1
The regulatory framework and the standard-setting process

1.1 Introduction to the standard-setting process

The first Statement of Standard Accounting Practice (SSAP) was published in 1970 in the United Kingdom. Prior to this, there were relatively few financial reporting requirements for companies. It was the highly publicised scandals of the late 1960s, such as the GEC takeover of AEI, that brought the need for more extensive regulations and the instigation of a standards-setting body.

The International Accounting Standards Committee (IASC) was set up in 1973. Between 1973 and its demise in April 2001 it published 41 international accounting standards (IASs). These were largely drafted by part-time volunteer boards from a wide background of experience and range of countries. It resulted in a rather slow and protracted process of developing standards. Many of these offered a number of options, and thus were largely ignored by the major standard-setting countries. However, problems started to emerge with multinationals having to prepare a number of different sets of financial statements for different jurisdictions. It therefore became difficult to make comparisons across countries – for example, when Daimler Benz was first quoted in New York, the same set of financial statements disclosed a profit of 630DM in Germany but a loss of 1300DM using US rules. The International Organisation for Securities and Exchange Commissions (IOSCO), a loose federation of all the major stock exchanges in the world, therefore offered a challenge to the IASC to carry out a review of existing standards to ensure that many of the options be removed and the standards strengthened. If satisfactorily achieved, then IASs would become acceptable for cross-border listings. That challenge was taken up by the Secretary-General of the IASC, Sir Bryan Carsberg, and he largely achieved his objectives by the end of 2000.

The big push, however, for the development of international standards was the need to solve the problem of financial instruments. This could only be solved on an international basis, and a group of standard setters (known as G4 + 1) attempted to get agreement. In addition, they started to investigate leasing and reporting financial performance. They were well on their way to producing some very interesting international agreements on future standards. However, the European Commission forced the G4 + 1 group to dissolve when it announced that all listed companies in the EC must comply, for their consolidated financial statements, with international standards. The G4 + 1 group (basically the UK/Ireland, USA, Canada New Zealand and Australia, and the IASC as observer) agreed to put their
support behind the development of a new Board to further improve existing international standards and to develop new standards. A new structure was finally set up in April 2001.

The principal body under the new structure is the International Accounting Standards Board (IASB), which has sole responsibility for establishing International Financial Reporting Standards (IFRSs). Other components of the structure are the Trustees of the IASC Foundation, the International Financial Reporting Interpretations Committee (IFRIC) and the Standards Advisory Council (SAC). The IASB held its first official meeting in London in April 2001, at which meeting it was resolved that all Standards and Interpretations issued by the IASC should continue to be applicable unless and until they are amended or withdrawn. It was agreed that new IASB standards would be called International Financial Reporting Standards (IFRSs).

When the term 'IFRSs' is used, it includes standards and interpretations approved by the IASB, and IAS and interpretations issued by the IASC.

The revised structure of the IASC is illustrated in Figure 1.1.

1.2 Trustees

The governance of the IASC Foundation rests with the Trustees. The initial nineteen Trustees include six from North America, seven from Europe, four from the Asia Pacific region, and one each from Africa and South America. They come from diverse functional backgrounds.

The Trustees have responsibility to:

- appoint the members of the Board, including those that will serve in liaison capacities with national standard setters, and establish their contracts of service and performance criteria;
• appoint the members of the IFRIC and the SAC;
• review annually the strategy of the IASC and its effectiveness;
• approve annually the budget of the IASC and its effectiveness;
• review broad strategic issues affecting accounting standards, promote the IASC and its work, and promote the objective of rigorous application of IFRS, provided that the Trustees shall be excluded from involvement in technical matters relating to accounting standards;
• establish and amend operating procedures for the Board, the IFRIC and the SAC.

The Trustees act by simple majority vote, except for amendments to the Constitution, which require a 75% majority.

1.3 The International Accounting Standards Board (IASB)

The IASB is the principal body under the new structure. The Board has fourteen members, of whom twelve serve full time and two part time. The Board's principal responsibilities are to:
• develop and issue IFRSs and Exposure Drafts; and
• approve Interpretations developed by the IFRIC.

