Accounting (Basics) - Lecture 2

Financial statements presentation

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Overall principles

- **Fair presentation** – it 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.
- **Compliance with IFRS for SMEs** – an entity whose financial statements comply with the IFRS for SMEs shall make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with the IFRS for SMEs unless they comply with all the requirements of these IFRS.
- **Going concern** – when preparing financial statements, the management of an entity using IFRS for SMEs shall make an assessment of the entity's ability to continue as a going concern. An entity is a going concern unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

Overall principles

- **Frequency of reporting** – an entity shall present a complete set of financial statements at least annually.
- **Consistency of presentation** – an entity shall retain the presentation and classification of items in the financial statements from one period to the next unless it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies, estimates and errors.
- **Comparative information** – an entity shall disclose comparative information in respect of the previous comparable period for all amounts presented in the current period's financial statements.

Overall principles

- **Materiality and aggregation** – an entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial.
- **Complete set of financial statements** – a complete set of financial statements of an entity shall include a statement of financial position, a statement of changes in equity for the reporting period, a statement of cash flows for the reporting period, notes.
- **Identification of the financial statements** – an entity shall clearly identify each of the financial statements and the notes and distinguish them from other information in the same document. Also an entity shall display the name of the reporting entity and any change in its name since the end of the preceding reporting period, whether the financial statements cover the individual entity or a group of entities, the date of the end of the reporting period and the period covered by the financial statements, the presentation currency, the level of rounding, if any, used in presenting amounts.

Statement of Financial position

- **Statement of financial position** reports the relationship of the assets, liabilities and equity of an entity at a specific point in time.
- As a minimum, the statement of financial position shall include line items that present the following amounts:

a) cash and cash equivalents
b) trade and other receivables
c) financial assets (excluding amounts shown in (a), (b), (j), (k))
d) Inventories
e) property, plant and equipment
f) investment property carried at fair value through profit or loss
g) intangible assets
h) biological assets carried at cost less accumulated depreciation and impairment.
i) biological assets carried at fair value
j) investments in associates
k) investments in jointly controlled entities
l) trade and other payables
m) financial liabilities (excluding amounts shown in (l) and (p))
n) liabilities and assets for current tax
o) deferred tax liabilities and deferred tax assets (these shall always be classified as non-current)
p) provisions
q) non-controlling interest, presented within equity separately from the equity attributable to the owners of the parent
r) equity attributable to the owners of the parent

Statement of Financial position

- An entity shall present **current** and **non-current assets**, and **current** and **non-current liabilities**, as separate classifications in its statement of financial position, except when a presentation based on liquidity provides information that is reliable and more relevant.
- An entity shall classify **an asset as current** when:
  a) it expects to realize the asset, or intends to sell or consume it, in the entity's **normal operating cycle**;
  b) it holds the asset **primarily for the purpose of trading**;
  c) it expects to realize the asset **within twelve months** after the reporting date; or
  d) the asset is **cash or a cash equivalent**, unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

Statement of Financial position

- An entity shall classify all **other assets as non-current**. When the entity's normal operating cycle is not clearly identifiable, its duration is assumed to be twelve months.
- An entity shall classify a **liability as current** when:
  a) it expects to settle the liability in the **entity's normal operating cycle**;
  b) the liability is due to be settled **within twelve months** after the reporting date; or
  c) the entity **does not have an unconditional right to defer settlement of the liability** for at least twelve months after reporting date.
- An entity shall classify all **other liabilities as non-current**.

Statement of Comprehensive Income and Income Statement

- **Statement of comprehensive income and income statement** report the relationship of the income and expenses of an entity during a specific period of time.
- An entity shall present its total comprehensive income for a period either:
  a) in a **single statement of comprehensive income**, in which case the statement of comprehensive income presents all items of income and expense recognized in the period, or
  b) in **two statements** – an **income statement and a statement of comprehensive income** – in which case the income statement presents all items of income and expense recognized in the period except those that are recognized in total comprehensive income outside of profit or loss as permitted or required by this IFRS.
- **A change from the single-statement approach** to the two-statement approach, or vice versa, is a **change in accounting policy**.

