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ACCOUNTING (BASICS) WORKBOOK

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IFRS for SMEs[1]

Quiz 1: What are not the IASB objectives?

- to develop and to promote the use and rigorous application a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions
- while developing a single set of high quality, understandable and enforceable global accounting standards and promoting their use to take account of the special needs of small and medium-sized entities and emerging economies
- to strive for worldwide use of International Accounting Standards instead of national accounting standards.

Quiz 2: What is the primary function of IASB?

- to develop and publish IFRS
- to develop and publish IFRS and strive for their worldwide use instead of national accounting standards
- to develop and publish IFRS and strive for their convergence with national accounting standards
- to develop and publish IFRS and strive for their worldwide use in general purpose financial statements and other financial reporting.

Quiz 3: What is the primary objective of IFRS?

- IFRS set out recognition, measurement, presentation and disclosure requirements dealing with transactions and other events and conditions that are important in general purpose financial statements
- IFRS provide a set of high quality, understandable and enforceable global accounting standards aimed to replace national accounting standards
- IFRS provide a tool for achieving highest relevance, representational faithfulness, transparency and comparability of accounting information provided by profit-oriented and nonprofit-oriented entities.

Quiz 4: What is the major difference between IFRS and US GAAP?

- IFRS are more principles-based, objective-oriented and with emphasis on professional judgment than US GAAP
- IFRS are more rules-based, procedure-oriented with emphasis on best practice than US GAAP
- IFRS are more principles-based, procedure-oriented without any emphasis on either best practice or professional judgment than US GAAP.

[1] On the basis of IFRS for SMEs (IASB, 2009), Preface and Section 1. See Lecture 1.

Quiz 5: Which indicators are used by EC to define small and medium sized entities (SMEs)?

- total value of balance sheet, total turnover, total number of employees during the financial year
- net assets, total turnover, total number of employees during the financial year
- total value of balance sheet, net turnover, average number of employees during the financial year
- net assets, net turnover, average number of employees during the financial year.

Quiz 6: Which categories of entities can use IFRS for SMEs?

- stock exchange listed entity (i.e. company without subsidiaries)
- stock exchange listed parent
- stock exchange listed subsidiaries
- stock exchange not listed subsidiaries
- subsidiaries without public accountability and whose parent uses full IFRSs
- entities holding assets in a fiduciary capacity for a broad group of outsiders as their primary function (asset under management – e.g. banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks).

Concepts and Principles[2]

Quiz 1: What is the primary objective of financial statements of SMEs?

- to insure the highest relevance, representational faithfulness, transparency and comparability of accounting information presented in financial reports which are provided by the entity for a broad range of users
- to provide information about the financial position, performance and cash flows of the entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs
- to provide information about the financial position, performance and cash flows of the entity that is useful for economic decision-making by a broad range of users, both entitled and not entitled to require financial reports tailored to meet their particular information needs.

Quiz 2: What does qualitative characteristics "reliability" mean?

- information presented in financial statements should be precise (e.g. little or no uncertainty in a measurement)
- information presented in financial statements should be free from material error and bias and insure a faithfully representation of the economic phenomenon
- information presented in financial statements should be relevant (i.e. its omission or misstatement could influence the economic decisions of users made on the basis of the financial statements)
- information presented in financial statements should be comprehensive (i.e. understandable by users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence)

Quiz 3: Decide which of the following statements are true?

- The financial position of an entity is the relationship of its assets, liabilities and equity as of a specific date as presented in the statement of financial position.
- The financial position of an entity is the relationship of its income and expenses during a reporting period.
- Performance of an entity is the relationship of its assets, liabilities and equity as of a specific date as presented in the statement of income.
- The financial position of an entity is "stock" amount (i.e. it is measured as of a specific date) while financial performance of an entity is "flow" amount (i.e. it is measured during a specific period).

[2] On the basis of IFRS for SMEs (IASB, 2009), Section 2.. See Lecture 1.

Quiz 4: What are the basic recognition criteria for an item being recognized in financial statements of an entity?

- it is certain that any future economic benefit associated with the item will flow to or from the entity and item's cost or value that can be measured reliably
- it is probable that any future economic benefit associated with the item will flow to or from the entity and item's cost or value that can be measured approximately
- it is probable that any future economic benefit associated with the item will flow to or from the entity and item's cost or value that can be measured reliably
- it is certain that any future economic benefit associated with the item will flow to or from the entity and item's cost or value that can be measured approximately.

Quiz 5:What are the two basic measurement bases applied to items recognized in financial statements of an entity?

- one – historical cost
- one – fair value
- two – historical cost and fair value.

Quiz 6: Decide which of the following statements are true?

- The requirements for recognizing and measuring individual items in its financial statements an entity should apply pervasive principles that are derived from the IASB Framework for the Preparation and Presentation of Financial Statements.
- The requirements for recognizing and measuring individual items in its financial statements an entity should apply pervasive principles that are derived from the IASB Framework for the Preparation and Presentation of Financial Statements and from full IFRSs.
- An entity shall prepare its financial statements using the accrual basis of accounting, under which individual items in its financial statements are recognized as assets, liabilities, equity, income or expenses when they satisfy the definitions and recognition criteria for those items.
- An entity shall prepare its financial statements using the accrual basis of accounting, under which individual items in its financial statements are recognized as assets, liabilities, equity, income or expenses regardless of degree of uncertainties associated with future economic benefits flowing to or out from the entity.

Example 1: Divide the following items into current and non/current assets, owner's equity and liabilities:

Item	**Assets**		**Equities**	
	Current	**Non-current**	**Liabilities**	**Owner's equity**
Car				
Technological line				
Building				
Inventories				

Parcel				
Merchandise				
Software				
Capital shares				
Animals				
Own products				
Cash				
Incomplete production				
Trade receivables				
Bank credits and assistance				
Cash on bank account				
Securities held for sale				
Trade payables				
Issued long-term bonds				
Liabilities to employees				
Liabilities to social institutions				
Deferred income tax				
Reserves				
Computers				
Common stocks				
Net profit				
Retained earnings				
Reserves				
Non-controlling interest				

Example 2: Decide whether the following items can be recognized as assets?

Item	**Yes/No**
Patent bought by an entity that makes possible to increase the volume of profit on CU150,000 annually	
Booked material for production of products	
New director of an entity. It is expected that he will increase net cash flows of the entity of CU135,000 during next 3 years	
Purchase of new machinery from financial leasing	
Parcel obtained from the state	
Minority interest in an associate	
Brand name of an entity valued for CU170,000	
Customer list	

Example 3: Decide whether the following items can be recognized as liabilities?

Item	**Yes/No**
Bill of exchange issued by an entity	
Advance payments received by an entity	
Deferred payment into state budget for mineral extraction	
Retirement benefits for employees in excess of strict legal obligations	
Product warranties provided for buyers by a manufacturing entity	

Outstanding lawsuits	

Example 4: Decide about recognition of the following items as current asset or non-current assets

Item	CA	Non-CA
Unneeded material at the stock		
License bought for 3 years		
New car in value CU10,000 from manufacturer		
Trade receivables with term of payment longer than 1 year		
Cash in bank		
Capital shares		
Software		
Investments in associates		
Capital shares		
Securities held for trade		
Bill of exchange received by customers		
Building, plant and equipment		
Bought goods		
Advance payment paid to company that guarantees the delivery of goods		

Example 5: Decide what impact the following operations have on entity's balance (notice, that every operation should be accounted on two accounts – debiting one account and crediting another account):

Item	Assets (+/-)		Equities (+/-)	
	Current	Non-current	Liabilities	Owner's equity
Owner invests cash				
Entity pays wages with cash				
Entity buys equipment with cash				
Entity purchases supplies on credit				
Owner withdraws cash				
Entity sells services on credit				
Entity sells goods for cash				
Entity sells extra equipment for cash				
Entity acquires services on credit				
Entity sells services for cash				
Entity borrows cash with note payable				

Entity pays rent with cash				
Entity collects (cashes) receivables				
Entity buys land with note payable				
Entity discovers shortage in inventories				
Entity pays dividends				
Entity pays trade payables with bank loan				
Entity acquires a stake in associate with cash				
Entity pays bank interest with cash on bank account				
Entity issues common stocks				
Entity acquires a bank loan				

Example 6: For the following items determine the amount of total assets and total equities. Divide total assets into current and non-current (fixed) assets. Divide equities into owner's equity and liabilities:

Item	Value (CU)
Material at the stock	100,000
Property, plant and equipment	1,000,000
Trade receivables	50,000
Securities held for sale	200,000
Cash	5,000
Business brand name	150,000
Cars	500,000
Cash on the bank account	200,000
Common stocks	1,065,000
Trade payables	40,000
Long-term bank loan	1,000,000
Reserves	100,000

Assets:	**Value (CU)**
Current assets	
Non-current assets	
Total assets	
Equity and liabilities:	
Short-term liabilities	
Short-term bank loan	
Long-term bank loan	
Owner's equity	
Total equity and liabilities	

Example 7: Decide whether following operations represent revenues or expenses and decide what impact they have on entity's economic result and balance (notice, that every operation should be accounted on two accounts – debiting one account and crediting another account):

Operation	Revenue / Cost	Impact on economic result (+/-)	Assets (+/-)		Equities (+/-)	
			Current	Non-current	Liabilities	Owner's equity
Revenue from sale of merchandise						
Decrease of merchandise sold						
Supplier's invoice bill for repairs						
Consumption of material						
Invoice bill for consumption of energy						
Travel costs						
Revenue from sale of services						
Representation costs						
Revenues from sale of material						
Paid credit interests						
Bank fees for organizing an account						
Revenues from sale of long-term property						
Revenue from financial investment						
Cashed interests from account						
Cashed fees						
Paid fees						
Securities sold						

Example 8: Compile a statement of income and estimate the amount of business result for the year (EAT):

Item	Value (CU)
Sale of merchandise to customers	550,000
Interests received	100,000
Merchandise sold	300,000
Dividends received	80,000
Depreciation	50,000
Paid interest from short-term credit	65,000
Consumption of office needs	30,000

Extraordinary costs	70,000
Road tax	25,000
Consumption of wages	120,000
Extraordinary revenues	10,000

Tax rate for income is 25%.

Sales	
Sale of merchandise	
Total sales	
Cost of sales	
Merchandise sold	
Total cost of sales	
Gross margin	
Operating expenses	
Depreciation	
Consumption of office needs	
Consumption of wages	
Road tax	
Operating income (EBIT)	
Dividends received	
Interests received	
Paid interest from short-term credit	
Income from ordinary activity (EBT)	
Tax for income from ordinary activity	
Extraordinary revenues	
Extraordinary costs	
Income for extraordinary activity	
Tax for income from extraordinary activity	
Business result (EAT)	

Financial statements presentation[3]

Quiz 1: What is does principle "fair presentation" mean?

- fair presentation requires an entity to disclose comparative information in respect of the previous comparable period for all amounts presented in the current period's financial statements
- fair presentation requires an entity to make an assessment of the entity's ability to continue its operations in the future
- 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
- fair presentation requires an entity to present a complete set of financial statements at least annually.

Quiz 2: What are recognition criteria for an item being recognized as a current asset?

- an entity expects to realize an item, or intends to sell or consume it, in the entity's normal operating cycle
- an entity holds such item primarily for the purpose of trading
- an entity expects to realize such an item within twelve months after the reporting date
- an entity does not have an unconditional right to defer settlement of such an item for at least twelve months after reporting date.