The key qualification for Board membership is technical expertise. The Trustees must also ensure that the Board is not dominated by any particular constituency or regional interest. To achieve a balance of perspectives and experience, at least five members must have backgrounds as practising auditors, at least three as financial statement preparers, at least three as users of financial statements, and at least one as an academic.

Seven of the fourteen board members have direct liaison responsibility with one or more national standard setters. The Board has full discretion over its technical agenda. It may outsource detailed research or other work to national standard setters or other organisations. The Board will normally form Steering Committees or other types of specialist advisory groups to give advice on major projects. The Board is required to consult the Standards Advisory Council on major projects, agenda decisions and work priorities.

Before issuing a final Standard, the Board must publish an Exposure Draft for public comment. Normally, it will also publish a Draft Statement of Principles or other discussion document for public comment on major projects.

The Board will normally issue bases for conclusions within IFRS and Exposure Drafts. Although there is no requirement to hold public hearings or to conduct field tests for every project, the Board must, in each case, consider the need to do so.

The publication of an Exposure Draft, IFRS or final Interpretation of the IFRIC requires approval by eight of the fourteen members of the Board. Other decisions of the Board, including the publication of a Draft Statement of Principles or discussion paper, require a simple majority of the members of the Board present at a meeting.

The IASB generally meets monthly (except August) for three to five days. It holds several meetings each year with representatives of its liaison standard-setting bodies, and generally three meetings each year with the Standards Advisory Council.
1.4 The Standards Advisory Council (SAC)

The Standards Advisory Council currently has 49 members, and provides a forum for organisations and individuals with an interest in international financial reporting to participate in the standard-setting process. Members are appointed for a renewable term of 3 years, and have diverse geographical and functional backgrounds. The Chairman of the IASB is also the Chairman of the SAC.

The SAC will normally meet three times each year at meetings open to the public to:

- advise the Board on priorities in the Board’s work;
- inform the Board of the implications of proposed standards for users and preparers of financial statements; and
- give other advice to the Board or to the Trustees.

1.5 The International Financial Reporting Interpretations Committee (IFRIC)

The International Financial Reporting Interpretations Committee (IFRIC) (until 2002 known as the Standing Interpretations Committee) has twelve members appointed by the Trustees for terms of 3 years. IFRIC members are not salaried, but their expenses are reimbursed. The IFRIC is chaired by a non-voting Chair who can be one of the members of the IASB, the Director of Technical Activities, or a member of the IASB’s senior technical staff. (In fact, the Director of Technical Activities was appointed the Chair of the IFRIC.) The IFRIC’s responsibilities are to:

- interpret the application of IFRS and provide timely guidance on financial reporting issues not specifically addressed in IFRS in the context of the IASB’s Framework, and undertake other tasks at the request of the Board;
- publish Draft Interpretations for public comment and consider comments made within a reasonable period before finalising an Interpretation; and
- report to the Board and obtain Board approval for final Interpretations.

A Draft or final Interpretation is approved by the IFRIC when not more than three voting members of the IFRIC vote against the Draft or final Interpretation. By allowing the IFRIC to develop Interpretations on financial reporting issues not specifically addressed in an IFRS, the new IASB constitution has broadened the IFRIC’s mandate beyond that of the former Standing Interpretations Committee.

1.6 Process of standard setting

The process of development of an IFRS will generally include the following:

- IASB staff work to identify and review all the issues related to a topic and study other national accounting standards and practices;
- a Steering Committee or advisory group may be formed to give advice on major projects;
- a Draft Statement of Principles or similar discussion document will be developed and published on major projects;
following receipt of comments on the initial discussion document, if any, the IASB will develop and publish an Exposure Draft; and
following receipt of comments on the Exposure Draft, the IASB will approve all IFRSs.

1.7 List of extant Financial Reporting Standards and International Standards

The extant financial Reporting Standards and International Standards are listed in Table 1.1.