Statement of Comprehensive Income and Income Statement

An entity's statement of comprehensive income for the year ended 31 December 20X8

	20X8	*20X7*
		Restated
	CU	*CU*
Revenue	745,000	693,000
Other income	45,000	36,520
Changes in inventories of finished goods and work in progress	31,000	23,000
Raw material and consumables used	(461,000)	(342,000)
Employee benefits expense (20X7: previously stated–CU180,000)	(220,000)	(197,000)
Depreciation and amortisation expense	(45,000)	(40,500)
Other expenses	(9,000)	(8,900)
Finance costs	(18,000)	(21,320)
Profit before tax (20X7: previously stated CU159,800)	**68,000**	**142,800**
Income tax expense (20X7: previously stated–CU39,950)	(42,000)	(35,700)
PROFIT FOR THE YEAR (20X7: previously stated CU119,850)	**26,000**	**107,100**
Other comprehensive income:		
Exchange differences on translating foreign operations, net of tax	(3,000)	6,000
Actuarial gains on defined benefit pension obligations, net of tax	1,000	(2,000)
Other comprehensive income for the year, net of tax	**(2,000)**	**4,000**
TOTAL COMPREHENSIVE INCOME FOR THE YEAR (20X7: previously stated CU123,850)	**24,000**	**111,100**

Statement of Comprehensive Income and Income Statement

An entity's income statement for the year ended 31 December 20X8

	20X8	*20X7*
		Restated
	CU	*CU*
Revenue	745,000	693,000
Other income	45,000	36,520
Changes in inventories of finished goods and work in progress	31,000	23,000
Raw material and consumables used	(461,000)	(342,000)
Employee benefits expense (20X7: previously stated–CU180,000)	(220,000)	(197,000)
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PROFIT FOR THE YEAR (20X7: previously stated CU119,850)	**26,000**	**107,100**

An entity – statement of comprehensive income for the year ended 31 December 20X8

	20X8	*20X7*
		Restated
	CU	*CU*
Profit for the year (20X7: previously stated CU119,850)	**26,000**	**107,100**
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Other comprehensive income for the year, net of tax	(2,000)	4,000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR (20X7: previously stated CU123,850)	**24,000**	**111,100**

Statement of Comprehensive Income and Income Statement

- Under the single-statement approach, the statement of comprehensive income shall include all items of income and expense recognized in a period. IFRS for SMEs provides different treatment for the following circumstances:
  a) **The effects of corrections of errors and changes in accounting** policies are presented as **retrospective adjustments of prior periods rather than as part of profit or loss** in the period in which they arise .
  b) **Three types of other comprehensive income** are recognized as part of total comprehensive income, outside of profit or loss, when they arise:
     i. some **gains and losses** arising **on translating the financial statements of a foreign operation**
     ii. some **actuarial gains and losses**
     iii. some **changes in fair values of hedging instruments**

Statement of Comprehensive Income and Income Statement

- As a minimum, an entity shall include in the statement of comprehensive income line items that present the following amounts for the period:

a) revenue
b) finance costs
c) share of the profit or loss of investments in associates and jointly controlled entities
d) tax expense excluding tax allocated to items (e), (g) and (h)
e) a single amount comprising the total of:
   i. the post-tax profit or loss of a discontinued operation, and
   ii. the post-tax gain or loss recognized on the measurement to fair value less costs to sell or on the disposal of the net assets constituting the discontinued operation.
f) profit or loss
g) each item of other comprehensive income
h) share of the other comprehensive income of associates and jointly controlled entities
i) total comprehensive income

Statement of Comprehensive Income and Income Statement

- Under the **two-statement approach**, the income statement shall display, as a minimum, line items that present the amounts in above mentioned paragraph (a) - (f) for the period, with profit or loss as the last line. The **statement of comprehensive income** shall begin with **profit or loss as its first line** and shall display, as a minimum, line items that present the amounts in above mentioned paragraph (g) - (i), and profit or loss for the period as well as **total comprehensive income for the period**.
- Regardless to chosen approach – single-statement or two-statement approach – IFRS for SMEs requires:
  a) to present the **effects of corrections of errors and changes as retrospective adjustments of prior periods rather than as part of profit or loss** in the period in which they arise.
  b) to present **additional line items, headings and subtotals** in the statement of comprehensive income, when such presentation is relevant for understanding of entity’s financial performance.