Quiz 3: Decide which of the following items should be at minimum included by an entity into the statement of comprehensive income:

- revenue, finance costs, share of the profit or loss of investments in associates and jointly controlled entities, tax expense, each item of other comprehensive income, total comprehensive income
- revenue, finance costs, share of the profit or loss of investments in associates and jointly controlled entities, tax expense, the post-tax profit or loss of a discontinued operation, the post-tax gain or loss from sell or on disposal of net assets constituting the discontinued operation, each item of other comprehensive income, total comprehensive income
- revenue, finance costs, share of the profit or loss of investments in associates and jointly controlled entities, tax expense, the post-tax profit or loss of a discontinued operation, the post-tax gain or loss from sell or on disposal of net assets constituting the discontinued operation, each item of other comprehensive income, extraordinary income

Quiz 4: Decide which of the following items should be included by an entity into the statement of change in equity:

- an entity's profit or loss for a reporting period, items of income and expense recognized in other comprehensive income for the period, the amounts of investments by, and dividends and other distributions to, equity investors during the period

[3] On the basis of IFRS for SMEs (IASB, 2009), Section 3-8. See Lecture 2.

- an entity's profit or loss for a reporting period, items of income and expense recognized in other comprehensive income for the period, retained earnings at the beginning and at the end of reporting period, the amounts of investments by, and dividends and other distributions to, equity investors during the period
- an entity's profit or loss for a reporting period, items of income and expense recognized in other comprehensive income for the period, the effects of changes in accounting policies and corrections of errors recognized in the period, the amounts of investments by, and dividends and other distributions to, equity investors during the period

Quiz 5: Decide which of the following are cash and cash equivalents?

- cash receipts from the sale of goods and the rendering of services
- cash payments to suppliers for goods and services
- money market instruments, e.g. T-bills and commercial loans
- cash payments or refunds of income tax
- demand deposits and demand loans
- term deposits and term loans.

Quiz 6: What are the primary objectives of notes to financial statements?

- to present information about the basis of preparation of the financial statements and the specific accounting policies used
- to provide information on relationship between entity's assets, liabilities and equity
- to provide information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them
- to present fair value measurement of entity's revenues and expenses.

Example 1: For the following items determine the amount of total assets and total equities. Divide total assets into current and non-current (fixed) assets. Divide equities into owner's equity and liabilities:

Item	Value (CU)
Building, plant and equipment	500,000
Amortization for building, plant and equipment	175,000
Materials	130,000
Merchandise	150,000
Cash	35,000
Receivables	100,000
Correcting for receivables	5,000
Company's brand name	45,000
Short-term bank loan	50,000
Long-term bank loan	100,000
Payables	75,000
Common stocks	350,000

Reserves	120,000
Retained earnings	30,000
Business result (profit or loss) of the current period	55,000

Assets:	**Value (CU)**
Current assets	
Non-current assets	
Total assets	
Equity and liabilities:	
Short-term liabilities	
Short-term bank loan	
Long-term bank loan	
Owner's equity	
Total equity and liabilities	

Example 2: For the following items determine the amount of profit of the year, other comprehensive income for the year and total comprehensive income for the year:

Item	**Value (CU)**
Revenue	750,000
Own production	450,000
Sales of unused equipment	200,000
Recovery amount of unused equipment sold	175,000
Sales of securities	180,000
Securities held for sale	185,000
Loss for the year from discontinued operations	25,000
Income tax expense for comprehensive income	18,000
Exchange differences on translating foreign operations, net of tax	15,000
Actuarial gains on defined benefit pension obligations, net of tax	20,000
Share of associates' other comprehensive income	12,000
Income tax expense for other comprehensive income	3,000

Item	**Value (CU)**
Profit/Loss for the year from continuing operations (before tax)	
Profit/Loss for the year from discontinued operations (before tax)	
Income tax expense for comprehensive income	
Profit/Loss for the year	
Other comprehensive income (before tax)	
Income tax expense for other comprehensive income	
Other comprehensive income for the year	

Total comprehensive income for the year	

Example 3: Find changes in owner's equity for the entity presented below:

Item	Value (CU)
Total equity	
Common stocks	500,000
Reserves	250,000
Fond for remeasurement	170,000
Retained earnings	120,000
Profit for the year from current period	50,000

Operations	Value (CU)
Creation of reserves	70,000
Share of retained earnings distributed to shareholders	(20,000)
Remeasurement of securities	50,000
Net profit for current period	30,000

	Share capital	Reserves	Fond for remeasurement	Retained earnings	Restated balance
Balance at the beginning of the period					
Creation of reserves					
Distribution to shareholders					
Remeasurement of securities					
Net profit					
Total					

Example 4: Compile statement of cash flow for entity the presented below:

Chosen items from statement of financial position:

Item	01.01.20X1	31.12.20X1
Software		32,000
Tangible assets		29,000
Corrections for software		1,400
Corrections for tangible assets		5,600
Material at stock		14,000
Merchandise in shops		10,800
Cash at cash box		24,800

Cash at bank account	100,000	75,000
Receivables from buyers		12,800
Receivables from employees		8,200
Payables		15,500
Deferred income tax		4,000
Deferred expences		1,000
Accrued expences		2,300
Common stocks	100,000	122,800
Long-term bank loan		54,000

Chosen items form statement of comprehensive income:

Item	Value (CU)
Revenues	
Revenues (sales of merchandise)	125,000
Other revenues	16,400
Interests received	1,200
Expenses	
Cost of sales (merchandise sold)	86,000
Repairing and maintenance	12,000
Other services (rent)	800
Wage costs	3,100
Social insurance	800
Other costs	1,400
Depreciation of non-current assets	7,000
Interests paid	1,700
Income tax	5,000

Cash flow statement – indirect method:

Item	Sum
Cash flows from operating activity:	
Profit for the year (before taxes)	
Adjustments:	
Depreciation of non-current assets	
Exchange difference loss	
Interests received	
Interests paid	
Cash flows before taxes and changes in working capital:	
Change in receivables	
Change in inventories	
Change in payables	

*Cash flow from operating activity	
Income tax paid	
Interests paid	
**Net cash flows from operating activity	
Cash flows from investing activity:	
Consideration transferred for acquisition of subsidiary, net from cash and cash equivalents	
Consideration transferred for purchase of building, plant and equipment	
Revenue from sale of equipment	
Interest received	
Dividends received	
**Net cash flows from investing activity	
Cash flows from financing activity:	
Sale of common stocks	
Long-term loans received	
Payment of financial leasing	
Dividends paid	
**Net cash flows from financing activity	
Net increase in cash and cash equivalents	
Cash and cash equivalents at the beginning of the reporting period	

Consolidated financial statements[4]

Quiz 1: Decide in which cases consolidated financial statements of an entity cannot be complied:

- when the parent entity is itself a subsidiary
- when the parent entity is itself a subsidiary and when the ultimate parent entity produces consolidated general purpose financial statements that comply with full IFRSs or with IFRS for SMEs
- when an entity has no subsidiaries other than one that was acquired with the intention of selling or disposing of it within one year.

Quiz 2: Decide in which cases control is presumed to exist:

- when the parent owns, directly or indirectly through subsidiaries, half of the voting power of an entity
- when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity
- when the parent owns half or less of the voting power of an entity but it has power over more than half of the voting rights by virtue of an agreement with other investors
- when the parent owns half or less of the voting power of an entity but it has power to govern the financial and operating policies of the entity under a statute or an agreement
- when the parent owns half or less of the voting power of an entity but it has power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body.

Quiz 3: Decide in which order individual procedures which are presented below should take place while compiling consolidated financial statements:

(i) eliminate the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary;

(ii) combine the financial statements of the parent and its subsidiaries line by line by adding together like items of assets, liabilities, equity, income and expenses;

(iii) measure and present non-controlling interest in the net assets of consolidated subsidiaries separately from the parent shareholders' equity in them;

(iv) measure and present non-controlling interest in the profit or loss of consolidated subsidiaries for the reporting period separately from the interest of the owners of the parent;

- (i), (ii), (iii), (iv)
- (iv), (iii), (ii), (i)
- (ii), (i), (iv), (iii)
- (iv), (iii), (ii), (i).

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[4] On the basis of *IFRS for SMEs* (IASB, 2009), Section 9 and Hyblova (2007). See Lecture 2.

Quiz 4: Decide which statements are true:

- Intragroup balances and transactions, including income, expenses and dividends, are eliminated only partly.
- The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall be prepared as of the same reporting date and using uniform accounting policies for like transactions and other events and conditions in similar circumstances.
- The income and expenses of a subsidiary are excluded from the consolidated financial statements.
- An entity shall disclose non-controlling interest in the profit or loss of the group separately in the statement of comprehensive income.

Quiz 5: What information should be disclosed in consolidated financial statements?

- the basis for concluding that control exists when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power
- any difference in the reporting date of the financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements
- intragroup balances and transactions, including income, expenses and dividends between parent and subsidiary.

Quiz 6: Decide which statements are true:

- IFRS for SMEs requires a parent to present consolidated financial statements.
- IFRS for SMEs requires a parent or a group of subsidiaries to present separate financial statements.
- IFRS for SMEs do does not require a group of two or more entities to present combined financial statements.

<u>Example 6: Compile consolidated statement of financial position for entity the presented below:</u>

Parent (P) acquires 100% of subsidiary (S) Goodwill = …			
Item	**Parent (CU)**	**Subsidiary (CU)**	**Consolidated statement of financial position (CU)**
Non-current tangible assets	750,000	210,000	
Consideration transferred (acquisition cost) by Parent (P)	300,000		
Goodwill			

Current assets	350,000	70,000	
Total assets	1,400,000	280,000	
Legal capital	1,100,000	220,000	
Retained earnings	300,000	60,000	
Total equity and liabilities	1,400,000	280,000	

Example 7: Compile consolidated statement of financial position and account for goodwill for the entity presented below:

Parent (P) acquires 100% of subsidiary (S) **Goodwill =** ***Consideration transferred – Fair value of acquired assets*** ***Goodwill = …***			
Item	**Parent (CU)**	**Subsidiary (CU)**	**Consolidated statement of financial position (CU)**
Non-current tangible assets	750,000	210,000	
Consideration transferred (acquisition cost) by Parent (P)	300,000		
Goodwill			
Current assets	350,000	70,000	
Total assets	1,400,000	280,000	
Legal capital	1,100,000	220,000	
Retained earnings	300,000	60,000	
Total equity and liabilities	1,400,000	280,000	

Example 8: Compile consolidated statement of financial position and account for goodwill and controlling interest for the entity presented below:

Parent (P) acquires 80% of subsidiary (S) ***Controlling interest (80%) = …*** ***Goodwill = …***			
Item	**Parent (CU)**	**Subsidiary (CU)**	**Consolidated statement of financial position (CU)**
Non-current tangible	750,000	210,000	

assets			
Consideration transferred (acquisition cost) by Parent (P)	300,000		
Goodwill			
Current assets	350,000	70,000	
Total assets	1,400,000	280,000	
Legal capital	1,100,000	220,000	
Retained earnings	300,000	60,000	
Non-controlling interest			
Total equity and liabilities	1,400,000	280,000	

Accounting policies, estimates and errors[5]

Quiz 1: Decide which statements are true:

- Entities are not allowed to deviate from basic requirements imposed by IFRS for SMEs while accounting for particular transactions, events or conditions.
- Entities are allowed to deviate from basic requirements imposed by IFRS for SMEs while accounting for particular transactions, events or conditions if IFRS for SMEs do not directly address to such particular transactions, events and/or conditions.
- Entities are allowed to deviate from basic requirements imposed by IFRS for SMEs while accounting for particular transactions, events or conditions if the effect of following the existing under IFRS for SMEs guidance will not be material.

