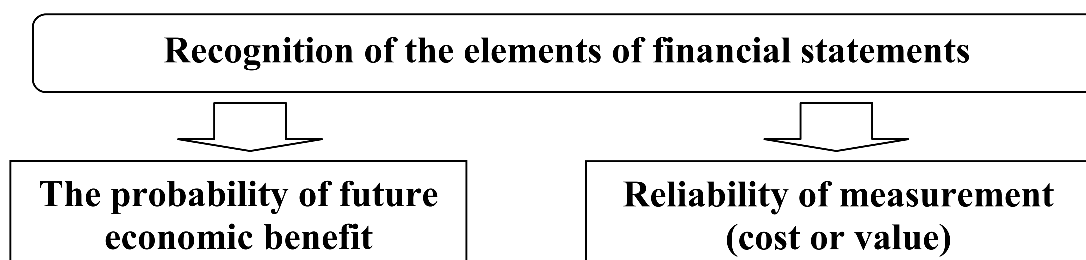
2) recognize gains when you collect the cash

Cost/Benefit - the benefit must exceed the cost when gathering and presenting financial information.

5. Recognition of the elements of financial statements

Recognition of asset (or any other element) means simply showing this asset in the balance sheet (or somewhere else in the financial statements).

IFRS Framework discusses WHEN to recognize or show certain item in the financial statements.



Recognition is the process of incorporating in the balance sheet or income

statement an item that meets the definition of an element and satisfies the following criteria for recognition:

- It is probable that any future economic benefit associated with the item will flow to or from the entity; and
- The item's cost or value can be measured with reliability.

An asset is recognised in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably.

A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably.

Income is recognised in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably.

This means, in effect, that recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable).

Expenses are recognised in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets (for example, the accrual of employee entitlements or the depreciation of equipment).

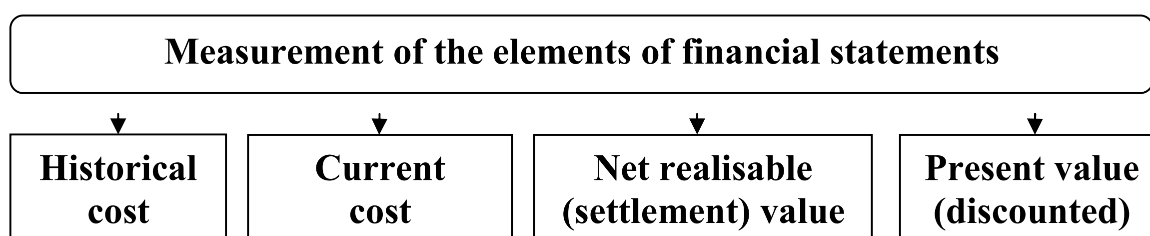
6. Measurement of the elements of financial statements

While recognition means WHEN (or WHETHER) to recognize, measurement means IN WHAT AMOUNT to recognize asset, liability, piece of equity, income or expense.

Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the balance sheet and income statement. This involves the selection of the particular basis of measurement.

Measurement involves assigning monetary amounts at which the elements of the financial statements are to be recognised and reported.

The IFRS Framework acknowledges that a variety of measurement bases are used today to different degrees and in varying combinations in financial statements.



Historical cost. Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

Current cost. Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

Realisable (settlement) value. Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.

Present value. Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of

business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

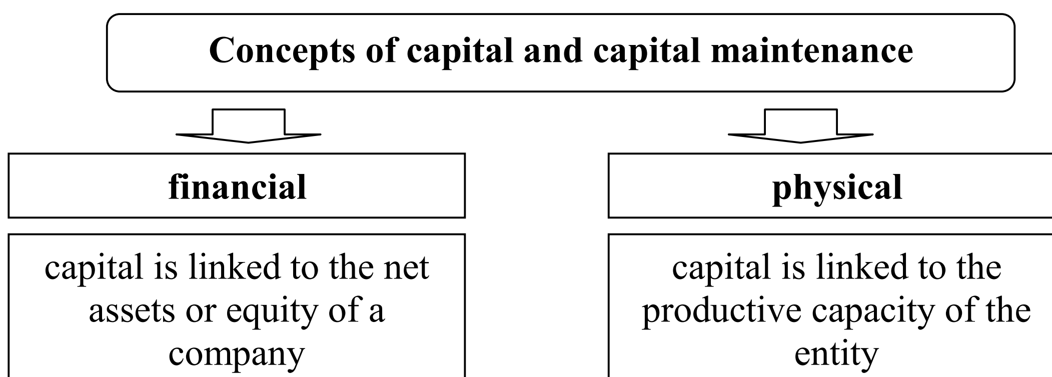
Historical cost is the measurement basis most commonly used today, but it is usually combined with other measurement bases.

For example, inventories are usually carried at the lower of cost and net realisable value, marketable securities may be carried at market value and pension liabilities are carried at their present value. Furthermore, some entities use the current cost basis as a response to the inability of the historical cost accounting model to deal with the effects of changing prices of non-monetary assets.

The IFRS Framework does not include concepts or principles for selecting which measurement basis should be used for particular elements of financial statements or in particular circumstances. Individual standards and interpretations do provide this guidance, however.

7. Concepts of capital and capital maintenance

The IFRS Framework identifies two concepts of capital and capital maintenance: financial and physical.



Based on selected concept of capital, an entity determines basis of measurement and accounting model used in preparation of the financial statements.

Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the entity.

Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of the entity based on, for example, units of

output per day.

Most entities use the financial capital maintenance concept, as it is the easiest to apply because it uses actual prices paid for goods, rather than making adjustments.

The concepts of capital give rise to the following concepts of capital maintenance:

(a) **Financial capital maintenance**. Under this concept a profit is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.

(b) **Physical capital maintenance**. Under this concept a profit is earned only if the physical productive capacity (or operating capability) of the entity (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.

Both capital maintenance concepts provide useful information.

Investors prefer to use the financial capital maintenance concepts as they are focused on increasing and maximizing the returns they get on their investments.

Staff and management may prefer to use the physical capital maintenance concept as it allows them to assess the entity’s ability to maintain its operating capacity.

This is useful for manufacturing businesses in particular where management may need to ensure the business can keep producing the same volume of goods.