Statement of Comprehensive Income and Income Statement

c) **not to present** or describe any items of **income and expense as 'extraordinary items'** in the statement of comprehensive income or in the notes.

d) to present an **analysis of expenses** using a classification based on either the **nature** of expenses or the **function** of expenses within the entity:

   i. **by nature of expense** - expenses are aggregated in the statement of comprehensive income according to their nature, e.g. depreciation, purchases of materials, transport costs

   ii. **by function of expense** – expenses are aggregated according to their function as part of cost of sales or, for example, the costs of distribution or administrative activities. At a minimum, an entity discloses its cost of sales under this method separately from other expenses.

Statement of Change in Equity and Statement of Income and Retained Earnings

- **The statement of changes in equity** presents 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, and the amounts of investments by, and dividends and other distributions to, equity investors during the period.
- An entity shall present a statement of changes in equity showing in the statement:
  a) **total comprehensive income** for the period, showing separately the total amounts attributable to owners of the parent and to non-controlling interests.

Statement of Change in Equity and Statement of Income and Retained Earnings

b) **for each component of equity** – the effects of **retrospective application** or retrospective restatement recognized.

c) **for each component of equity** – a r**econciliation** between the carrying amount at the beginning and the end of the period, separately disclosing changes resulting from:

   i. profit or loss.

   ii. each item of other comprehensive income.

   iii. the amounts of investments by, and dividends and other distributions to, owners, showing separately issues of shares, treasury share transactions, dividends and other distributions to owners, and changes in ownership interests in subsidiaries that do not result in a loss of control.

Statement of Change in Equity and Statement of Income and Retained Earnings

- **The statement of income and retained earnings** presents an entity's profit or loss and changes in retained earnings for a reporting period. IFRS for SMEs permits an entity to present a statement of income and retained earnings in place of a statement of comprehensive income and a statement of changes in equity if the only changes to its equity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy.
- An entity shall present, in the statement of income and retained earnings, the following items in addition to the information required by statement of comprehensive income and income statement:
    a) **retained earnings** at the **beginning of the reporting period**.

Statement of Change in Equity and Statement of Income and Retained Earnings

b) **dividends** declared and paid or payable during the period.

c) **restatements** of retained earnings for **corrections of prior period errors**.

d) restatements of retained earnings for **changes in accounting policy.**

e) **retained earnings** at the **end of the reporting period**.

Statement of Cash Flow

- **Cash equivalents** are **short-term, highly liquid investments held to meet short-term cash commitments** rather than for investment or other purposes. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. **Bank overdrafts** are normally considered financing activities similar to borrowings. However, if they are repayable on demand and form an integral part of an entity's cash management, bank overdrafts are a component of cash and cash equivalents.
- An entity shall present a statement of cash flows that presents cash flows for a reporting period classified by **operating activities**, **investing activities and financing activities**.
- **Operating activities** are the **principal revenue-producing activities of the entity.** Therefore, cash flows from operating activities generally result from the transactions and other events and conditions that enter into the determination of profit or loss.

Statement of Cash Flow

- Examples of cash flows from operating activities are:
  a) cash receipts from the **sale of goods** and the **rendering of services**.
  b) cash **receipts from royalties, fees, commissions** and other revenue.
  c) cash **payments to suppliers** for goods and services.
  d) cash payments to and on behalf of employees.
  e) cash **payments or refunds of income tax**, unless they can be specifically identified with financing and investing activities.

Statement of Cash Flow

- **Investing activities** are the **acquisition and disposal of long-term assets** and other investments not included in cash equivalents. Examples of cash flows arising from investing activities are:
  a) cash payments to **acquire property, plant and equipment, intangible assets and other long-term assets**.
  b) cash receipts from **sales of property, plant and equipment, intangibles and other long-term assets.**
  c) cash payments **to acquire equity or debt instruments of other entities and interests in joint ventures.**
  d) cash receipts from **sales of equity or debt instruments of other entities and interests in joint ventures.**
  e) cash advances and loans made to other parties.
  f) cash receipts from the repayment of advances and loans made to other parties.
  g) cash payments for futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the payments are classified as financing activities.
  h) cash receipts from futures contracts, forward contracts, option contracts and swap contracts, except when the contracts are held for dealing or trading, or the receipts are classified as financing activities.