Quiz 2: What changes are treated as changes in accounting policy?

- application of new accounting policy which is aimed to improve quality of accounting for particular transactions, events or conditions
- application of new accounting policy which is aimed to raise reliability, relevance and faithfulness of compiled financial statements
- application of new accounting policy for transactions, other events or conditions, which differ in substance from those previously occurring
- application of new accounting policy for transactions, other events or conditions, which did not occur previously or were not material.

Quiz 3: What changes are treated as changes in accounting estimates?

- application of new accounting estimates for adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset on the basis of new information or new developments and, accordingly, are not corrections of errors
- application of new accounting estimates for recognition of an asset or a liability, or the amount of the periodic consumption of an asset on the basis of existing information (i.e. information which was available in previous periods) which may help to improve existing quality of financial statements prepared
- application of new accounting estimates for measurement of the new carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset on the basis of existing information (i.e. information which was available in previous periods) which may help to improve existing quality of financial statements prepared.

Quiz 4: Prior period errors are results of:

- a failure to use, or misuse of, reliable accounting information
- mathematical mistakes and mistakes in applying accounting policies
- oversights or misinterpretations of facts and fraud
- all mention above.

[5] On the basis of *IFRS for SMEs* (IASB, 2009), Section 10, and Hyblova (2007). See Lecture 3.

Example 1: Account for a change in estimate

An entity bought a fixed asset for CU2,500, the defined period of depreciation was 10 years. In the 6th year on the basis of new information the entity changed the period of depreciation for 8 years.

Original depreciation plan:

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
Depreciation (CU)										

Change in estimate:

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**
Depreciation (CU)								

Example 2: Account for a correction of prior period errors

In the 2d year an entity found, that in the 1st year there was an expense of CU50,000, which was not accounted. Balance of retained earnings at the beginning of the 1st year was CU200,000 and at the beginning of the 2st year – CU350,000.

	1 year	**2 year**
Revenues (CU)	250,000	500,000
Expenses (CU)	100,000	300,000
Profit (CU)	150,000	200,000

Corrected statements

CIS in 1 year	
Revenues	
Expenses	
Profit	

CIS in 2 year	
Revenues	
Expenses	
Profit	

Correction of retained earnings:

Item	**1 year**	**2 year**
Retained earnings at the beginning of the period (CU)		
Correction of errors (CU)		
Corrected retained earnings at the beginning of the period (CU)		

Property, plant and equipment[6]

Quiz 1: Which of the following categories of assets can be recognized as PPE?

- assets held for use in the production or supply of goods or services
- assets held for rental to others
- assets held for administrative purposes
- assets expected to be used in <1 period.

Quiz 2: Decide which statements are true:

- Spare parts and servicing equipment are usually carried as part of property, plant and equipment, and they are depreciated together with the main asset to which they belong.
- If the major components of an item of property, plant and equipment have significantly different patterns of consumption of economic benefits, an entity shall allocate the initial cost of the asset to its major components and depreciate each such component separately over its useful life.
- Land and buildings shall be accounted together.

Quiz 3: At initial measurement the cost of an item of property, plant and equipment comprises all of the following:

- purchase price
- legal and brokerage fees
- non-refundable and refundable import duties and purchase taxes
- trade discounts and rebates
- costs of site preparation as well costs of dismantling and removing the item and restoring the site on which it is located
- initial delivery and handling, installation and assembly
- costs of advertising and promotional activities
- administration and other general overhead costs
- borrowing costs.

Quiz 4: At subsequent measurement the cost of an item of property, plant and equipment is estimated in the following way:

- initially recognized cost minus accumulated depreciation and minus accumulated impairment loss
- initially recognized cost plus accumulated depreciation and minus accumulated impairment loss
- initially recognized cost minus accumulated depreciation, plus impairment loss and minus impairment loss reversal
- initially recognized cost minus accumulated depreciation, minus impairment loss and plus impairment loss reversal.

[6] On the basis of *IFRS for SMEs* (IASB, 2009), Section 17, and Hyblova (2007). See Lecture 3.

Quiz 5: The depreciation charge for each period shall be recognized in

- statement of financial position
- statement of comprehensive income
- statement of change in equity
- statement of retained earnings
- statement of cash flow

Quiz 6: Change in annual depreciation charge on the basis of new information is accounted as:

- change in accounting policy
- change in accounting estimate
- correction of prior period error.

Example 1: Costs of acquisition an item and restoring the site after dismantling and removing the item acquired

On 1.1.20X1 an entity bought a building for CU200,000. Expected lifetime of the building is 5 years and after the end of this lifetime it will be necessary to restore the site on which the building is located. Estimated costs of site restoring are CU50,000, average interest rate is 10% p.a.

Present value entity's costs for site restoration (CU)	
Acquisition cost of building (CU)	

Interest amortization schedule:

Year	**Initial value of reserve (CU)**	**Interest (CU)**	**Final value of reserve (CU)**
20X1			
20X2			
20X3			
20X4			
20X5			

Example 2: Estimate annual amounts of component depreciation

An entity has equipment with balance value CU250,000, lifetime period of which is 6 years. As part of this equipment there is a spare part with balance value CU50,000, which is replaced every 3 years.

Estimation of depreciation and recoverable amount:

Depreciation of equipment (CU)	
Depreciation of spare part (CU)	
Recoverable amount in the 1st year (CU)	
Recoverable amount in the 2st year (CU)	
Recoverable amount in the 3st year (CU)	
Recoverable amount in the 4st year (CU)	
Recoverable amount in the 5st year (CU)	

Recoverable amount in the 6st year (CU)	

Depreciation and recoverable amount:

	1 year	**2 year**	**3 year**	**4 year**	**5 year**	**6 year**
Depreciation of equipment without spare part (CU)						
Depreciation of spare part (CU)						
Total depreciation (CU)						
Recoverable amount (CU)						

Example 3: Estimate annual amounts of depreciation

An entity has equipment with balance value CU2,500. Lifetime is defined as 4 years, recoverable amount is CU100. It is assumed that equipment will produce 20 units in the first two years of its lifetime and 30 units of the remaining last two years of its lifetime.

Estimated annual amount of depreciation under straight-line method, method of double declining balance and production method will be:

Year	**Straight-line depreciation (CU)**	**DDB (CU)**	**Production depreciation (CU)**
1			
2			
3			
4			
Total			

Intangible assets other than Goodwill[7]

Quiz 1: What are the recognition criteria for intangible assets?

- it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity
- the cost or value of the asset can be measured reliably
- the asset is the result of internal activity of an entity.

Quiz 2: Which of the following items can be recognized as intangible assets?

- internally generated brands and publishing titles
- acquired logos and customer lists
- start-up activities (i.e. start-up costs)
- training activities
- purchased software
- advertising and promotional activities
- relocating or reorganizing part or all of an entity
- internally generated goodwill
- acquired in a business combination goodwill.

Quiz 3: An intangible asset, which was acquired in a business combination, is not recognized when:

- it arises from legal or other contractual rights
- its fair value cannot be measured reliably
- its cost cannot be measured reliably.

Quiz 4: At initial measurement the cost of an item of property, plant and equipment comprises all of the following:

- purchase price
- legal and brokerage fees
- non-refundable and refundable import duties and purchase taxes
- trade discounts and rebates
- initial delivery and installation
- costs of advertising and promotional activities
- administration and other general overhead costs
- borrowing costs.

Quiz 5: At subsequent measurement the cost of an item of property, plant and equipment is estimated in the following way:

- initially recognized cost minus accumulated depreciation and minus accumulated impairment loss

[7] On the basis of *IFRS for SMEs* (IASB, 2009), Section 18. See Lecture 4.

- initially recognized cost plus accumulated amortization and minus accumulated impairment loss
- initially recognized cost minus accumulated amortization, plus impairment loss and minus impairment loss reversal
- initially recognized cost minus accumulated amortization, minus impairment loss and plus impairment loss reversal.

Quiz 6: Decide which statements are true:

- All intangible assets shall be considered to have a finite useful life.
- The useful life of an intangible asset that arises from contractual or other legal rights can exceed the period of the contractual or other legal rights.
- The residual value of an intangible asset is always zero.
- If an entity is unable to make a reliable estimate of the useful life of an intangible asset, the life shall be presumed to be 10 years.

Example 1: Estimate the initially recognized amount for software

On 1 January 20X1 an entity purchased a new software package to operate its production equipment for CU400,000, including CU50,000 refundable purchase taxes. The purchase price was funded by incurring a loan of CU405,000 (including CU5,000 loan origination fees). The loan is secured against the software licenses. In January 20X1 the entity incurred the following costs in customizing the software so that it is more suited to the systems used by the entity:

Item	Value (CU)
Labor	50,000
Depreciation of plant and equipment used to perform the modifications	7,000

In January 20X1 the entity's production staff were trained in how to operate the new software. Training costs included:

Item	Value (CU)
Cost of an expert external instructor	3,000
Labor	1,000

In February 20X1 the entity's production team tested the software and the information technology team made further modifications necessary to get the new software to function as intended by management. The following costs were incurred in the testing phase:

Item	Value (CU)
Material, net of CU3,000 recovered from the sale of the scrapped output	11,000
Labor	5,000
Depreciation of plant and equipment while it was used to perform the modifications	2,000

The new software was ready for use on 1 March 20X1. However, because of low initial order levels, the entity incurred a loss of CU4,000 on operating the software during March.

What is the cost of the software at initial recognition?

Example 2: Estimate the carrying amount of franchise licence

On 1 January 20X1 an entity acquired a franchise licence for CU450,000. Management measured the amortisation of the licence at CU150,000 per year. At 31 December 20X3 in response to the entry into the market of a competing franchisor the entity assessed the recoverable amount of the franchise licence at CU120,000.

What is the recognized carrying amount of franchise licence at 31 December 20X3?

Business combinations and Goodwill[8]

Quiz 1: Decide in which order individual procedures which are presented below should take place while accounting for a business combination ("purchase method" under IFRS for SMEs and "acquisition method" under full IFRS):

(i) identifying an acquirer and acquisition date;

(ii) recognizing the assets acquired and liabilities assumed at fair value;

(iii) recognizing any difference between the cost of the business combination and the fair value of assets acquired and liabilities assumed;

(iv) allocating, at the acquisition date, the cost of the business combination to the assets acquired and liabilities and provisions for contingent liabilities assumed;

(v) measuring the cost of the business combination as aggregate of the fair value of assets given, liabilities assumed and equity issued including transaction costs.

- (i), (ii), (iii), (iv), (v)
- (ii), (i), (iv), (iii), (v)
- (iii), (ii), (i), (v), (iv)
- (i), (ii), (v), (iv), (iii).

Quiz 2: Decide which statements are true:

- An acquirer shall be identified for all business combinations.
- An acquiree shall be identified for all business combinations.
- The acquisition date is the date on which the acquirer effectively obtains control of the acquire.
- The acquisition date is the date on which the acquiree effectively obtains control of the acquirer.

Quiz 3: Which indicators are used for identification an acquirer:

- comparison of fair value of net assets of combining entities
- identification of transfer of cash or cash equivalents from one combining entity to another one
- comparison of net annual turnovers of combining entities
- comparison of combining entities' powers to select management team of the resulting combined entity
- comparison of average number of employers average during the financial year.