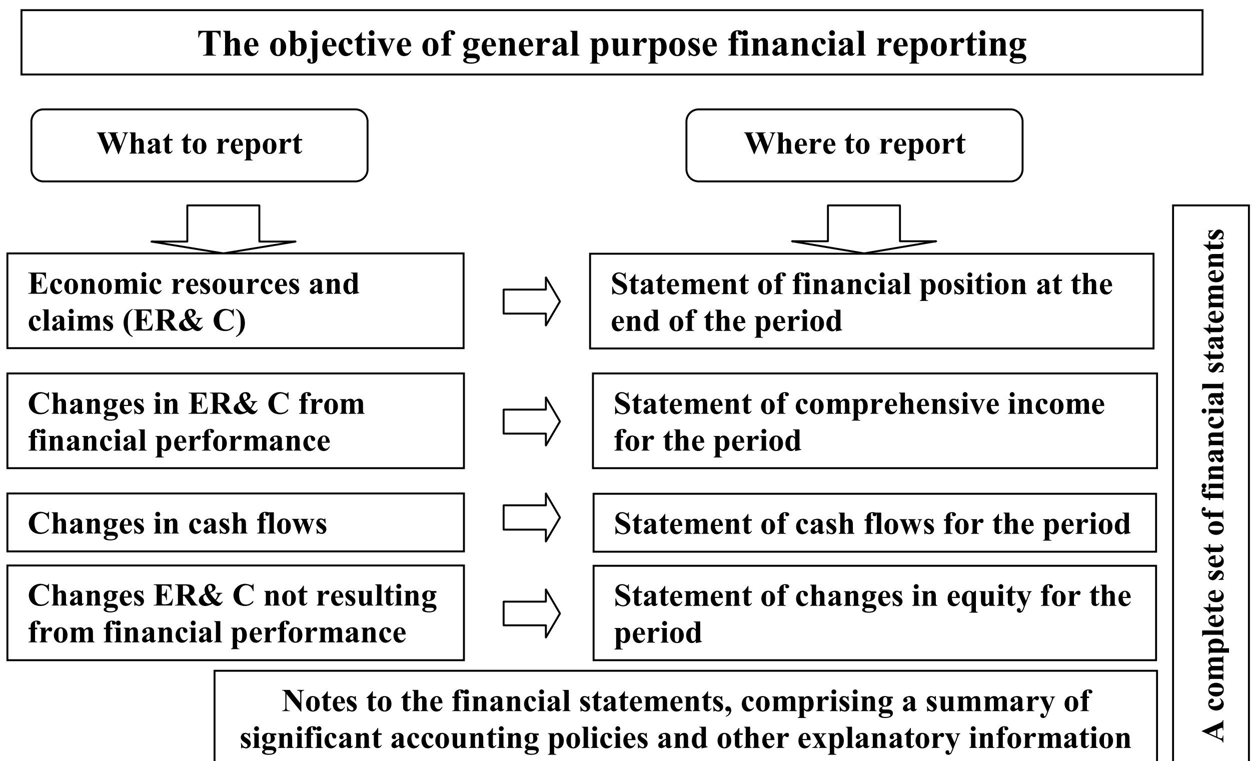
11. PRESENTATION OF FINANCIAL STATEMENTS

1. Purpose and Complete set of financial statements

2. General features of financial statements

1. Purpose and Complete set of financial statements

The objective of general purpose financial statements is to provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making economic decisions.



To meet that objective, financial statements provide information about an entity's:

- assets
- liabilities
- equity
- income and expenses, including gains and losses
- contributions by and distributions to owners (in their capacity as owners)
- cash flows.

That information, along with other information in the notes, assists users of

financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.

At a more refined level, there is a different purpose associated with each of the financial statements.

The purpose of the balance sheet is to inform the reader about the current status of the business as of the date listed on the balance sheet. This information is used to estimate the liquidity, funding, and debt position of an entity, and is the basis for a number of liquidity ratios.

The income statement informs the reader about the ability of a business to generate a profit.

In addition, it reveals the volume of sales, and the nature of the various types of expenses, depending upon how expense information is aggregated. When reviewed over multiple; time periods, the income statement can also be used to analyze trends in the results of company operations.

Finally, the purpose of the statement of cash flows is to show the nature of cash receipts and disbursements, by a variety of categories. This information is of considerable use, since cash flows do not always match the revenues and expenses shown in the income statement.

Financial Statements provide useful information to a wide range of **users**:

Managers require Financial Statements to manage the affairs of the company by assessing its financial performance and position and taking important business decisions.

Shareholders use Financial Statements to assess the risk and return of their investment in the company and take investment decisions based on their analysis.

Prospective Investors need Financial Statements to assess the viability of investing in a company.

Investors may predict future dividends based on the profits disclosed in the Financial Statements. Furthermore, risks associated with the investment may be gauged from the Financial Statements. For instance, fluctuating profits indicate higher risk. Therefore, Financial Statements provide a basis for the investment

decisions of potential investors.

Financial Institutions (e.g. banks) use Financial Statements to decide whether to grant a loan or credit to a business. Financial institutions assess the financial health of a business to determine the probability of a bad loan. Any decision to lend must be supported by a sufficient asset base and liquidity.

Suppliers need Financial Statements to assess the credit worthiness of a business and ascertain whether to supply goods on credit. Suppliers need to know if they will be repaid. Terms of credit are set Умови кредиту встановлюються according to the assessment of their customers' financial health.

Customers use Financial Statements to assess whether a supplier has the resources to ensure the steady supply of goods in the future. This is especially vital where a customer is dependant on a supplier for a specialized component.

Employees use Financial Statements for assessing the company's profitability and its consequence on their future remuneration and job security.

Competitors compare their performance with rival companies to learn and develop strategies to improve their competitiveness.

General Public may be interested in the effects of a company on the economy, environment and the local community.

Governments require Financial Statements to determine the correctness of tax declared in the tax returns. Government also keeps track of economic progress through analysis of Financial Statements of businesses from different sectors of the economy.

In addition, financial statements can be presented for individual subsidiaries or business segments, to determine their results at a more refined level of detail.

In short, the financial statements have a number of purposes, depending upon who is reading the information and which financial statements are being perused.

Reports that are presented outside of the financial statements – including financial reviews by management, environmental reports, and value added statements – are outside the scope of IFRSs.

Term before 2007 revision of IAS	Term as amended by IAS 1 (2007)
balance sheet	statement of financial position
cash flow statement	statement of cash flows
income statement	statement of comprehensive income (income statement is retained in case of a two-statement approach)
recognised in the income statement	recognised in profit or loss
recognised [directly] in equity (only for OCI components)	recognised in other comprehensive income
recognised [directly] in equity (for recognition both in OCI and equity)	recognised outside profit or loss (either in OCI or equity)
removed from equity and recognised in profit or loss ('recycling')	reclassified from equity to profit or loss as a reclassification adjustment
Standard or/and Interpretation	IFRSs
on the face of	in
equity holders	owners (exception for 'ordinary equity holders')
balance sheet date	end of the reporting period
reporting date	end of the reporting period
after the balance sheet date	after the reporting period

2. General features of financial statements

IAS 1 Presentation of Financial Statements represents a basis of the whole IFRS reporting, as it sets overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.