<table>
<thead>
<tr>
<th>UK Accounting Standards (SSAPs and FRs)</th>
<th>International Accounting Standards (IFRSs and IASs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SSAP 4 Accounting for Government Grants</td>
<td>IAS 20 Accounting for Government Grants and Disclosure of Government Assistance</td>
</tr>
<tr>
<td>SSAP 5 Accounting for Value Added Tax</td>
<td>IAS 2 Inventories</td>
</tr>
<tr>
<td>SSAP 9 Stocks and Long Term Contracts</td>
<td>IAS 11 Construction and Service Contracts</td>
</tr>
<tr>
<td>SSAP 13 Accounting for Research and Development</td>
<td>IAS 38 Intangible Assets</td>
</tr>
<tr>
<td>FRS 21 Events after the Balance Sheet Date</td>
<td>IAS 10 Events After the Balance Sheet Date</td>
</tr>
<tr>
<td>SSAP 19 Investment Properties</td>
<td>IAS 40 Investment Properties</td>
</tr>
<tr>
<td>FRS 23 The Effect of Change in Foreign Exchange Rates</td>
<td>IAS 21 The Effect of Changes in Foreign Exchange Rates</td>
</tr>
<tr>
<td>SSAP 21 Accounting for Leases and Hire Purchase Contracts</td>
<td>IAS 17 Leases</td>
</tr>
<tr>
<td>SSAP 25 Segmental Reporting</td>
<td>IAS 14 Segment Reporting</td>
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<tr>
<td>FRS 1 Cash Flow Statements</td>
<td>IAS 7 Cash Flow Statements</td>
</tr>
<tr>
<td>FRS 2 Accounting for Subsidiary Undertakings</td>
<td>IAS 27 Consolidated and Separate Financial Statements</td>
</tr>
<tr>
<td>FRS 3 Reporting Financial Performance</td>
<td>IAS 8 Account Policies, Changes in Accounting Estimates and Errors</td>
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<tr>
<td>FRS 26 Financial Instruments: Measurement</td>
<td>IFRS 5 Non Current Assets Held for Sale and Presentation of Discontinued Operations</td>
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<td>FRS 5 Reporting the Substance of Transactions</td>
<td>IFRS 3 Business Combinations</td>
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<tr>
<td>FRS 6 Acquisitions and Mergers</td>
<td>IFRS 3 Business Combinations</td>
</tr>
<tr>
<td>FRS 7 Fair Values in Acquisition Accounting</td>
<td>IAS 28 Investments in Associates</td>
</tr>
<tr>
<td>FRS 8 Related Party Disclosures</td>
<td>IAS 31 Financial Reporting of Interests in Joint Ventures</td>
</tr>
<tr>
<td>FRS 9 Associates and Joint Ventures</td>
<td>IFRS 3 Business Combinations</td>
</tr>
<tr>
<td>FRS 10 Goodwill and Intangible Assets</td>
<td>IAS 36 Impairment of Assets</td>
</tr>
<tr>
<td>FRS 11 Impairments of Fixed Assets and Goodwill</td>
<td>IFRS 3 Business Combinations</td>
</tr>
</tbody>
</table>

Table 1.1 Extant financial reporting standards and international standards
Table 1.1  (Continued)

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<tr>
<td>FRS 22 Earnings Per Share</td>
<td>IAS 33 Earnings Per Share</td>
</tr>
<tr>
<td>FRS 15 Tangible Fixed Assets</td>
<td>IAS 16 Property, Plant and Equipment</td>
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<tr>
<td>FRS 16 Current Tax</td>
<td>IAS 23 Borrowing Costs</td>
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<tr>
<td>FRS 17 Retirement Benefits</td>
<td>IAS 12 Income Taxes</td>
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<tr>
<td>FRS 18 Accounting Policies</td>
<td>IAS 19 Employee Benefits</td>
</tr>
<tr>
<td>FRS 19 Deferred Tax</td>
<td>IAS 1 Presentation of Financial Statements</td>
</tr>
<tr>
<td>FRS 20 Share Based Payment</td>
<td>IAS 8 Accounts Policies, Changes in Accounting Estimates and Errors</td>
</tr>
<tr>
<td>AN G FRS 5 Reporting the Substance of Transactions: Revenue Recognition</td>
<td>IAS 12 Income Taxes</td>
</tr>
<tr>
<td>SORP Retirement Benefit Plans</td>
<td>IFRS 2 Share Based Payment</td>
</tr>
<tr>
<td>–</td>
<td>IAS 18 Revenue</td>
</tr>
<tr>
<td>SBP Interim Accounts</td>
<td>IAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions</td>
</tr>
<tr>
<td>–</td>
<td>IAS 34 Interim Financial Reporting</td>
</tr>
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<td>–</td>
<td>IAS 41 Agriculture</td>
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<td>–</td>
<td>IFRS 1 First Time Adoption of Financial Reporting Standards</td>
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<tr>
<td>–</td>
<td>IFRS 4 Insurance Contracts</td>
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<td>–</td>
<td>IFRS 6 Explorations For and Evaluations of Mineral Resource</td>
</tr>
</tbody>
</table>