Quiz 4: The cost of a business combination as the aggregate of:

[8] On the basis of *IFRS for SMEs* (IASB, 2009), Section 19. See Lecture 4.

- the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquire, minus any costs directly attributable to the business combination
- the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree, plus any costs directly attributable to the business combination
- the carrying amounts, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquire, minus any costs directly attributable to the business combination
- the carrying amounts, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree, plus any costs directly attributable to the business combination.

Quiz 5: When a business combination agreement provides for an adjustment to the cost of the combination contingent on future events, the acquirer:

- shall include the estimated amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is probable and can be measured reliably
- shall not include the estimated amount of that adjustment in the cost of the combination at the acquisition date even though if the adjustment is probable and can be measured reliably
- shall include the estimated amount of that adjustment in the cost of the combination at the acquisition date even though if the adjustment is not highly probable and can be measured only approximately.

Quiz 6: Goodwill is recognized and measured as:

- any difference between the cost of the business combination and the acquirer's interest in the total fair value of the identifiable assets, liabilities and provisions for contingent liabilities so recognized
- any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and provisions for contingent liabilities so recognized
- any difference between the cost of the business combination and the acquirer's interest in the carrying amounts of the identifiable assets, liabilities and provisions for contingent liabilities so recognized.

<u>Example 1: Compile the consolidated statement of financial position</u>

SME A purchased a competitor's (SME B) taxi business for CU 42 000, which was paid in cash on the date of acquisition. The business combination was effected by the assets, obligations and operations of the taxi business being transferred to SME A. Information about the assets, liabilities and contingent liabilities of the acquired business at the acquisition date:

Item	Carrying amount in SME B's financial statements (CU)	Fair value (CU)
Taxis	15, 000	20,000
Taxi licenses	5,000	15,000
Brand (registered trade name)	-	6,000
Possible obligation for a court case	-	(1,000)
Total	20,000	40,000

Item	SME A Carrying amount (CU)
Assets	
Non-current assets	
Property, plant and equipment - taxis	35,000
Intangible asset - taxi licenses	10,000
Current assets	
Cash	60,000
Total assets	105,000
Equity	
Share capital	5,000
Reserves	100,000
Total equity	105,000

Therefore, immediately after the acquisition, SME A's statement of financial position was as follows:

Item	Before acquisition (CU)	Effect of acquisition (CU)	After acquisition (CU)
Assets			
Non-current assets			
Property, plant and equipment - taxis			
Intangible asset - goodwill			
Intangible asset - taxi licenses			
Intangible asset - brand			
Current assets			
Cash			
Total assets			
Current liabilities			
Liability - court case			
Equity			
Share capital			
Reserves			
Total equity			

Example 2: Estimate cost of a business combination

SME A acquires 100 per cent of the equity interests in SME B in exchange for cash of CU230,000. In addition, SME A paid the following costs that are related directly to the business combination:

Item	Value (CU)
Advisory services	85,000
Legal assistance	15,000
Accounting services	10,000
Valuation services	5,000

What is the cost of a business combination?

Example 3: Estimate the recognized amount of goodwill

At 1 January 20X5 SME A acquired 100 per cent of the equity interests in SME B in exchange for cash of CU230,000. The fair value of SME B's identifiable assets acquired and liabilities assumed are as follows (no contingent liabilities exist):

Item	Value (CU)
Equipment	75,000
Inventory	35,000
Accounts receivable	20,000
Patents	15,000
Accounts payable	30,000

What is the value of goodwill that the entity should recognize?

Leases[9]

Quiz 1: The major difference between financial and operating lease is:

- substantial transfer of all the risks and costs incidental to ownership
- substantial transfer of all the risks and rewards incidental to ownership
- substantial transfer of all the risks and uncertainties incidental to ownership
- substantial transfer of all the rewards and costs incidental to ownership.

Quiz 2: A lessee shall recognize its financial lease as:

- rights and obligations of use its statement of financial position at amounts equal to the carrying amount of the leased property or, if lower, the present value of the minimum lease payments, determined at the inception of the lease
- rights and obligations of use its statement of financial position at amounts equal to the recoverable amount of the leased property or, if lower, the present value of the minimum lease payments, determined at the inception of the lease
- rights and obligations of use its statement of financial position at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, determined at the inception of the lease.

Quiz 3: A lessor shall recognize assets held under a finance lease in:

- in its statements of financial position and present them as a receivable at an amount equal to the net investment in the lease
- in its statements of financial position and present them as a receivable at an amount equal to its fair value
- in its statements of financial position and present them as a receivable at an amount equal to its carrying amount.

Quiz 4: A lessee shall recognize lease payments provided under operating lease:

- as an expense in its first statement of comprehensive income when the contract on operating lease was signed
- as a revenue in its first statement of comprehensive income when the contract on operating lease was signed
- as an expense on a straight-line basis in all its statements of comprehensive income throughout the whole life of the contract on operating lease
- as a revenue on a straight-line basis in all its statements of comprehensive income throughout the whole life of the contract on operating lease.

Quiz 5: A lessor shall recognize lease payments received under operating lease:

- as an expense in its first statement of comprehensive income when the contract on operating lease was signed

[9] On the basis of *IFRS for SMEs* (IASB, 2009), Section 20, and Hyblova (2007). See Lecture 5.

- as a revenue in its first statement of comprehensive income when the contract on operating lease was signed
- as an expense on a straight-line basis in all its statements of comprehensive income throughout the whole life of the contract on operating lease
- as a revenue on a straight-line basis in all its statements of comprehensive income throughout the whole life of the contract on operating lease.

Example 1: Compile financial statement of financial lessee

On 1 January 20X1 an entity entered, as lessee, into a three-year non-cancellable lease of a machine. At the end of the lease term ownership of the machine passes to the lessee. There were made three lease payments for CU5,000 always paid by 31 December. The interest rate implicit in the lease is 15 per cent per year. Real value of machine is CU13,000. Estimated lifetime of machine is 5 years, estimated residual value at the end of lifetime is CU700.

Present value of lease payments is: …
The initially measured value of machine is: …

Schedule of lease payments:

Year	% rate	Payment (CU)	Liability (CU)	Interest (CU)	Reduction of liability (CU)	Liability at the end of the reporting period (CU)
1						
2						
3						
Total						

Depreciation of leased machine is: ...

Balance 20X1 (CU)			
Non-current assets		Business result for current period	
Cash		Liability	
Total assets		Total equity and liabilities	

Income statement 20X1 (CU)	
Depreciation	
Interest	
Business result for current period	

Balance 20X2 (CU)			
Non-current assets		Business result for	

		previous period	
		Business result for current period	
Cash		Liability	
Total assets		Total equity and liabilities	

Income statement 20X2 (CU)	
Depreciation	
Interest	
Business result for current period	

Balance 20X3 (CU)			
Non-current assets		Business result for previous period	
		Business result for current period	
Cash		Liability	
Total assets		Total equity and liabilities	

Income statement 20X3 (CU)	
Depreciation	
Interest	
Business result for current period	

Example 2: Compile financial statement of financial lessor

Given info – see Example 1, except of the interest rate implicit – 13.5 per cent.

Schedule of lease payments:

Year	**% rate**	**Payment (CU)**	**Liability (CU)**	**Interest (CU)**	**Reduction of liability (CU)**	**Liability at the end of the reporting period (CU)**
1						
2						
3						
Total						

Depreciation of leased machine: …

Balance 20X1 (CU)			
Non-current assets		Business result for current period	
Cash		Liability	
Total assets		Total equity and liabilities	

Income statement 20X1 (CU)	
Depreciation	
Interest	
Business result for current period	

Balance 20X2 (CU)			
Non-current assets		Business result for previous period	
		Business result for current period	
Cash		Liability	
Total assets		Total equity and liabilities	

Income statement 20X2 (CU)	
Depreciation	
Interest	
Business result for current period	

Balance 20X3 (CU)			
Non-current assets		Business result for previous period	
		Business result for current period	
Cash		Liability	
Total assets		Total equity and liabilities	

Income statement 20X3 (CU)	
Depreciation	
Interest	
Business result for current period	

Impairment of assets[10]

Quiz 1: Impairment test for inventories is carried out by:

- comparing the carrying amount of each item of inventory (or group of similar items) with its selling price less costs to complete and sell
- comparing the carrying amount of each item of inventory (or group of similar items) with its fair value
- comparing the carrying amount of each item of inventory (or group of similar items) with its recoverable amount.

Quiz 2: Impairment test for assets other than inventories is carried out by:

- comparing the carrying amount of each item of inventory (or group of similar items) with its selling price less costs to complete and sell
- comparing the carrying amount of each item of inventory (or group of similar items) with its fair value
- comparing the carrying amount of each item of inventory (or group of similar items) with its recoverable amount.

Quiz 3: If there is an indication that an asset may be impaired, this may indicate that the entity should review:

- the remaining useful life of such asset
- the depreciation (amortization) method used for such asset
- the residual value for such asset
- all mentioned above.

Quiz 4: If asset's fair value less costs to sell and its value in use exceed asset's carrying amount, then:

- such asset is not impaired
- such asset is impaired
- it is not necessary to estimate both asset's fair value less costs to sell and its value in use.

Quiz 5: Impairment loss shall be allocated to reduce the carrying amount of the assets of the unit in the following order:

- first, to reduce the carrying amount of all assets other than goodwill, which comprise a cash-generating unit, and then to any goodwill allocated to the cash-generating unit
- first, to reduce the carrying amount of any goodwill allocated to the cash-generating unit, and then, to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the cash-generating unit
- to reduce the carrying amount of all assets, which comprise a cash-generating unit.

[10] On the basis of *IFRS for SMEs* (IASB, 2009), Section 27. See Lecture 5.

Example 1: Perform impairment test and estimate the recognized amount of impairment loss

A retailer holds three items of inventory (X, Y, and Z) at 31 December 20X0. It is likely that all items of inventory will be sold. Based on the information provided in the table below, is the entity required to record any impairment loss at 31 December 20X0?

	Carrying amount (CU)	**Selling price estimated at 31/12/20X0 (CU)**	**Costs to sell estimated at 31/12/20X0 (CU)**
Item X	35,000	40,000	2,000
Item Y	50,000	50,000	5,000
Item Z	75,000	85,000	15,000

Impairment test:

	Item X	**Item Y**	**Item Z**
Carrying amount (CU)			
Selling price estimated at 31/12/20X0 (CU)			
Costs to sell estimated at 31/12/20X0 (CU)			
Selling price less cost to sell (CU)			
Impairment loss for the year ended 31/12/20X0 (CU)			
Carrying amount of the inventory after recognition of impairment loss (CU)			

Example 2: Perform impairment test and estimate the recognized amount of impairment loss

On 31 December 20X1 an entity holds raw materials to be consumed in the manufacturing of product A. Before testing for impairment the entity carries the raw materials at their cost of CU100,000. At 31 December 20X1 the replacement cost of the raw materials is CU80,000.

On 31 December 20X1 management estimate that it will cost CU60,000 to convert the CU100,000 of raw material into finished goods. Furthermore, they estimate that CU25,000 will be incurred to sell those finished goods. The finished goods are expected to be sold for CU200,000.

Must the entity record an impairment loss?