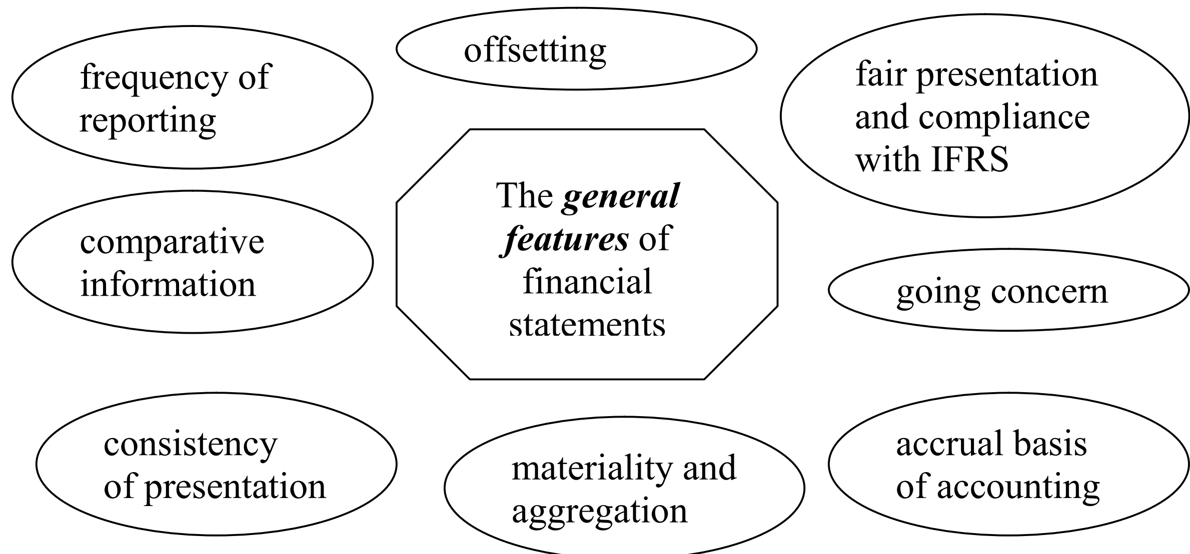
Underlying Assumption

is

Going concern

It means that an entity will continue to operate for the foreseeable future (usually 12 months after the reporting date).

According to IAS 1 general features of financial statements (which can also be called as fundamental principles for preparation and presentation of financial statements) are:



As you can see that underlying assumptions form part of the fundamental principles but not all of the principles are underlying assumptions as given in framework.

Fair presentation and compliance with IFRSs

The financial statements must «present fairly» the financial position, financial performance and cash flows of an entity.

Fair presentation requires the faithful representation of the effects of transactions, other events, and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework.

The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.

To achieve the fair presentation the entity should make sure the following:

- The selection and application of accounting policies as per IAS8
- The information contained in financial statements should have all the qualitative characteristics of financial statements
- Complete disclosure should be given as per the IFRS

IAS 1 requires an entity whose financial statements comply with IFRSs to make an explicit and unreserved statement of such compliance in the notes.

Financial statements cannot be described as complying with IFRSs unless

they comply with all the requirements of IFRSs (which includes International Financial Reporting Standards, International Accounting Standards, IFRIC Interpretations and SIC Interpretations).

Going concern

The Conceptual Framework notes that financial statements are normally prepared assuming the entity is a going concern and will continue in operation for the foreseeable future.

At the end of each reporting period, when entity will prepare its financial statements, the management is required to assess of whether the entity has ability to continue its business as a going concern. If management identifies that it has ability to continue its business as a going concern then its financial statement will be prepared on a going concern basis.

The entity will be treated as going concern, if it can continue its operations for the foreseeable future such that neither the management has intention nor the circumstances are there that the entity will have to curtail its business activities.

If management has significant concerns about the entity's ability to continue as a going concern, the uncertainties must be disclosed. If management concludes that the entity is not a going concern, the financial statements should not be prepared on a going concern basis, in which case IAS 1 requires a series of disclosures.

Accrual basis of accounting

IAS 1 requires that an entity prepare its financial statements, except for cash flow information, using the accrual basis of accounting.

Materiality and aggregation

Each material class of similar items must be presented separately in the financial statements. Dissimilar items may be aggregated only if they are individually immaterial.

Offsetting

The entity should not offset any assets and liabilities or any income and expense, except it is required by a IFRS.

Frequency of Reporting

An entity shall present a complete set of financial statements (including comparative information) at least annually. When an entity changes the end of its reporting period and presents financial statements for a period longer or shorter than one year an entity shall disclose, in addition to the period covered by the financial statements

(a) The reason for using a longer or shorter period, and

(b) The fact that amounts presented in the financial statements are not entirely comparable.

Comparative Information

IAS 1 requires an entity to disclose the comparative information in respect of the previous accounting period similar to those amounts which are presented in the financial statements of the current accounting period. If comparative amounts are changed or reclassified, various disclosures are required.

Consistency of presentation

The presentation and classification of items in the financial statements shall be retained from one period to the next unless a change is justified either by a change in circumstances or a requirement of a new IFRS.

The entity should use the same accounting policies in the preparation and presentation of financial statements for the similar events and transactions, from one period to the next in order to ensure the comparability of financial statements unless the change is required by the circumstance laid down in IAS 8

12. STRUCTURE AND CONTENT OF FINANCIAL STATEMENTS

1. Identification of the financial statements

2. Statement of financial position

3. Statement of comprehensive income

4. Statement of cash flows

5. Statement of changes in equity

6. Notes to the Financial Statements

7. Accounting policies, changes in accounting estimates and errors

1. Identification of the financial statements

An entity shall clearly identify the financial statements and distinguish them from other information in the same published document.

The financial statements of the entity should be identified and distinguished from the other information using the following:

- The title of the entity presenting financial statements
- Whether these are the financial statements of an individual entity or consolidated financial statements for the group of entities
- The reporting date for which financial statements are presented
- The presentation currency for the amounts reported in financial statements
- The level of rounding up for the amounts reported in financial statements

2. Statement of financial position

Statement of Financial Position, also known as the Balance Sheet, presents the financial position of an entity at a given date. It is comprised of three main components: assets, liabilities and equity (the acronym ALE).

The structure of the statement of financial position is similar to the basic accounting equation: *Assets = Liabilities + Equity*.

An asset is something that an entity owns or controls in order to derive economic benefits from its use.

An entity shall present current and non-current assets, and current and non-

current liabilities, as separate classifications in its statement of financial position except when a presentation based on liquidity provides information that is reliable and more relevant.