Statement of Cash Flow

- **Financing activities** are activities that result in **changes in the size and composition of the contributed equity and borrowings of an entity.** Examples of cash flows arising from financing activities are:
  a) cash proceeds from **issuing shares or other equity instruments.**
  b) cash payments to owners **to acquire or redeem the entity's shares.**
  c) cash proceeds from **issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings**.
  d) cash **repayments of amounts borrowed**

Statement of Cash Flow

- An entity shall present **cash flows from operating activities** using either:
  a) **indirect method**, whereby the net cash flow from operating activities is determined **by adjusting profit or loss** for the effects of:
     i. changes during the period in **inventories and operating receivables and payables**;
     ii. **non-cash items** such as depreciation, provisions, deferred tax, accrued income (expenses) not yet received (paid) in cash, unrealized foreign currency gains and losses, undistributed profits of associates, and non-controlling interests; and
     iii. all other items for which the cash effects relate to investing or financing.

  or

Statement of Cash Flow

b) **the direct method**, whereby **net cash flow** from operating activities is presented by disclosing information about major classes of gross cash receipts and gross cash payments. Such information may be obtained either:

   i. from the **accounting records** of the entity; or

   ii. **by adjusting sales, cost of sales and other items in the statement of comprehensive income** (or the income statement, if presented) for:

      - changes during the period in inventories and operating receivables and payables;
      - other non-cash items; and
      - other items for which the cash effects are investing or financing cash flows.

Statement of Cash Flow

- An entity shall present **separately major classes of gross cash receipts and gross cash payments** arising **from investing and financing activities.**
- An entity shall record cash flows arising from transactions in a **foreign currency** in the **entity's functional currency by applying to the foreign currency amount the exchange rate** between the functional currency and the foreign currency **at the date of the cash flow.** The entity shall translate **cash flows of a foreign subsidiary at the exchange rates** between the entity's functional currency and the foreign currency **at the dates of the cash flows**.
- **Unrealized gains and losses** arising from changes in **foreign currency exchange rates are not cash flows**. The entity shall remeasure cash and cash equivalents held during the reporting period at period-end exchange rates. **The entity shall present the resulting unrealized gain or loss separately from cash flows from operating, investing and financing activities**

Statement of Cash Flow

- An entity shall **present separately cash flows from interest and dividends received and paid**, and classify them as cash flows from **operating, investing or financing activities**.
- An entity shall **present separately cash flows arising from income tax** and shall classify them as cash flows from **operating activities** unless they can be specifically identified with financing and investing activities.
- Many investing and financing activities do not have a direct impact on current cash flows even though they affect the capital and asset structure of an entity. **An entity shall exclude from the statement of cash flows investing and financing transactions that do not require the use of cash or cash equivalents.**

Notes to Financial Statements

- The notes shall:
  a) present information about the **basis** of preparation of the financial statements and the specific accounting policies used;
  b) disclose the **information required** by IFRS for SMEs that is not presented elsewhere in the financial statements; and
  c) provide **information** that is not presented elsewhere in the financial statements but is **relevant** to an understanding of any of them.
- An entity shall, as far as practicable, present the notes in a systematic manner. An entity shall cross-reference each item in the financial statements to any related information in the notes.
- An entity normally presents the notes in the following **order:**
  a) a statement that the financial statements have been prepared in **compliance with IFRS for SMEs**;

Notes to Financial Statements

b) **a summary of significant accounting policies applied**, which comprises disclosure of:

   i. the **measurement basis** (or bases) used in preparing the financial statements.

   ii. the **other accounting policies** used that are relevant to an understanding of the financial statements.

iii. **supporting information** for items presented in the financial statements, in the sequence in which each statement and each line item is presented.

- An entity shall disclose in the notes information about **the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date**, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of their nature and their carrying amount at the end of the reporting period.