Example 3: Perform impairment test and estimate the recognized amount of impairment loss

On 30 September 20X6 a fire destroyed inventory that had a carrying amount of CU500,000. The entity immediately registered a claim of CU700,000 for the replacement cost of the inventory with an insurance company. However, the insurance company disputed the claim, citing negligence on the part of the entity. On 15 November 20X6, the fire authorities completed their investigation and found an electrical fault to be the cause of the fire. As a result of these findings the insurance

company notified the entity that its claim for CU700,000 would be settled in full. The insurance company paid the entity CU700,000 on 30 November 20X6.

How would the entity account for its inventories for the year ended 31 December 20X6?

Example 4: Perform impairment test, estimate the recognized amount of impairment loss and impairment loss reversal

A retailer holds three items of inventory (X, Y, and Z) at 31 December 20X0. All three inventories stay unsold at 31 December 20X1.

	Cost (CU)	Accumulated impairment loss at 31/12/20X0 (CU)	Carrying amount at 31/12/20X1 before impairment reversal test (CU)	Selling price estimated at 31/12/20X1 (CU)	Costs to sell estimated at 31/12/20X1 (CU)
Item X	35,000	-	35,000	35,000	5,000
Item Y	45,000	5,000	45,000	50,000	2,000
Item Z	70,000	5,000	70,000	80,000	5,000

Decide about reversal of impairment and calculate the values:

	Item X	Item Y	Item Z
Carrying amount (CU)			
Accumulated impairment loss at 31/12/20X0 (CU)			
Carrying amount at 31/12/20X1 before impairment test (CU)			
Selling price estimated at 31/12/20X1 (CU)			
Costs to sell estimated at 31/12/20X1 (CU)			
Selling price less cost to sell (CU)			
Impairment loss for the year ended 31/12/20X1 (CU)			
Reversal of impairment loss for the year ended 31/12/20X1 (CU)			

Example 6: Estimate value in use

At the end of 20X0 an entity tests a machine for impairment. The machine was bought five years earlier for CU300,000, when its useful life was estimated to be 15 years and the estimated residual value was nil. At 31 December 20X0, after recognizing the depreciation charge for 20X0, the machine's carrying amount was CU200,000 and its remaining useful life was estimated at 10 years.

The machine's value in use is calculated using a pre-tax discount rate of 14 per cent per year. Budgets approved by management reflect expected cash inflows net of the estimated costs necessary to maintain the level of economic benefit expected to arise from the machine in its current condition

Assume, for simplicity, that the expected future cash flows occur at the end of each reporting period. The discounted cash flow will be:

Year	Estimated future cash flow (CU)	Probability	Probability-weighted future cash flow (CU)	Present value factor 14%	Discounted cash flow (CU)
20X1	23,939	0.95			
20X2	27,878	0.9			
20X3	31,522	0.85			
20X4	44,371	0.8			
20X5	53,313	0.75			
20X6	59,941	0.7			
20X7	66,865	0.65			
20X8	78,907	0.6			
20X9	85,976	0.55			
20X0	93,148	0.5			
Value in use					

Carrying amount before impairment loss: …

Recoverable amount: …

Impairment loss: …

Carrying amount after impairment loss (i.e. recoverable amount): …

Example 7: Perform impairment test for goodwill and estimate the recognized amount of impairment loss

On 31 December 20X1, Entity T acquires 100% of voting rights in Entity M for CU10,000. Entity M has manufacturing plants in three countries. The data below relates to the end of 20X1

	Allocation of purchase price (CU)	Fair value of identifiable assets (CU)	Goodwill (CU)
Activities in Country A	3,000	2,000	
Activities in Country B	2,000	1,500	
Activities in Country C	5,000	3,500	

Goodwill arising on the acquisition of Entity M has been allocated to three cash-generating units (Countries A, B and C).

During 20X2, a new government is elected in Country A. It passed legislation that significantly restricts exports of the main product produced by Entity T and its subsidiaries (ie Group T). As a result, and for the foreseeable future, Group T's production in Country A will be cut by 40 per cent. The significant export restriction and the resulting production decrease require Group T to estimate the recoverable amount of Country A's cash-generating unit at the end of 20X2. Management estimates cash flow forecasts for Country A operations and determines the cash-generating unit's recoverable amount to be CU1,360.

	Goodwill (CU)	**Identifiable assets (CU)**	**Total (CU)**
Historical cost			
Accumulated amortization/depreciation (20X2)			
Carrying amount			
Impairment loss			
Carrying amount after impairment loss			

At the end of 20X2, Entity T compares the carrying amount of Country A's assets CU2,633 with their recoverable amount CU1,360 and records an impairment loss of CU1,273. The impairment loss is recorded first against the carrying amount of goodwill CU800 and next against the carrying amount of identifiable assets CU473.

Inventories[11]

Quiz 1: Which of the following categories of assets can be recognized as inventories

- assets held for sale in the ordinary course of business (finished goods)
- assets being in the process of production for further sale (work in process)
- assets in the form of materials or supplies to be consumed in the production process or in the rendering of services (raw materials & consumables)
- assets expected to be used in >1 period.

Quiz 2: Inventories should be measured at :

- cost
- purchase price
- the lower of cost and estimated selling price less costs to complete and sell
- the lower of cost and fair value less costs to complete and sell.

Quiz 3: Cost of inventories is the sum of:

- costs of purchase and costs of conversion
- direct costs, indirect costs and other costs (allocated production overheads)
- costs of purchase, costs of conversion (e.g. allocated production of overheads) and other costs incurred in bringing the inventory to their present location and condition
- salaries of factory staff and storage costs necessary in the production process before a further production stage and selling costs
- abnormal amounts of wasted materials and selling costs.

Quiz 4: Impairment test for inventories is carried out by:

- comparing the carrying amount of each item of inventory (or group of similar items) with its selling price less costs to complete and sell
- comparing the carrying amount of each item of inventory (or group of similar items) with its fair value
- comparing the carrying amount of each item of inventory (or group of similar items) with its recoverable amount.

Quiz 5: When inventories are sold, the entity shall recognize the carrying amount of those inventories as:

- an expense in the period in which the related revenue is recognized
- a revenue in the period in which the related expense is recognized
- an expense in the period in which the related receivable is paid off
- a revenue in the period in which the related payable is settled.

[11] On the basis of IFRS for SMEs (IASB, 2009), Section 13. See Lecture 6.

Example 1: Estimate the cost of purchase

A retailer imported goods at a cost of CU 200, including CU 35 non-refundable import duties and CU 10 refundable purchase taxes. The risks and rewards of ownership of the imported goods were transferred to the retailer upon collection of the goods from the harbour warehouse. The retailer was required to pay for the goods upon collection. The retailer incurred CU15 to transport the goods to its retail outlet and a further CU 10 in delivering the goods to its customer. Further selling costs of CU 5 were incurred in selling the goods.

What is the recognized cost of purchase of inventories?

Example 2: Estimate the cost of purchase

A retailer buys a good priced at CU350 per unit. However, the supplier awards the retailer a 10 per cent discount on orders of 100 units or more.

The retailer buys 100 units in a single order. What is the recognized cost of purchase of inventories?

Example 3: Estimate the cost of purchase

A retailer buys a good priced at CU350 per unit. However, the supplier awards the retailer a 10 per cent discount on orders of 100 units or more. Furthermore, when the retailer has purchased 1,000 or more units in a calendar year, the supplier awards the retailer a further volume discount of 5 per cent of the list price. The additional volume discount applies to all units acquired by the retailer during the calendar year.

On 1 January 20X1 the retailer buys 1,000 units from the supplier in a single order. What is the recognized cost of purchase of inventories?

Example 4: Estimate overhead costs per unit of production

An entity incurred fixed production overheads of CU900,000 during a one-month period in which it manufactured 250,000 units of production. When operating at normal capacity the entity manufactures 250,000 units of production per month.

What is the recognized amount of fixed production overhead cost to each unit produced during the month?

Example 5: Estimate per unit costs for by-products

An entity manufactures a chemical 'A' for use in the agriculture industry. The production process requires a mixture of base chemicals followed by a maturation process, and from which, a product 'A' and a by-product 'C' are produced.

The total costs of a production run (i.e. including direct costs and the allocation of overheads) are CU100,000.

Each production run produces:

- 5,000 litres of product A, sales value = CU250,000
- 1,000 litres of (by-product) C, sales value = CU2,000

The entity accounts for the by-product by deducting its selling price from the cost of the main product. In this example, the costs to complete and sell the by-product are negligible and have been ignored.

What are the per unit costs of product A?

Example 6: Joint product

The facts are the same as in example 5. However, in this example, instead of the by-product there is another joint product 'B' resulting from the maturation process. Furthermore, the total costs (i.e. including direct costs and the allocation of overheads) of a production run are CU300,000.

Each production run produces:

- 5,000 litres of product A, sales value = CU250,000
- 4,000 litres of product B, sales value = CU400,000

The entity allocates the joint process costs to the products produced on the basis of their relative sales values.

What are the per unit costs of by-products A and B?

Example 7: Cost formulas

An entity sells fiber cables. It measures the cost of inventories by using the FIFO method and the weighted average cost formula calculated at the end of the period (i.e. the periodic method). The following movements in inventory occurred in 20X5.

Date	Description	Units	Total cost	Cost per unit
01-Jan	Opening balance	1,000	10,000	10

02-Feb	Sold	200		
25-Feb	Purchased	400	6 000	15
02-Mar	Purchased	200	4 000	20
25-Mar	Sold	900		
Closing inventories		500		

Using the FIFO cost formula the cost of the inventories sold in the period and the cost of inventory held at the end of the period are determined by assuming that units that were purchased first are sold first, as follows:

Date	Description	Units	Cost per unit	Inventory cost	Cost of goods sold
01-Jan	Opening balance				
02-Feb	Sold				
	Balance				
25-Feb	Purchased				
02-Mar	Purchased				
25-Mar	Sold				
	Balance				

Using the weighted average cost formula the cost of the inventories sold in the period and the cost of inventory held at the end of the period are as follows:

Date	Description	Units	Cost per unit	Inventory cost
01-Jan	Opening balance			
25-Feb	Purchased			
02-Mar	Purchased			
Total goods available for sale in the period				
Total goods sold in the period				
Closing inventory				

Provisions and Contingencies[12]

Quiz 1: What are the criteria for provisions and contingencies being recognized?

- the entity has an obligation at the reporting date as a result of a past event
- the entity has a corresponding receivable at the reporting date as a result of a past event
- it is probable (i.e. more likely than not) that the entity will be required to transfer economic benefits in settlement
- it is probable (i.e. more likely than not) that the entity will be receive a transfer of economic benefits in settlement
- the amount of the obligation can be estimated approximately
- the amount of the obligation can be estimated reliably.

Quiz 2: A provision should be measured at:

- cost
- fair value
- best estimate of the amount required to settle the obligation at the reporting date.

Quiz 3: Decide which statements are true:

- When the provision involves a large population of items, the estimate of the amount reflects the weighting of all possible outcomes by their associated probabilities.
- When the provision arises from a single obligation, the individual most likely outcome may be the best estimate of the amount required to settle the obligation.
- At subsequent measurement an entity can charge against a provision any expenditures, even those for which the provision was not originally recognized.

Quiz 4: An entity:

- shall recognize contingent assets and liabilities
- shall not recognize contingent assets and liabilities.
- shall not recognize contingent assets, but shall recognize contingent liabilities
- shall recognize contingent assets, but shall not recognize contingent liabilities.