When that exception applies, an entity shall present all assets and liabilities in order of liquidity.

The entity will present an asset as **current asset**, if it meets any of the following criteria:

- It is held for trading in the normal course of business
- It will be realized within a period of 12 months from the reporting date
- It is expected to be sold or consumed in the normal course of business
- It is cash or cash equivalent as defined in IAS 7

The entity will present all other assets as non-current assets.

Assets are also classified in the statement of financial position on the basis of their nature:

- Tangible & intangible: Non-current assets with physical substance are classified as *property, plant and equipment* whereas assets without any physical substance are classified as *intangible assets*. Goodwill is a type of an intangible asset.
- Inventories balance includes goods that are held for sale in the ordinary course of the business. Inventories may include raw materials, finished goods and works in progress.
- Trade receivables include the amounts that are recoverable from customers upon credit sales. Trade receivables are presented in the statement of financial position after the deduction of allowance for bad debts.
- Cash and cash equivalents include cash in hand along with any short term investments that are readily convertible into known amounts of cash.

A **liability** is an obligation that a business owes to someone and its settlement involves the transfer of cash or other resources. Liabilities must be classified in the statement of financial position as current or non-current depending

on the duration over which the entity intends to settle the liability. A liability which will be settled over the long term is classified as non-current whereas those liabilities that are expected to be settled within one year from the reporting date are classified as current liabilities.

An entity shall classify a liability as current when:

(a) it expects to settle the liability in its normal operating cycle;

(b) it holds the liability primarily for the purpose of trading;

(c) the liability is due to be settled within twelve months after the reporting period; or

(d) it does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

Terms of a liability that could, at the option of the counterparty result in its settlement by the issue of equity instruments do not affect its classification.

An entity shall classify all other liabilities as non-current.

Liabilities are also classified in the statement of financial position on the basis of their nature:

- Trade and other payables primarily include liabilities due to suppliers and contractors for credit purchases. Sundry payables which are too insignificant to be presented separately on the face of the balance sheet are also classified in this category.
- Short term borrowings typically include bank overdrafts and short term bank loans with a repayment schedule of less than 12 months.
- Long-term borrowings comprise of loans which are to be repaid over a period that exceeds one year. Current portion of long-term borrowings include the installments of long term borrowings that are due within one year of the reporting date.
- Current Tax Payable is usually presented as a separate line item in the statement of financial position due to the materiality of the amount.

Equity is what the business owes to its owners. Equity is derived by deducting total liabilities from the total assets. It therefore represents the residual

interest in the business that belongs to the owners.

Equity is usually presented in the statement of financial position under the following categories:

- *Share capital* represents the amount invested by the owners in the entity
- *Retained Earnings* comprises the total net profit or loss retained in the business after distribution to the owners in the form of dividends.
- *Revaluation Reserve* contains the net surplus of any upward revaluation of property, plant and equipment recognized directly in equity.

As a minimum, the statement of financial position shall include line items that present the following amounts:

ASSETS	EQUITY AND LIABILITIES
Property, plant and equipment	Issued capital and reserves attributable to owners of the parent
Investment property	
Intangible assets	Non-controlling interests
Financial assets	Financial Liabilities
Investments accounted for using equity method	Provisions
Biological assets	
Inventories	
Trade and other receivables	Trade and other payables
Cash and cash equivalents	
Totals of assets in accordance with IFRS 5 Non-current assets Held for Sale and Discontinued Operations	Totals of liabilities in accordance with IFRS 5 Non-current assets Held for Sale and Discontinued Operations
Current tax assets	Current tax liabilities
Deferred tax assets	Deferred tax liabilities

The statement of financial position must reflect the basic accounting principles and guidelines such as the cost, matching, and full disclosure principle.

Accordingly, the statement of financial position is more meaningful when it is prepared under the accrual method of accounting.

Statement of Financial Position helps users of financial statements to assess the financial soundness of an entity in terms of liquidity risk, financial risk, credit

risk and business risk.

Following is an illustrative **example of a Statement of Financial Position** prepared under the format prescribed by IAS 1 Presentation of Financial Statements.

Statement of Financial Position as at 31st December 2017

	Notes	2017 USD	2016 USD
ASSETS			
Non-current assets			
Property, plant & equipment	**9**	**130,000**	120,000
Goodwill	**10**	**30,000**	30,000
Intangible assets	**11**	**60,000**	50,000
		220,000	200,000
Current assets			
Inventories	**12**	**12,000**	10,000
Trade receivables	**13**	**25,000**	30,000
Cash and cash equivalents	**14**	**8,000**	10,000
		45,000	50,000
TOTAL ASSETS		**265,000**	250,000
EQUITY AND LIABILITIES			
Equity			
Share capital	**4**	**100,000**	100,000
Retained earnings		**50,000**	40,000
Revaluation reserve	**5**	**15,000**	10,000
Total equity		**165,000**	150,000
Non-current liabilities			
Long term borrowings	**6**	**35,000**	50,000
Current liabilities			
Trade and other payables	**7**	**35,000**	25,000
Short-term borrowings	**8**	**10,000**	8,000
Current portion of long-term borrowings	**6**	**15,000**	15,000
Current tax payable	**9**	**5,000**	2,000
Total current liabilities		**65,000**	50,000
Total liabilities		**100,000**	100,000
TATAL EQUITY AND LIABILITIES		**265,000**	250,000

3. Statement of comprehensive income

Income Statement is a report of income, expenses and the resulting profit or loss earned during an accounting period.

An entity shall present all items of income and expense recognised in a period:

(a) in a single statement of comprehensive income, or

(b) in two statements: a statement displaying components of profit or loss (separate statement of comprehensive income) and a second statement beginning with profit or loss and displaying components of other comprehensive income (statement of comprehensive income).

The statement of comprehensive income has 2 basic elements:

Profit or loss for the period: here, all items of income and expenses must be recognized.

Other comprehensive income: items recognized directly to equity or reserves, such as changes in revaluation surplus, gains or losses from subsequent measurement of available-for-sale financial assets, etc.

As a minimum, the statement of comprehensive income shall include line items that present the following amounts for the period:

PROFIT OR LOSS
Revenue
Gains and losses arising from the derecognition of financial assets at amortized cost
Finance costs
Share of the profit or loss of associates and joint ventures accounted for using the equity method
Tax expense
Post-tax profit/gain or loss of operations or assets in accordance with IFRS 5 (Non-current assets Held for Sale and Discontinued Operations)
Profit or loss
OTHER COMPREHENSIVE INCOME
Each component of other comprehensive income classified by nature
Share of the other comprehensive income of associates and joint ventures accounted for using equity method
Total comprehensive income

Profit or loss for the period, as well as total comprehensive income shall be

both presented in allocation:

- attributable to non-controlling interests and
- attributable to owners of the parent.