1.8  Framework for the Preparation and Presentation of Financial Statements (1989)

Background

One of the main problems that faced standard-setting bodies in their quest to develop authoritative accounting standards was their failure to publish standards that were consistent with each other. There was no firm foundation on which they could be built. As a result, the actual standards were produced in an *ad hoc* manner with very little logical thought behind their publication. The Framework is an attempt to put this right by introducing the core principles that should govern financial reporting.

Objective of financial statements

This section of the Framework argues that there are several users of financial reporting and that the Annual Report is the main vehicle of communicating with users. The information
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should largely be directed towards meeting their needs. These needs are twofold – to ensure the reporting entity has performed adequately (the stewardship function), and to ensure that the user has sufficient information on which to make decisions about the future (i.e. the decision-making function). In order to provide information that may be helpful to users it is recommended that the entity provide information about the financial position, performance and changes in financial position of the organisation. The financial statements should be prepared under both the accruals and going concern bases.

Qualitative characteristics

This section of the Framework identifies the key primary qualitative characteristics that should make the information in the Annual Report useful to users. There are four principal characteristics, two relating to the content of the Report and two in relation to its presentation; these are described below.

Relevance

The information must be relevant, i.e. up to date and current, and actually used by the reader. Included within this characteristic is the concept of materiality. It provides a threshold or cut-off judgement rather than a primary qualitative characteristic.

Reliability

The reader must have faith in the information provided, and it must be free from material error and represent faithfully what it is supposed to represent. It must be free from bias, and the information must be complete within the bounds of materiality.

This characteristic tends to come into conflict with that of relevance, since relevance would favour the adoption of current subjective values whereas reliability would gravitate towards the adoption of historic and more objective costs. Where the two do clash, the International Accounting Standards Board (IASB) favours relevance.

Transactions should also be accounted for in accordance with their substance and not merely their legal form. A degree of caution (prudence) must also be exercised in making estimates under conditions of uncertainty.

Comparability

This is really the former consistency concept, and insists that information must be comparable from period to period and within like items in the same period. It also requires sufficient disclosure for a user to appreciate the significance of transactions. However, it does not mean uniformity, and accounting policies must be reviewed when more relevant and reliable alternatives exist.

Understandability

This concept insists that the information being provided by the reporting entity be presented in such a way that it is as understandable as possible to the user. However, this does not mean that it is so simple that the information being provided becomes meaningless.
The elements of financial statements

This chapter of the Framework contains the key elements in a set of financial statements. It defines the balance sheet elements first, and then argues that the income statement should pick up any residuals – e.g. a gain is either an increase in an asset or a decrease in a liability. The main definitions are as follows:

**Financial position:**
- Asset: ‘Resource controlled by the enterprise as a result of a past events and from which future economic benefits are expected to flow to the enterprise’
- Liability: ‘A present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits’
- Equity: ‘The residual interest in the assets of the enterprise after deducting all of its liabilities’.

**Financial performance:**
- Incomes: ‘Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases in liabilities that result in increases in equity, other than contributions from equity participants’
- Expenses: ‘Decreases in economic benefits during the accounting period in the form of outflows or depletions of assets that result in decreases in equity, other than distributions to equity participants’.

Clearly this section of the Framework puts the balance sheet on a pedestal, with its concentration on getting the assets and liabilities right first before looking at the income statement. This represents a cultural swing for the UK from its former profit and loss and accruals based preference. The accruals concept is now clearly downgraded in importance in that expenditure cannot be matched against future income unless it can meet the definition of an asset in the first place. Similarly the prudence concept has been given a ‘knock’, as a liability can only be created if there is either a legal or constructive obligation in place. A mere intention to expend monies in the future is not sufficient on its own.