<u>Example 1: Initial measurement of provisions</u>

An entity's production process causes contamination to the land on which the entity's plant is built. The entity is required by law to restore the environment at the end of its plant's useful life. The estimated lifetime of the plant is 5 years. The entity envisages costs for site restoration varying from CU200,000 with 55% of probability and to CU275,000 with 45% probability. Adjustment for uncertainties is 5% and appropriate discount factor for risk-adjusted cash flows is 10%.

What is the recognized amount of the provision, if any, in this case?

[12] On the basis of IFRS for SMEs (IASB, 2009), Section 21. See Lecture 6.

Example 2: Initial measurement of provisions

An entity sells 1,000 units of a product with warranties under which the entity will repair any manufacturing defects that become apparent within the first six months after purchase. If a minor defect is detected in a product, estimated repair costs of CU100 will result. If a major defect is detected in a product, estimated repair costs of CU400 will result. The entity's experience together with its future expectations indicate that 75 per cent of the goods sold have no defects, 20 per cent of the goods sold have minor defects and 5 per cent of the goods sold have major defects.

For the purpose of this example, the risks specific to the liability and the time value of money have been ignored.

What is the recognized amount of the provision, if any, in this case?

Example 3: Initial measurement of provisions

A customer has initiated a lawsuit against an entity associated with personal injury when using one of the entity's products. The entity's lawyers estimate from experience that at the reporting date (31 December 20X1) the entity has:

a) a 30 per cent chance of being ordered to pay the customer compensation of CU2 million and a 70 per cent chance of being ordered to pay compensation of CU300,000. The ruling is expected to take place in two years' time. The entity determines that a discount rate of 4 per cent is appropriate to adjust for the risks specific to the liability.
b) a 25 per cent chance of being ordered to pay the customer compensation of CU100,000, a 50 per cent chance of being ordered to pay compensation of CU300,000 and a 25 per cent chance of being ordered to pay compensation of CU500,000. For the purpose of this example, the risks specific to the liability and the time value of money have been ignored.
c) a 75 per cent chance of winning the lawsuit and thereby avoiding the payment of compensation. Furthermore, the entity's lawyers estimate that the entity has a 10 per cent chance of being ordered to pay the customer compensation of CU2 million and a 15 per cent chance of being ordered to pay compensation of CU300,000. For the purpose of this example, the risks specific to the liability and the time value of money have been ignored.

What is the recognized amount of provision, if any, in every of these cases?

Example 4: Expenditures charged against a provision

An entity recognized a CU40,000 provision for a lawsuit at 31 December 20X1. In March 20X2 the case was dismissed without the right to appeal. In April 20X2 the entity undertook an advertising campaign costing CU40,000. The entity made the following entry in its accounting records to recognize the advertising campaign:

Db: Provision for lawsuit (liability) = CU40,000
Cr: Cash = CU40,000
Is such accounting (journal entry) correct?

Basic and other financial instruments[13]

Quiz 1: Which categories of financial instruments are basic ones?

- cash
- demand and fixed-term deposits when the entity is the depositor, e.g. bank accounts.
- commercial paper and commercial bills held
- asset-backed securities, such as collateralised mortgage obligations, repurchase agreements and securitised packages of receivables
- options, rights, warrants, futures contracts, forward contracts and interest rate swaps that can be settled in cash or by exchanging another financial instrument
- accounts, notes and loans receivable and payable
- bonds and similar debt instruments
- financial instruments that qualify and are designated as hedging instruments
- investments in non-convertible preference shares and non-puttable ordinary and preference shares.

Quiz 2: At initial measurement basic financial instruments should be measured at:

- transaction price including transaction costs unless the arrangement constitutes, in effect, a financing transaction
- fair value through profit or loss unless the arrangement constitutes, in effect, a financing transaction
- transaction price including transaction costs except in the initial measurement of financial assets and liabilities that are measured at fair value through profit or loss unless the arrangement constitutes, in effect, a financing transaction
- transaction price including transaction costs except in the initial measurement of financial assets and liabilities that are measured at fair value through profit or loss.

Quiz 3: At initial measurement other financial instruments should be measured at:

- fair value
- carrying amount
- historical cost

Quiz 4: At subsequent measurement basic financial instruments should be measured at:

- initially recognized amount minus any repayments of the principal minus the cumulative amortization, and plus, in the case of a financial asset, any reduction for impairment or uncollectibility
- initially recognized amount minus any repayments of the principal minus the cumulative amortization, and minus, in the case of a financial asset, any reduction for impairment or uncollectibility

[13] On the basis of IFRS for SMEs (IASB, 2009), Section 11-12. See Lecture 7.

- initially recognized amount minus any repayments of the principal minus the cumulative amortization, and plus, in the case of a financial liability, any reduction for impairment or uncollectibility.

Example 1: Initial measurement, fin assets

An entity incurred CU10 broker transaction fees to buy 50 non-puttable ordinary shares for cash of CU500 in:

a) a listed company
b) an unlisted company

What is the recognized value of ordinary shares acquired in case of listed company and in case of unlisted company?

Example 2: Initial measurement, fin assets

An entity provides services to a customer and charges the customer CU200 with payment due within 60 days. Payment terms of 30–90 days are normal in the industry.

What is the recognized value of the receivable?

Example 3: Initial measurement, fin assets

An entity deposits CU20,000 into a 120-day notice deposit account with a bank. The entity will receive fixed interest at 1.644 % for the 120-day period (i.e. equivalent to 5 per cent per year ignoring compounding), payable at the end of the deposit period. The market rate for this type of deposit with the bank is 1.644 % per 120-day period.

What is the recognized value of the deposit?

Example 4: Initial measurement, fin liabilities

An entity buys goods from a manufacturer for CU400 with 120 days' interest-free credit, the normal business terms in the industry.

What is the recognized value of the payable?

Example 5: Initial measurement, fin liabilities

An entity utilizes CU1,500 of an interest-free overdraft facility it has with a bank to pay an amount outstanding to a supplier. The overdraft is repayable on demand. The bank has not indicated that it will request repayment in the near future. The entity does not expect to pay off the amount during the year.

What is the recognized value of the loan?

Example 6: Initial measurement, fin liabilities

A bank provides an entity with a four-year loan of CU5,000 on normal market terms, including charging interest at

a) a fixed rate of 8 % per year. Interest is payable at the end of each year. The figure of 8 % is considered the market rate for similar four-year fixed-interest loans with interest paid annually in arrears.
b) a variable rate of LIBOR plus 250 basis points, with interest payments receivable annually in arrears.

What is the recognized value of the loan charged at a fixed rate and at a variable rate?

Example 7: Subsequent measurement, fin assets

An entity bought 50 non-puttable ordinary shares during the year for cash of CU500 and incurred broker transaction fees of CU10 in:

a) a listed company. At the year-end the shares are quoted at CU11 per share.
b) an unlisted company. The shares are not publicly traded and the fair value of the shares cannot otherwise be measured reliably.

What is the recognized and subsequently measured value of ordinary shares acquired in case of listed company and in case of unlisted company?

Example 8: Subsequent measurement, fin liabilities

An entity buys goods from a manufacturer for CU400 on 1 November 20X2 with 120 days' interest-free credit, which are normal business terms in the industry. At the entity's financial year-end (31 December 20X2) it has not yet paid the manufacturer.

What is the recognized and subsequently measured value of the payable?

Example 9: Subsequent measurement, fin liabilities

An entity has an interest-free overdraft facility with a bank. The overdraft is repayable on demand by the bank. However, the bank has not indicated that it will request repayment in the near future. At the entity's financial year-end CU2,000 is outstanding on the overdraft. The entity does not expect to pay off the amount during the year.

What is the recognized and subsequently measured value of the loan?

Example 10: Subsequent measurement, fin liabilities (amortization)

A bank provides an entity with a five-year loan for CU1,000. The first two years of the loan are interest-free. After that, interest is payable monthly in arrears at the variable quoted market interest rate in the jurisdiction as quoted at the start of each month. The entity is charged an upfront fee of CU70 for the interest-free period.

The estimated annual effective interest rate is 3.695%. What is the recognized and subsequently measured value of the loan?

Example 11: Subsequent measurement, fin assets (amortization)

On 1 January 20X0, an entity acquires a bond for CU900, incurring transaction costs of CU50. Interest of CU40 is receivable annually, in arrears, over the next five years (31 December 20X0-31 December 20X4). The bond has a mandatory redemption of CU1,100 on 31 December 20X4.

The estimated annual effective interest rate is 6.9583%. What is the recognized and subsequently measured value of the bond acquired?

Example 12: Impairment loss measurement

At the end of a financial reporting period an entity has an outstanding balance of CU1,000 due from a customer. This balance was not discounted as the transaction took place on normal business terms (short-term credit) with no hidden financing transaction.

a) Because of financial difficulties being experienced by the customer, the entity does not expect the customer to repay any of the CU1,000.
b) The entity has given the customer extra time to pay off the debt. The entity expects the customer will be able to pay about one year after the reporting date.

What is the recognized amount of the impairment loss in both cases?

Example 13: Impairment of fin instruments, reversal

The facts are the same as in previous example, however, in this example, after the prior year financial statements were authorized for issue the entity received CU200 from the customer. The entity does not expect to receive the remaining CU800.

What is the recognized amount of the impairment loss reversal?

Example 14: Valuation techniques

Entity A owns 250 ordinary shares in company XYZ, an unquoted company. Company XYZ has a total share capital of 5,000 shares with nominal value of CU10.

a) Entity XYZ's after-tax maintainable profits are estimated at CU70,000 per year. An appropriate price/earnings ratio determined from published industry data is 15 (before lack of marketability adjustment). Entity A's management estimates that the discount for the lack of marketability of company XYZ's shares and restrictions on their transfer is 20 per cent. Entity A values its holding of company XYZ shares on the basis of earnings.

b) An entity A estimates the fair value of the shares it owns in company XYZ using a net asset valuation technique. The fair value of company XYZ's net asset including those recognized in its statement of financial position and those that are not recognized is CU850,000.

What is the recognized value of the entity A's investment in company XYZ's shares in both cases?

Equity and liabilities[14]

Quiz 1: Equity includes:

- investments by the owners of the entity plus additions to those investments earned through profitable operations and retained for use in the entity's operations, minus reductions to owners' investments as a result of unprofitable operations and distributions to owners
- investments by the owners of the entity minus additions to those investments earned through profitable operations and retained for use in the entity's operations, plus reductions to owners' investments as a result of unprofitable operations and distributions to owners
- investments by the owners of the entity minus additions to those investments earned through profitable operations and retained for use in the entity's operations, minus reductions to owners' investments as a result of unprofitable operations and distributions to owners.

Quiz 2: Which financial instruments are recognized as equity:

- a financial instrument entitling the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation
- a financial instrument which is subordinate to all other classes of instruments
- a financial instrument entitling the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation, however these payments are subject to a maximum amount (a ceiling)
- a financial instrument entitling the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation, and these payments are required to be provided before liquidation (e.g. a mandatory dividend).

Quiz 3: Ordinary shares issued shall be measured at:

- at carrying amount of the cash or other resources received or receivable, excluding direct costs of issuing the equity instruments
- at carrying amount of the cash or other resources received or receivable, including direct costs of issuing the equity instruments
- at fair value of the cash or other resources received or receivable, excluding direct costs of issuing the equity instruments
- at fair value of the cash or other resources received or receivable, including direct costs of issuing the equity instruments.

Quiz 4: Option issued shall be accounted for:

- as for original issue of ordinary shares and other equity instruments
- as for original issue of bonds and other debt instruments
- as for original issue of forwards and other derivatives

[14] On the basis of IFRS for SMEs (IASB, 2009), Section 22. See Lecture 8.