The entity might choose to ***classify expenses*** recognized in profit or loss for the period by their nature or by their function.

Income statement is prepared on the accruals basis of accounting.

This means that income (including revenue) is recognized when it is **earned** rather than when receipts are realized *(although in many instances income may be earned and received in the same accounting period).*

Conversely, expenses are recognized in the income statement when they are **incurred** even if they are paid for in the previous or subsequent accounting periods.

Following is an illustrative **example of an Income Statement** prepared in accordance with the format prescribed by IAS 1 Presentation of Financial Statements.

Income Statement for the Year Ended 31st December 2017

	Notes	2017 USD	2016 USD
Revenue	**16**	**120,000**	100,000
Cost of Sales	**17**	**(65,000)**	(55,000)
Gross Profit		**55,000**	45,000
Other Income	**18**	**17,000**	12,000
Distribution Cost	**19**	**(10,000)**	(8,000)
Administrative Expenses	**20**	**(18,000)**	(16,000)
Other Expenses	**21**	**(3,000)**	(2,000)
Finance Charges	**22**	**(1,000)**	(1,000)
Profit before tax		**40,000**	30,000
Income tax	**23**	**(12,000)**	(9,000)
Net Profit		**28,000**	21,000

Income statement comprises of the following **main elements**:

Revenue includes income earned from the principal activities of an entity. So for example, in case of a manufacturer of electronic, revenue will comprise of the sales from electronic appliance business. Conversely, if the same manufacturer earns interest on its bank account, it shall not be classified as revenue but as other

income.

Cost of Sales represents the cost of goods sold or services rendered during an accounting period.

Hence, for a retailer, cost of sales will be the sum of inventory at the start of the period and purchases during the period minus any closing inventory.

In case of a manufacturer however, cost of sales will also include production costs incurred in the manufacture of goods during a period such as the cost of direct labor, direct material consumption, depreciation of plant and machinery and factory overheads, etc.

Other Income consists of income earned from activities that are not related to the entity's main business. For example, other income of an entity that manufactures electronic appliances may include:

- Gain on disposal of fixed assets
- Interest income on bank deposits
- Exchange gain on translation of a foreign currency bank account

Distribution Cost includes expenses incurred in delivering goods from the business premises to customers.

Administrative Expenses generally comprise of costs relating to the management and support functions within an organization that are not directly involved in the production and supply of goods and services offered by the entity.

Examples of administrative expenses include:

- Salary cost of executive management
- Legal and professional charges
- Depreciation of head office building
- Rent expense of offices used for administration and management purposes
- Cost of functions / departments not directly involved in production such as finance department, HR department and administration department

Other Expenses is essentially a residual category in which any expenses that are not suitably classifiable elsewhere are included.

Finance Charges usually comprise of interest expense on loans and debentures.

The effect of present value adjustments of discounted provisions are also included in finance charges (e.g. unwinding of discount on provision for decommissioning cost).

Income tax expense recognized during a period is generally comprised of the following three elements:

- Current period's estimated tax charge
- Prior period tax adjustments
- Deferred tax expense

Prior period financial information is presented along side current period's financial results **to facilitate comparison of performance** over a period.

It is therefore important that prior period comparative figures presented in the income statement relate to a similar period.

Income Statement provides the basis for measuring performance of an entity over the course of an accounting period.

Performance can be assessed from the income statement in terms of the following:

- Change in sales revenue over the period and in comparison to industry growth
- Change in gross profit margin, operating profit margin and net profit margin over the period
- Increase or decrease in net profit, operating profit and gross profit over the period
- Comparison of the entity's profitability with other organizations operating in similar industries or sectors

Income statement also forms the basis of important financial evaluation of an entity when it is analyzed in conjunction with information contained in other financial statements such as:

- Change in earnings per share over the period

- Analysis of working capital in comparison to similar income statement elements (e.g. the ratio of receivables reported in the balance sheet to the credit sales reported in the income statement, i.e. debtor turnover ratio)
- Analysis of interest cover and dividend cover ratios

Income statement does not report transactions with the owners of an entity.

Hence, dividends paid to ordinary shareholders are not presented as an expense in the income statement and proceeds from the issuance of shares is not recognized as an income. Transactions between the entity and its owners are accounted for separately in the statement of changes in equity.

4. Statement of Cash Flows

Statement of Cash Flows also known as Cash Flow Statement, presents the movement in cash flows over the period as classified under operating, investing and financing activities.

Cash and cash equivalents generally consist of the following:

- Cash in hand
- Cash at bank
- Short term investments that are highly liquid and involve very low risk of change in value (therefore usually excludes investments in equity instruments)
- Bank overdrafts in cases where they comprise an integral element of the organization's treasury management (e.g. where bank account is allowed to float between a positive and negative balance (i.e. overdraft) as opposed to a bank overdraft facility specifically negotiated for financing a shortfall in funds (in which case the related cash flows will be classified under financing activities).

As income statement and balance sheet are prepared under the accruals basis of accounting, it is necessary to adjust the amounts extracted from these financial statements (e.g. in respect of non cash expenses) in order to present only the movement in cash inflows and outflows during a period.

All cash flows are classified under operating, investing and financing

activities.

Operating Activities

Cash flow from operating activities presents the movement in cash during an accounting period from the **primary revenue generating** activities of the entity.

For example, operating activities of a hotel will include cash inflows and outflows from the hotel business (e.g. receipts from sales revenue, salaries paid during the year etc), but interest income on a bank deposit shall not be classified as such (i.e. the hotel's interest income shall be presented in investing activities).

Profit before tax as presented in the income statement could be used as a starting point to calculate the cash flows from operating activities.

Following adjustments are required to be made to the profit before tax to arrive at the cash flow from operations:

1. Elimination of non cash expenses (e.g. depreciation, amortization, impairment losses, bad debts written off, etc)
2. Removal of expenses to be classified elsewhere in the cash flow statement (e.g. interest expense should be classified under financing activities)
3. Elimination of non cash income (e.g. gain on revaluation of investments)
4. Removal of income to be presented elsewhere in the cash flow statement (e.g. dividend income and interest income should be classified under investing activities unless in case of for example an investment bank)
5. Working capital changes (e.g. an increase in trade receivables must be deducted to arrive at sales revenue that actually resulted in cash inflow during the period)

Investing Activities

Cash flow from investing activities includes the movement in cash flow as a result of the purchase and sale of assets other than those which the entity primarily trades in (e.g. inventory). So for example, in case of a manufacturer of cars, proceeds from the sale of factory plant shall be classified as cash flow from investing activities whereas the cash inflow from the sale of cars shall be presented

under the operating activities.