**Recognition of the elements of financial statements**

Even if a transaction meets the definition of an asset/liability, it will not be recorded on the balance sheet unless it meets the following two recognition criteria:

1. Is there sufficient evidence that a change in assets or liabilities has occurred?
2. Can it be measured at cost or value with sufficient reliability?

If these cannot be passed initially then the transactions must be written off directly to income. If one of the criteria is subsequently failed, then the asset/liability must then be removed or derecognised from the balance sheet. It is possible that the asset/liability will need to be remeasured where there is sufficient evidence that the amount has changed, and the new amount measured with sufficient reliability.
Measurement of the elements of financial statements

Measurement is the process of determining the monetary amounts at which the elements are to be recognised in the balance sheet and income statement.

A number of different measurement bases are employed to different degrees and in various combinations in financial statements. They include the following:

1. **Historic cost.** Assets recorded at cash paid at date of acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation or the amount of cash expected to be paid to satisfy the liability, e.g. taxation.

2. **Current cost.** Assets recorded at cash that would have to be paid to acquire the same or equivalent asset. Liabilities are carried at the undiscounted amount of cash required to settle the obligation.

3. **Realisable value.** Assets recorded at cash that would be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values, i.e. the undiscounted amounts of cash expected to be paid to satisfy the liabilities in normal course of business.

4. **Present value.** Assets recorded at the present discounted value of future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

The most popular basis is historic cost, but it is usually combined with other bases – e.g. inventories at lower of cost and net realisable value, marketable securities at market value, and pension liabilities at present value.

Some entities adopt current cost accounting to cope with the inability of historic cost accounting to deal with the effects of changing prices.

Concepts of capital and capital maintenance

The following concepts exist:

1. **Financial capital maintenance.** Profit is only earned if the financial amount of net assets at the end of the period exceeds the financial amount of net assets at the start of the period after excluding distributions to and contributions from owners during the period. It can be measured in either nominal or in purchasing power units.

2. **Physical capital maintenance.** Profit is earned only if the physical productive capacity of the entity at the end of the period exceeds the physical productive capacity at the start of the period after excluding distributions to and contributions from owners during the period.

Capital maintenance links the concepts of capital and the concepts of profit, as it provides a reference by which profit is measured. Only inflows of assets in excess of amounts needed to maintain capital may be regarded as profit. Profit is the residual amount that remains after expenses have been deducted from income. If expenses exceed income, the residual amount is a net loss.

Physical capital maintenance requires the adoption of the current cost basis of measurement. The financial capital maintenance concept does not require the use of a particular basis of measurement. Selection of appropriate basis is dependent on the type of financial capital that the entity is seeking to maintain.
The main difference between the two types of capital maintenance is on the effects of changes in the prices of assets and liabilities of the entity. Generally, capital is maintained if an entity has as much capital at the end of the period as at the start. Any amount over and above that is profit.

Under financial capital maintenance, where capital is defined in nominal terms, profit is the increase in nominal money capital over the period. Holding gains are therefore included in profit, but only when disposed. Under the current purchasing power approach, profit represents the increase in purchasing power over the period. Thus only that part of the increase in prices of assets that exceeds the increase in the general level of prices is regarded as profit; the rest is a capital maintenance adjustment and therefore part of equity.

Under physical capital maintenance, where capital is defined in terms of productive capacity, profit represents the increase in that capital over the period. All price changes are viewed as changes in the measurement of the physical productive capacity of the entity, and thus are treated as capital maintenance adjustments that are part of equity.

The choice of model will depend on the different degrees of relevance and reliability available, and management must seek an appropriate balance between the two. The Framework is applicable to a range of accounting models, and provides guidance on preparing and presenting the financial statements constructed under the chosen model. The IASB is not at present intending to prescribe a particular model other than in exceptional circumstances, e.g. hyperinflationary economies (IAS 29), but this intention will be reviewed in the light of world developments.

Summary

The Framework was published in late 1989 in the form of a statement of best practice which will form the cornerstone of all future standard-setting procedures.