Quiz 5: While accounting for treasury share reaquirement an entity shall:

- include into equity the fair value of the consideration given for the treasury shares
- deduct from equity the present value of the consideration given for the treasury shares
- deduct from equity the fair value of the consideration given for the treasury shares.

Example 1: issue of shares

SME A has issued share capital of CU100,000, which was contributed at par value of CU1 per share on incorporation of SME A.

- At a later date SME A issued further 50,000 ordinary shares at par value CU1 per share and sold them at a price of CU5 per share. The shares are issued for cash. (issued-subscribed and paid)
- At a later date SME A issued further 50,000 ordinary shares at par value CU1 per share and intended to sell them at a price of CU5 per share. The issue was subscribed by investors in total amount but cash for SME A was not delivered yet. (issued-subscribed, not yet paid)
- At a later date SME A intended to issue further 50,000 ordinary shares at par value CU1 per share and to sell them at a price of CU5 per share. The additional 50,000 ordinary shares have been subscribed for and paid for, but are yet to be issued. SME A does not have any obligation to refund the cash received (not yet issued-subscribed and paid)
- At a later date SME A intended to issue further 50,000 ordinary shares at par value CU1 per share and to sell them at a price of CU5 per share. The additional 50,000 ordinary shares have been subscribed for, but are yet to be issued and paid. (not yet paid-subscribed, not yet paid)

What is the accounting for issue of additional ordinary shares in every of the presented above cases? Compile extract from the statement of financial position.

Example 2: issue of shares

On 1 January 20X1 SME B issues 150,000 ordinary shares in exchange for 1,000 ounces of gold. The par value of the shares is CU2 per share when gold was trading at CU800 per ounce.

What is the accounting for issue of ordinary shares? Compile extract from the statement of financial position.

Example 3: issue of shares

SME A issues 200,000 ordinary shares at CU1.25 per share. The par value of the ordinary shares of the entity is CU1 per share. The shares are issued for cash and CU1,000 share issue costs are incurred.

What is the accounting for issue of ordinary shares?

Example 4: issue of shares, sales of options

At 31 December 20X0 as a year-end SME A has ordinary share capital of CU100,000, which was contributed at par on incorporation of SME A. The par value of the shares of the entity is CU1 per share.

On 1 January 20X1 the entity issues a further 150,000 ordinary shares at CU5 per share. The shares are issued for cash.

Also on 1 January 20X1, as an incentive to encourage investment, each shareholder is permitted to buy one share option for every share purchased on 1 January 20X1 at CU0.5 per option. Each option allows the holder to buy one share on 31 January 20X2 at CU4 per share. 100,000 share options are purchased.

On 31 January 20X2 100,000 share options are converted into ordinary shares. The commercial law to which the entity is subject requires to account for depletion of share option reserve as share premium.

What is the accounting for conversion of options into ordinary shares? Compile extract from the statement of financial position.

Example 5: bonus issue of shares

On 31 December 20X0 SME A's statement of financial position included the following items:

Item	Value (CU)
Share capital (10,000 ordinary shares at CU10 par value each)	100,000
Share premium	20,000
Retained earnings	1,080,000
Total equity attributable to owners	**1,200,000**

On 1 January 20X1 SME A gave its existing shareholders one bonus share for every two shares held. The commercial law to which the entity is subject requires bonus issues to first be accounted for as a depletion of share premium, if any.

What is the accounting for issue of bonus shares? Compile extract from the statement of financial position.

Example 6: treasury shares

On 31 December 20X0 SME A's statement of financial position included the following:

Item	Value (CU)
Share capital (10,000 ordinary shares at CU10 par value each)	100,000
Share premium	500,000
Retained earnings	600,000
Total equity attributable to owners	**1,200,000**

On 1 January 20X1 SME A reacquires 4,000 shares in itself from its shareholders for cash consideration of CU75 per share.

What is the accounting for treasury shares? Compile extract from the statement of financial position.

Example 7: cash distributions to owners

In 20X1 SME A declares and pays a dividend of CU0.5 per share to the owners of SME A in respect of the year ended 31 December 20X1. SME A has 100,000 ordinary shares in issue.

What is the accounting for cash distributions to owners?

Example 8: non-cash distributions to owners

On 31 December 20X1 SME A declares and distributes to its owner (who owns 100 per cent of SME A) a tract of land (classified as property, plant and equipment) with a carrying amount of CU1,000 and a fair value of CU100,000.

What is the accounting for non-cash distributions to owners?

Example 9: change in a parent's interest without loss of control

Since SME Z was formed it has been owned 75 per cent by SME A and 25 per cent by SME B. On 31 December 20X5, when the carrying amount of SME Z's net assets was CU100,000, SME A reduced its holding in SME Z to 60 per cent by selling 15 per cent of SME Z's shares to SME B for CU20,000.

What is the accounting for change in SME A's interest in SME Z?

Revenue[15]

Quiz 1: An entity shall recognize revenue when:

- goods are sold or services are exchanged for similar goods or services
- goods are sold or services are exchanged for similar goods or services in a transaction that has commercial substance
- goods are sold or services are exchanged for dissimilar goods or services in a transaction that has commercial substance.

Quiz 2: An entity shall include in revenue:

- only the gross inflows of economic benefits received and receivable by the entity on its own account, including all amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes
- only the gross outflows of economic benefits paid and payable by the entity from its own account, including all amounts paid on behalf of third parties such as sales taxes, goods and services taxes and value added taxes
- only the gross outflows of economic benefits paid and payable by the entity from its own account, excluding all amounts paid on behalf of third parties such as sales taxes, goods and services taxes and value added taxes
- only the gross inflows of economic benefits received and receivable by the entity on its own account, excluding all amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added taxes.

Quiz 3: An entity shall measure the revenue transaction at:

- the fair value of the goods or services received adjusted by the amount of any cash or cash equivalents transferred
- the present value of the goods or services given up adjusted by the amount of any cash or cash equivalents transferred
- the acquisition cost of the goods or services given up adjusted by the amount of any cash or cash equivalents transferred.

Quiz 4: An entity shall measure the revenue from transaction involving the rendering of services and construction contracts

- by reference to the percentage of completion method applied at the end of the reporting period
- by reference to the effective interest rate method applied at the end of the reporting period
- by reference to the discounting method applied at the end of the reporting period.

[15] On the basis of IFRS for SMEs (IASB, 2009), Section 23. See Lecture 8.

Example 1: revenue from the sale of goods

A manufacturer sells one of its products for CU500 per unit.

- However, the manufacturer gives customers a 20 per cent discount on orders of 100 units or more. A customer buys 100 units in a single order.
- However, the manufacturer gives customers a 20 per cent discount on orders of 100 units or more. Furthermore, when the customer has purchased 1,000 or more units in a single annual financial reporting period, the retailer awards the customer a further volume discount of 10 per cent of the list price for all units acquired by the customer in that financial year. A customer buys 100 units of the product each month for one annual financial reporting period.
- A manufacturer sells its product on credit. To encourage early settlement the retailer awards its customers a 10 per cent early settlement discount provided that the customer settles within 30 days of buying the goods. Normal credit terms are 60 days. Customer 1 pays within 30 days of the date of purchase to settle the amount owing for 90 units bought from the entity. Customer 2 pays within, 60 days after the date of purchase, to settle the amount owing for 90 units bought from the entity.

What is the recognized amount of revenue in each of the presented above cases?

Example 2: revenue from rendering of services

A calibration engineer entered into a contract to calibrate a manufacturer's machine at six-month intervals over a two-year period ending 31 December 20X2. On 1 January 20X1 the manufacturer paid the calibration engineer CU10,000. The cost to the calibration engineer of performing each calibration is approximately CU1,000.

What is the amount of revenue recognized at 31 December 20X1?

Example 3: revenue from rendering of services

An entity provides maintenance services to a third party under a contract for a fixed price of CU100,000. The entity initially estimated that its total costs under the contract will be CU60,000. At the end of the reporting period (20X1) the entity has incurred CU50,000 costs and it expects to incur a further CU15,000 costs to complete the maintenance services.

The entity determines the stage of completion of the contract by reference to the proportion that costs incurred for work performed to date bear to the estimated total costs.

What is the amount of revenue recognized at the end of the reporting period 20X1?

Example 4: revenue from rendering of services

A security firm enters into contracts to provide armed responses to homeowners when their alarm systems are triggered. The security firm has a 30 June year-end. On 1 January 20X1 one homeowner

paid the security firm CU10,000. In return for the fixed fee, the security firm is contractually obliged to provide its armed response services to the homeowner for a two-year period.

What is the amount of revenue recognized at the end of each reporting period during the lifetime of the contract?

Example 5: revenue from rendering of services

A vehicle dealer enters into contracts to maintain its customer's new vehicle for a three-year period.

On 1 January 20X1 a customer paid the dealer CU10,000. Experience has shown that the costs to the dealer of maintaining new vehicles of the model owned by the customer are on average CU1,000 in the first year of ownership, CU1,000 in the second year and CU3,000 in the third year.

What is the amount of revenue recognized at the end of each reporting period during the lifetime of the contract?

Example 6: revenue from construction contracts

Under a construction contract, a contractor agrees to a fixed contract price of CU2,000 to refurbish the kitchen of a residential flat. The contractor's initial estimate of contract costs at 1 February 20X1, the date the contract is agreed, is CU1,200. The contract price will be paid to the contractor on completion of the refurbishment. The refurbishment was completed on 31 July 20X1 at a cost of CU1,250 (i.e. actual costs incurred under the contract as at 31 July 20X1 are CU1,250).

- The contractor has a 31 December year-end.
- The contractor has a 30 June year-end. As at 30 June 20X1 contract costs incurred for work performed to date are CU800 and the contractor estimates that costs to complete the contract will be CU400 (i.e. total contract costs will be CU1,200). The contractor determines the stage of completion of the contract by calculating the proportion that contract costs incurred for work performed to date bear to the latest estimated total contract costs.

What is the amount of revenue recognized at the end of each reporting period during the lifetime of the contract in each of the presented above cases?

Example 7: revenue from construction contracts

Under a construction contract, a contractor agrees to receive a 40 per cent fixed return on its direct contract costs from the customer. The contractor's initial estimate of contract costs at 1 January 20X1, the date the contract is agreed, is CU2,000 (all of which are considered direct costs). Therefore, expected revenue under the contract is CU2,800. The contract is expected to last two years. The contractor has a 31 December year-end.

At 31 December 20X1 contract costs of CU1,045 have been incurred and the contractor expects total contract costs to be CU1,900 (all considered direct costs). At 31 December 20X2 actual costs are CU2,000. However, only CU1,800 meet the criteria in the contract to be considered direct costs when determining the 40 per cent fixed return.

The contractor determines the stage of completion of the contract by calculating the proportion that contract costs incurred for work performed to date bear to the latest estimated total contract costs.

What is the amount of revenue recognized at the end of each reporting period during the lifetime of the contract?

Income tax[16]

Quiz 1: Income tax consists of:

- domestic taxes that are based on taxable profits
- foreign taxes that are based on taxable profits
- taxes that are payable by a subsidiary, associate or joint venture on distributions to the reporting entity
- all of the above.

Quiz 2: Decide in which order individual procedures which are presented below should take place while accounting for a deferred tax (the first four steps of the deferred tax methodology)

(i) Compute any temporary differences, unused tax losses and unused tax credits;

(ii) Determine the tax basis at the reporting date of all those assets and liabilities, and of other items that have a tax basis;

(iii) Recognize deferred tax assets and liabilities arising from the temporary differences, unused tax losses and unused tax credits;

(iv) Identify which assets and liabilities are expected to affect taxable profit if they were recovered or settled for their carrying amount.