Cash flow from investing activities consists primarily of the following:

- Cash outflow expended on the purchase of investments and fixed assets
- Cash inflow from income from investments
- Cash inflow from disposal of investments and fixed assets

Financing activities

Cash flow from financing activities includes the movement in cash flow resulting from the following:

- Proceeds from issuance of share capital, debentures & bank loans
- Cash outflow expended on the cost of finance (i.e. dividends and interest expense)
- Cash outflow on the repurchase of share capital and repayment of debentures & loans

Following is an illustrative cash flow statement presented according to the **indirect method** suggested in IAS 7 Statement of Cash Flows

ABC PLC Statement of Cash Flows for the year ended 31 December 2017

	Notes	**2017 USD**	2016 USD
Cash flows from operating activities			
Profit before tax		**40,000**	35,000
Adjustments for:			
Depreciation	**4**	**10,000**	8,000
Amortization	**4**	**8,000**	7,500
Impairment losses	**5**	**12,000**	3,000
Bad debts written off	**14**	**500**	-
Interest expense	**16**	**800**	1,000
Gain on revaluation of investments		**(21,000)**	-
Interest income	**15**	**(11,000)**	(9,500)
Dividend income		**(3,000)**	(2,500)
Gain on disposal of fixed assets		**(1,200)**	(1,850)
		35,100	40,650

Working Capital Changes:			
Movement in current assets:			
(Increase) / Decrease in inventory		**(1,000)**	550
Decrease in trade receivables		**3,000**	1,400
Movement in current liabilities:			
Increase / (Decrease) in trade payables		**2,500**	(1,300)
Cash generated from operations		**39,600**	41,300
Dividend paid		**(8,000)**	(6,000)
Income tax paid		**(12,000)**	(10,000)
Net cash from operating activities (A)		**19,600**	25,300
Cash flows from investing activities			
Capital expenditure	**4**	**(100,000)**	(85,000)
Purchase of investments	**11**	**(25,000)**	-
Dividend received		**5,000**	3,000
Interest received		**3,500**	1,000
Proceeds from disposal of fixed assets		**18,000**	5,500
Proceeds from disposal of investments		**2,500**	2,200
Net cash used in investing activities (B)		**(96,000)**	(73,300)
Cash flows from financing activities			
Issuance of share capital	**6**	**1000,000**	-
Bank loan received		**-**	100,000
Repayment of bank loan		**(100,000)**	-
Interest expense		**(3,600)**	(7,400)
Net cash from financing activities (C)		**896,400**	92,600
Net increase in cash & cash equivalents (A+B+C)		**820,000**	44,600
Cash and cash equivalents at start of the year		**77,600**	33,000
Cash and cash equivalents at end of the year	**24**	**897,600**	77,600

Statement of cash flows provides important insights about the liquidity and solvency of a company which are vital for survival and growth of any organization. It also enables analysts to use the information about historic cash flows to form projections of future cash flows of an entity (e.g. in NPV analysis) on which to base their economic decisions. By summarizing key changes in financial position during a period, cash flow statement serves to highlight priorities of management.

For example, increase in capital expenditure and development costs may indicate a higher increase in future revenue streams whereas a trend of excessive

investment in short term investments may suggest lack of viable long term investment opportunities. Furthermore, comparison of the cash flows of different entities may better reveal the relative quality of their earnings since cash flow information is more objective as opposed to the financial performance reflected in income statement which is susceptible to significant variations caused by the adoption of different accounting policies.

5. Statement of Changes in Equity

Statement of Changes in Equity details the change in owners' equity over an accounting period by presenting the movement in reserves comprising the shareholders' equity.

Movement in shareholders' equity over an accounting period comprises the following elements:

- Net profit or loss during the accounting period attributable to shareholders
- Increase or decrease in share capital reserves
- Dividend payments to shareholders
- Gains and losses recognized directly in equity
- Effect of changes in accounting policies
- Effect of correction of prior period error

As a ***minimum***, the statement of changes in equity must contain the following items:

- total comprehensive income for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interest;

- for each component of equity, the effects of retrospective application or retrospective restatement recognised in accordance with IAS 8; and

- for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately disclosing changes resulting from:

1) profit or loss;

2) other comprehensive income; and

3) transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control.

Also, IAS 1 prescribes to present amount of dividends recognized as distributions and the related amount per share on the face of the statement of changes in equity or in the notes.

Following are **the main elements of statement of changes in equity**:

Opening Balance represents the balance of shareholders' equity reserves at the start of the comparative reporting period as reflected in the prior period's statement of financial position. The opening balance is unadjusted in respect of the correction of prior period errors rectified in the current period and also the effect of changes in accounting policy implemented during the year as these are presented separately in the statement of changes in equity.

Effect of Changes in Accounting Policies Since changes in accounting policies are applied retrospectively, an adjustment is required in stockholders' reserves at the start of the comparative reporting period to restate the opening equity to the amount that would be arrived if the new accounting policy had always been applied.

Effect of Correction of Prior Period Error The effect of correction of prior period errors must be presented separately in the statement of changes in equity as an adjustment to opening reserves. The effect of the corrections may not be netted off against the opening balance of the equity reserves so that the amounts presented in current period statement might be easily reconciled and traced from prior period financial statements.

Restated Balance represents the equity attributable to stockholders at the start of the comparative period after the adjustments in respect of changes in accounting policies and correction of prior period errors as explained above.

Changes in Share Capital Issue of further share capital during the period must be added in the statement of changes in equity whereas redemption of shares

must be deducted therefrom. The effects of issue and redemption of shares must be presented separately for share capital reserve and share premium reserve.

Dividends Dividend payments issued or announced during the period must be deducted from shareholder equity as they represent distribution of wealth attributable to stockholders.

Income / Loss for the period represents the profit or loss attributable to shareholders during the period as reported in the income statement.

Changes in Revaluation Reserve Revaluation gains and losses recognized during the period must be presented in the statement of changes in equity to the extent that they are recognized outside the income statement. Revaluation gains recognized in income statement due to reversal of previous impairment losses however shall not be presented separately in the statement of changes in equity as they would already be incorporated in the profit or loss for the period.

Other Gains & Losses Any other gains and losses not recognized in the income statement may be presented in the statement of changes in equity such as actuarial gains and losses arising from the application of IAS 19 *Employee Benefit*.

Closing Balance represents the balance of shareholders' equity reserves at the end of the reporting period as reflected in the statement of financial position.

Statement of changes in equity helps users of financial statement to identify the factors that cause a change in the owners' equity over the accounting periods. Whereas movement in shareholder reserves can be observed from the balance sheet, statement of changes in equity discloses significant information about equity reserves that is not presented separately elsewhere in the financial statements which may be useful in understanding the nature of change in equity reserves. Examples of such information include share capital issue and redemption during the period, the effects of changes in accounting policies and correction of prior period errors, gains and losses recognized outside income statement, dividends declared and bonus shares issued during the period.

Following is an illustrative **example of a Statement of Changes in Equity** prepared according to the format prescribed by IAS 1 Presentation of Financial

Statements.

ABC Plc Statement of changes in equity for the year ended 31st December 2017

	Share Capital	Retained Earnings	Revaluation Surplus	Total Equity
	USD	USD	USD	**USD**
Balance at 1 January 2016	**100,000**	**30,000**	**-**	**130,000**
Changes in accounting policy	-	-	-	**-**
Correction of prior period error	-	-	-	**-**
Restated balance	**100,000**	**30,000**	**-**	**130,000**
Changes in equity for the year 2016				
Issue of share capital	-	-	-	**-**
Income for the year	-	25,000	-	**25,000**
Revaluation gain	-	-	10,000	**10,000**
Dividends	-	(15,000)	-	**(15,000)**
Balance at 31 December 2016	**100,000**	**40,000**	**10,000**	**150,000**
Changes in equity for the year 2017				
Issue of share capital	-	-	-	**-**
Income for the year	-	30,000	-	**30,000**
Revaluation gain	-	-	5,000	**5,000**
Dividends	-	(20,000)	-	**(20,000)**
Balance at 31 December 2017	**100,000**	**50,000**	**15,000**	**165,000**

6. Notes to the Financial Statements

These contain the information (financial and non-financial) in addition to the information which is presented in the other components of financial statements such as statement of profit or loss and other comprehensive income, statement of changes in equity, statement of financial position and statement of cash flows.

These are in the form of narrative descriptions and include the following:

- Basis used by the entity for the preparation of the financial statements
- Accounting policies of the entity
- Disclosures required by the standards

7. Accounting policies, changes in accounting estimates and errors

Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

Events after Reporting Period are those that occur between the end of the reporting period and when the financial statements are authorized for issue.

Following are **Examples** of accounting policies:

- Valuation of inventory using FIFO, Average Cost or other suitable basis as per IAS 2
- Classification, presentation and measurement of financial assets and liabilities under categories specified under IAS 32 and IAS 39 such as held to maturity, available for sale or fair value through profit and loss
- Timing of recognition of assets, liabilities, expenses and income
- Basis of measurement of non-current assets such as historical cost and revaluation basis
- Accruals basis of preparation of financial statements

Management must consistently review its accounting policies to ensure they comply with the latest pronouncements by IASCF and that the adopted policies result in presentation of most relevant and reliable financial information for users.

Changes in Accounting Policies

Accounting Policies must be applied consistently to promote comparability between financial statements of different accounting periods.

However, a change in accounting policy may be necessary to enhance the relevance and reliability of information contained in the financial statements. Such changes may be required as a result of changes in IFRS or may be applied voluntarily by the management.

An entity shall change an accounting policy only if the change:

(a) is required by an IFRS; or

(b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

As a general rule, changes in Accounting Policies must be applied retrospectively in the financial statements. Retrospective application means that entity implements the change in accounting policy as though it had always been

applied.

Consequently, entity shall adjust all comparative amounts presented in the financial statements affected by the change in accounting policy for each prior period presented.

Exemption from Retrospective Application of Accounting Policies

Retrospective application is applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

Retrospective application of a change in accounting policy may be exempted in the following circumstances:

- A change in accounting policy is required by a new IFRS or a change to an existing IFRS / IAS and the transitional provisions of those standards allow or require prospective application of a new accounting policy. Specific transitional guidance of IFRS must be followed in such circumstances.
- The application of a new accounting policy is in respect of transactions, events and circumstances that are substantially different from those that transpired in the past.
- The effect of retrospective application of a change in accounting policy is immaterial.
- The retrospective application of a change in accounting policy is impracticable. This may for example be the case where entity has not collected sufficient data to enable objective assessment of the effect of a change in accounting estimate and it would be unfeasible or impractical reconstruct such data.

Where impracticability impairs an entity's ability to apply a change in accounting policy retrospectively from the earliest prior period presented, the new accounting policy must be applied prospectively from the beginning of the earliest period feasible which may be the current period.

Following must be **disclosed** in the financial statements of the accounting period in which a change in accounting policy is implemented:

- Title of IFRS
- Nature of change in accounting policy
- Reasons for change in accounting policy
- Amount of adjustments in current and prior period presented
- Where retrospective application is impracticable, the conditions that caused the impracticality

Accounting Estimates

Preparation of financial statements may involve the **use of accounting estimates** in determining the carrying amounts of assets & liabilities and the associated expense or income for the period where such amounts cannot be measured precisely.

Examples of accounting estimates include the following:

- Valuation of land where it is accounted for at revalued cost
- Impairment of non-current assets
- Useful lives of non-current assets
- Pattern of economic benefits expected to be received from non-current assets for calculating depreciation
- Impairment of receivables (bad debts)
- Pension Benefit obligations
- Provision for slow moving and obsolete inventory

Accounting Estimates involve management's judgment of expected future benefits and obligations relating to assets and liabilities (and associated expense and income) based on information that best reflects the conditions and circumstances that exist at the reporting date. By its nature, estimates are subjective and may require frequent revisions in future. Revision of estimates must be distinguished correction of errors which occur because of not using information that was available at the time of preparation of financial statements.

Changes in Accounting Estimates

A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that

results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities.

Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

Estimates must be revised when new information becomes available which indicates a change in circumstances upon which the estimates were formed.

Changes in Accounting Estimates must be accounted for **prospectively** in the financial statements, i.e. the effects of the change must be incorporated in the accounting period in which the estimates are revised. Therefore, carrying amounts of assets and liabilities and any associated expense and gains are adjusted in the period of change in estimate.

Prospective application of changes in estimates prevents frequent revisions in prior period comparative figures which might cause unnecessary complications in respect of financial statement balances that are expected to be revised in future due to availability of new information or the experience of new events.

When it is hard to differentiate between a change in accounting policy and a change in accounting estimate, the change is accounted for prospectively.

Prior period errors are omissions 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:

(a) was available when financial statements for those periods were authorised for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Examples of accounting errors included the following:

- Misapplication of accounting policies: e.g. not recognizing sale upon transfer of goods to a customer
- Fraud: e.g. overstating sales revenue by issuing fake invoices before

the reporting date

- Misunderstanding of, or failure to notice, information at the time of preparation of financial statements: e.g. not writing off a receivable who had been announced as insolvent before the authorization of financial statements
- Arithmetical Errors
- Omission of transactions and events from the financial statements

Errors must be distinguished from changes made to prior period estimates that had been based on information that best reflected the conditions and circumstances that existed at the reporting date.