- (i), (ii), (iii), (iv)
- (iv), (ii), (i), (iii)
- (ii), (iv), (i), (iii)
- (ii), (i), (iii), (iv).

Quiz 3: Decide which statements are true:

- An entity shall recognize a current tax liability for tax payable on taxable profit for the current and past periods.
- An entity shall measure a current tax liability (asset) at the amounts it expects to pay (recover) using the tax rates and laws that have been enacted or substantively enacted by the reporting date.
- An entity shall not recognize changes in a current tax liability or current tax asset.
- An entity shall not include in the amounts recognized the effect of the possible outcomes of a review by the tax authorities.

Quiz 4: Deferred tax arises from:

- the difference between the amounts recognized for the entity's assets and liabilities in the statement of financial position and the recognition of those assets and liabilities by the tax authorities, and the carryforward of currently unused tax losses and tax credits

[16] On the basis of IFRS for SMEs (IASB, 2009), Section 29. See Lecture 9.

- the difference between the amounts recognized for the entity's assets and liabilities in the statement of financial position and the recognition of those assets and liabilities by the tax authorities
- the difference between the amounts which were recognized by an entity and which were paid by an entity in current and past periods.

Example 1: current tax

An entity has a year-end of 31 March. The tax year in the jurisdiction runs from 1 April to 31 March. The relevant income tax rate for 20X7/20X8 is 15 per cent. The entity has an accounting profit of CU150,000 for the year ended 31 March 20X8. The rules determining the determination of taxable profit in the jurisdiction are identical to the IFRS for SMEs for the year ended 31 March 20X8, except for the following income and expenses:

- CU20,000 royalty revenue recognized in 20X8 is exempt from income tax.
- No tax deduction is permitted for entertainment expenses of CU5,000.
- No tax deduction for bad debts is allowed until the debtors are derecognized from the financial statements. The bad debt provision, which is offset against trade receivables, was CU4,000 on 31 March 20X7 and CU4,500 on 31 March 20X8.
- The building is depreciated at a faster rate for tax purposes. The amount of tax depreciation deductible in the year ended 20X8 was CU43,000. The amount of accounting depreciation in the financial statements for the same building for the year was CU35,000.

The deferred tax impact of the transactions above is ignored in this question. What is the recognized amount of current income tax?

Example 2: current tax

An entity calculates its taxable profit to be CU100,000 for the tax year 20X7/20X8 determined in accordance with the relevant tax rules in its jurisdiction. The tax year in the jurisdiction runs from 1 April to 31 March. The appropriate income tax rate for 20X7/20X8 is 20 per cent. The current tax payable for the tax year 20X7/20X8 is payable by 30 September 20X8 and the entity makes the payment on 15 September 20X8. The entity has a 31 March financial year end (end of the reporting period).

What is the recognized amount of current income tax? How should it be accounted for?

Example 3: carryback for current tax loss

In accordance with the relevant tax rules in its jurisdiction, an entity estimates its taxable loss for the tax period 20X7/20X8 at CU9,000. The tax legislation in the jurisdiction permits entities to carry back losses three tax years into the past. Taxable income in 20X6/20X7 was CU7,000, in 20X5/20X6 it was CU5,000 and in 20X4/20X5 it was CU3,000. The entity has a 30 September

financial year-end (end of the reporting period) and this coincides with the entity's tax year. The relevant income tax rates are as follows:

- 18 per cent in 20X6/20X7 and 20X7/20X8
- 20 per cent in 20X5/20X6
- 17 per cent in 20X4/20X5.

What is the recognized amount of carryback for current tax loss if:

- The tax legislation in the jurisdiction permits entities to carry back losses three tax years into the past and there is no requirement on which of the three years the loss is set off against first.
- The tax legislation in the jurisdiction permits entities to carry back losses three tax years into the past and there is a requirement that the entity should set the losses against the most recent period possible, i.e. 20X6/20X7 first, 20X5/20X6 second and 20X4/20X5 last.

Example 4: deferred tax

The only difference between an entity's accounting profit and its taxable profit arises from the laws permitting the cost of a particular type of machinery with a useful life of three years to be fully deductible for tax purposes in the year of purchase. For financial reporting purposes, the entity depreciates the machine on a straight-line basis over three years to a nil residual value. The entity acquired the machine for CU600 on 1 January 20X1. Its accounting profit is CU1,000 for each of the years 20X1–20X3. The entity incurs income tax at the rate of 30 per cent of its taxable profit.

What is the recognized amount of current tax and deferred tax liabilities in every of three years?

Example 5: deferred tax

An entity has an item of equipment that is depreciated faster for tax purposes than for financial reporting purposes. On 31 December 20X1 a temporary difference of CU1,000 arises related to this equipment that is expected to increase taxable profit in the future. The temporary difference is expected to reverse in five years' time. In the entity's jurisdiction, tax is payable at 20 per cent on the first CU100,000 of taxable profit earned, 25 per cent on the next CU200,000 of taxable profit earned, 30 per cent on the next CU200,000 of taxable profit earned, and 35 per cent on any remainder (ie excess above CU500,000). In 20X1 the entity earned taxable profit of CU400,000. In 20X6 the entity expects to earn taxable profit of CU650,000.

What is the recognized amount of differed tax liability?

Foreign currency transactions[17]

Quiz 1: An entity's functional currency is:

- the currency in which the financial statements are presented
- the currency of the primary economic environment in which the entity operates
- the currency in which sales prices for the entity's goods and services are denominated and settled
- always the local currency of the country in which the entity is based.

Quiz 2: Which of the following factors is not a primary indicator of an entity's functional currency:

- the currency that mainly influences labor, material and other costs of providing goods or services
- the currency that mainly influences sales prices for goods and services
- the currency in which funds from investing activities are generated
- the currency of the country whose competitive forces and regulations mainly determine the sales prices of the goods and services.

Quiz 3: Entity's net investment in that foreign operation is:

- a long-term monetary item that is receivable from or payable to a foreign operation in the foreseeable future
- a long-term monetary item that is receivable from or payable to a foreign operation, but not in the foreseeable future
- a short-term monetary item that is receivable from or payable to a foreign operation, but not in the foreseeable future.

Quiz 4: The effect of a change in functional currency is accounted for:

- prospectively
- retrospectively
- both variants mentioned above.

Quiz 5: An entity may present its financial statements in:

- any currency (or currencies)
- functional currency only.

<u>Example 1: reporting foreign currency transactions in the functional currency, initial recognition</u>

An entity with a functional currency of CU sells inventory with a carrying amount of CU10,000 to a customer on credit for FCU30,000. The spot exchange rate when the sale is recognized is CU1 = FCU2.

[17] On the basis of IFRS for SMEs (IASB, 2009), Section 30. See Lecture 9.

What is the recognized amount of sale? How it should be accounted for?

Example 2: reporting foreign currency transactions in the functional currency, initial recognition

An entity with a functional currency of CU borrows FCU100,000 from a bank when the spot exchange rate is CU1 = FCU2.5.

What is the recognized amount of borrowing? How it should be accounted for?

Example 3: reporting foreign currency transactions in the functional currency, initial recognition

An entity with a functional currency of CU buys a machine (property, plant and equipment) from an overseas supplier for cash of FCU10,000. The spot exchange rate is FCU1 = CU2 on the date the machine is initially recognized.

What is the recognized amount of machine? How it should be accounted for?

Example 4: reporting foreign currency transactions in the functional currency, subsequent recognition and measurement

On 24 December 20X1 an entity with a functional currency of CU buys raw materials from a supplier on credit for FCU100,000. The entity pays the supplier on 17 January 20X2. The entity has a financial year-end of 31 December 20X1.

The spot exchange rates are as follows:

- 24 December 20X1: CU2 = FCU1
- 31 December 20X1: CU2.1 = FCU1
- 17 January 20X2: CU2.05 = FCU1

What is the recognized amount of purchase of inventories? How it should be accounted for?

Example 5: reporting foreign currency transactions in the functional currency, subsequent recognition and measurement

On 1 January 20X1 a bank transfers FCU5,000 to an entity in return for a promise to pay fixed interest of 8 per cent per year for two years (due at the end of each year of the loan period, i.e. 31 December) and a payment of FCU5,000 at the end of the two-year period.

At the inception of the loan 8 per cent is the market rate for similar two-year fixed-interest FCU-denominated loans.

The entity's functional currency is CU.

Exchange rates over the loan are:

- 1 January 20X1: CU1 = FCU5
  Average exchange rate in 20X1: CU1 = FCU5.06
- 31 December 20X1: CU1 = FCU5.1
  Average exchange rate in 20X2: CU1 = FCU4.9
- 31 December 20X2: CU1 = FCU4.8

In this example, the average currency exchange rate for the year is not materially different from the actual rate.

What is the recognized amount of loan during its lifetime? How it should be accounted for?

<u>Example 6: reporting at the end of the subsequent reporting periods, overseas investment property</u>

On 1 June 20X0 an entity based in country A with a functional currency of CU buys an investment property in country B (local currency FCU) for FCU500,000.

The fair value of the investment property is reliably measurable in FCU without undue cost or effort on an ongoing basis. Consequently, in accordance with Section 16 Investment Property, the entity measures its investment property, after initial recognition ,at fair value through profit or loss.

The entity has a year-end of 31 December.

The spot exchange rates and fair values of the investment property (FVIP) are as follows:

- 1 June 20X0: CU1 = FCU1.1 and FVIP = FCU500,000
- 31 December 20X0: CU1 = FCU1.05 and FVIP = FCU520,000
- 31 December 20X1: CU1 = FCU1.2 and FVIP = FCU540,000

On 1 April 20X2 the investment property is sold for FCU570,000 when the exchange rate is CU1 = FCU1.1.

What is the recognized amount overseas investment property during its lifetime? How it should be accounted for?

Transition to IFRS[18]

Quiz 1: Financial statements prepared in accordance with these IFRS are an entity's first such financial statements if, for example, the entity:

- did not present financial statements for previous periods
- presented its most recent previous financial statements under national requirements that are consistent with these IFRS in all respects
- presented its most recent previous financial statements in conformity with full IFRSs.

Quiz 2: Decide in which order individual procedures which are presented below should take place while compiling entity's opening statement of financial position as of its date of transition to the IFRS for SMEs (i.e. the beginning of the earliest period presented):

(i) reclassify items that it recognized under its previous financial reporting framework as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under these IFRS;

(ii) apply this IFRS in measuring all recognized assets and liabilities;

(iii) recognize all assets and liabilities whose recognition is required by the IFRS for SMEs;

(iv) not recognize items as assets or liabilities if these IFRS does not permit such recognition.

- (i), (ii), (iii), (iv)
- (iv), (iii), (ii), (i)
- (iii), (iv), (i), (ii)
- (ii), (i), (iv), (iii).

Quiz 3: An entity that had never presented financial statements decided to adopt the IFRS for SMEs in 20X8. The entity's financial statements for the year ended 31 December 20X8 conformed to the IFRS for SMEs. Full comparative information is provided for one year. What is the entity's date of transition to the IFRS for SMEs?

- 1 January 20X5
- 1 January 20X6
- 1 January 20X7
- 1 January 20X8.

[18] On the basis of IFRS for SMEs (IASB, 2009), Section 35. See Lecture 10.

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