Errors in financial statements reduce the reliability of information presented. Errors must therefore be discovered and corrected on a timely basis to ensure that users can rely on the information contained in the financial statements.

Correction of Prior Period Accounting Errors

Prior Period Errors must be corrected **Retrospectively** in the financial statements. Retrospective application means that the correction affects only prior period comparative figures. Current period amounts are unaffected.

Therefore, comparative amounts of each prior period presented which contain errors are restated. If however, an error relates to a reporting period that is before the earliest prior period presented, then the opening balances of assets, liabilities and equity of the earliest prior period presented must be restated.

Errors discovered after reporting date

Accounting Errors discovered after the reporting date but before the authorization of financial statements are adjusting events after the reporting date as per IAS 10 and must therefore be corrected in the current period prior to the issuance of financial statements.

Impracticability in Correction of Prior Period Errors

The retrospective correction of accounting errors may be impracticable. This may be the case for example where entity has not collected sufficient data to enable it to determine the effect of correction of an accounting error and it would be unfeasible or impractical to reconstruct such data.

Where impracticability impairs an entity's ability to correct an accounting error retrospectively from the earliest prior period presented, the correction must be applied prospectively from the beginning of the earliest period feasible (which may be the current period).

Disclosure

- The nature of prior period errors corrected during the period
- The amount of restatement made at the start of the earliest prior period presented
- The circumstances that resulted in impracticability to correct an accounting error retrospectively and how and from when the error has been corrected

Material Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

Retrospective restatement is correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.

Consistency of accounting policies

An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless an IFRS specifically requires or permits categorisation of items for which different policies may be appropriate. If an IFRS requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category.

SUGGESTED READING

International Financial Reporting Standards (IFRS)

№	Name	Issued
IFRS 1	First-time Adoption of International Financial Standards	2008*
IFRS 2	Share-based Payment	2004
IFRS 3	Business Combinations	2008*
IFRS 4	Insurance Contracts	2004
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations	2004
IFRS 6	Exploration for and Evaluation of Mineral Assets	2004
IFRS 7	Financial Instruments: Disclosures	2005
IFRS 8	Operating Segments	2006
IFRS 9	Financial Instruments	2013*
IFRS 10	Consolidated Financial Statements	2011
IFRS 11	Joint Arrangements	2011
IFRS 12	Disclosure of Interests in Other Entities	2011
IFRS 13	Fair Value Measurement	2011
IFRS 14	Regulatory Deferral Accounts	2014
IFRS 15	Revenue from Contracts with Customers	2014
IFRS 16	Leases	2016
IFRS 17	Insurance Contracts	2017

International Accounting Standards (IASs)

№	Name	Issued
IAS 1	Presentation of Financial Statements	2007*
IAS 2	Inventories	2005*
IAS 7	Statement of Cash Flows	1992
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors	2003
IAS 10	Events After the Reporting Period	2003
IAS 11	Construction Contracts	1993
IAS 12	Income Taxes	1996*
IAS 16	Property, Plant and Equipment	2003*
IAS 17	Leases	2003*
IAS 18	Revenue	1993*
IAS 19	Employee Benefits (2011)	2011*
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance	1983
IAS 21	The Effects of Changes in Foreign Exchange Rates	2003*
IAS 23	Borrowing Costs	2007*
IAS 24	Related Party Disclosures	2009*
IAS 26	Accounting and Reporting by Retirement Benefit Plans	1987
IAS 27	Separate Financial Statements (2011)	2011
IAS 28	Investments in Associates and Joint Ventures (2011)	2011
IAS 29	Financial Reporting in Hyperinflationary Economies	1989
IAS 32	Financial Instruments: Presentation	2003*
IAS 33	Earnings Per Share	2003*

IAS 34	Interim Financial Reporting	1998
IAS 36	Impairment of Assets	2004*
IAS 37	Provisions, Contingent Liabilities and Contingent Assets	1998
IAS 38	Intangible Assets	2004*
IAS 40	Investment Property	2003*
IAS 41	Agriculture	2001

IFRIC Interpretations

№	Name	Issued
IFRIC 1	Changes in Existing Decommissioning, Restoration and Similar Liabilities	2004
IFRIC 2	Members' Shares in Co-operative Entities and Similar Instruments	2004
IFRIC 4	Determining Whether an Arrangement Contains a Lease	2004
IFRIC 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds	2004
IFRIC 6	Liabilities Arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment	2005
IFRIC 7	Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies	2005
IFRIC 9	Reassessment of Embedded Derivatives	2006
IFRIC 10	Interim Financial Reporting and Impairment	2006
IFRIC 12	Service Concession Arrangements	2006
IFRIC 13	Customer Loyalty Programmes	2007
IFRIC 14	IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction	2007
IFRIC 15	Agreements for the Construction of Real Estate	2008
IFRIC 16	Hedges of a Net Investment in a Foreign Operation	2008
IFRIC 17	Distributions of Non-cash Assets to Owners	2008
IFRIC 18	Transfers of Assets from Customers	2009
IFRIC 19	Extinguishing Financial Liabilities with Equity Instruments	2009
IFRIC 20	Stripping Costs in the Production Phase of a Surface Mine	2011
IFRIC 21	Levies	2013

IFRIC 22	Foreign Currency Transactions and Advance Consideration	2016
IFRIC 23	Uncertainty over Income Tax Treatments	2017

SIC Interpretations

№	Name	Issued
SIC-7	Introduction of the Euro	1998
SIC-10	Government Assistance – No Specific Relation to Operating Activities	1998
SIC-15	Operating Leases – Incentives	1999
SIC-25	Income Taxes – Changes in the Tax Status of an Enterprise or its Shareholders	2000
SIC-27	Evaluating the Substance of Transactions in the Legal Form of a Lease	2000
SIC-29	Disclosure – Service Concession Arrangements	2001
SIC-31	Revenue – Barter Transactions Involving Advertising Services	2001
SIC-32	Intangible Assets – Web Site Costs	2001

Other pronouncements

Name	Issued
Conceptual Framework for Financial Statements 2010	2010
Preface to International Financial Reporting Standards	2002*
IFRS for Small and Medium Sized Entities	2009
IFRS Practice Statement Management Commentary	2010

The IFRS® Foundation [Electronic resource]. – Mode of access: http://www.ifrs.org

The #1 website for global accounting news [Electronic resource]. – Mode of access: https://www.iasplus.com/en

Навчальне видання

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