The Framework has set out the concepts that underlie the preparation and presentation of financial statements for external users. The purpose of the Framework is to:

- assist the IASB in developing future IFRSs and reviewing existing IFRSs;
- assist the IASB to promote harmonisation;
- assist national standard setters to develop national standards;
- assist preparers to apply IFRSs and in dealing with topics not covered by an IFRS;
- assist auditors in forming an opinion as to whether or not financial statements conform with IFRSs;
- assist users in interpreting information in financial statements;
- provide those with an interest in the work of the IASB about its approach to formulating IFRSs.

It is not an IFRS itself, but where an IFRS conflicts with the Framework the IFRS prevails. However, this is likely to be rare and to diminish over time. The Framework will be revised from time to time, with experience.

The financial statements should include a balance sheet, income statement, a statement of changes in financial position, and back-up notes. Supplementary information (e.g. segment reporting) is also included, but not Directors’ Reports, Discussion and Analysis Statements or Chairman’s Reports. The Framework should be applied to all commercially reporting entities.
Users and their needs are specifically covered in the Framework:

1. **Investors.** Concerned about risk and return provided by their investments. Need information to determine buy, hold or sell decisions, and to assess the entity’s ability to pay dividends.
2. **Employees.** Concerned about the stability and profitability of their employers and assessing the ability of the entity to provide remuneration, retirement benefits etc. to employees.
3. **Lenders.** Concerned about whether or not their loans and interest can be repaid.
4. **Suppliers and other trade creditors.** Concerned about whether or not they will be paid when due.
5. **Customers.** Concerned about the continuance of the business, especially if they have a long term involvement with the entity.
6. **Governments and their agencies.** Interested in the allocation of resources and information on taxation policies, national statistics etc.
7. **Public.** Can provide information about the local economy, numbers employed, environmental issues etc.

There are common needs of users, and financial statements should meet most of those needs. Information for management purposes is specialised, although published statements may be used by them in assessing financial performance, position and changes in financial position of the entity.

1.9 **IFRS 1 First Time Adoption of International Financial Reporting Standards (July 2003)**

**Key points**

The objective of the IFRS is to ensure that an entity’s first IFRS statements and interim accounts contain high quality information that:

- is transparent over all periods concerned;
- provides a suitable starting point for accounting under IFRSs; and
- can be generated at a cost that does not exceed the benefits to users.

Entities must apply the IFRS in:

- their first IFRS financial statements; and
- each interim report under IAS 34 for part of the period covered by its first IFRS statements.

The first IFRS statements are the first annual statements in which the entity adopts IFRSs by an explicit and unreserved statement of compliance. However, IFRS 1 does not apply to an entity when:

- an entity stops applying national Gaap when presenting both national and international sets of financial statements in the same year; or
- an entity presented statements in the previous year under national Gaap and they also contained an explicit statement of compliance with IFRSs; or
• an entity presented statements in previous year with a statement of unreserved compliance, even if qualified by the auditors.

In addition, IFRS 1 does not apply to changes in accounting policies. These are subject to:

• IAS 8; and
• specific transitional requirements in other IFRSs.

An entity must prepare an opening IFRS balance sheet at the date of transition to IFRSs, and must adopt the same accounting policies in its opening IFRS balance sheet throughout all periods presented in its first IFRS statements. They should comply with each effective IFRS at the reporting date for its first financial statements. A new IFRS may be applied that is not yet mandatory if it may be permitted to be adopted early (see Example 1.1).

Example 1.1
Consistent application of latest version of IFRSs

Background
The reporting date for A’s first IFRS accounts is 31.12.2005. It has opted for only 1 year’s comparatives, thus its date of transition to IFRSs is 1.1.2004.

Application of requirements
Entity A is required to apply the IFRSs for periods ending on 31.12.2005 in:

• preparing its opening IFRS balance sheet at 1.1.2004; and

If a new IFRS is not yet mandatory but is permitted, entity A is permitted but not required to apply that IFRS in its first IFRS statements.

An entity shall, in its opening balance sheet:

• recognise all assets and liabilities required by IFRSs;
• not recognise assets and liabilities if IFRSs do not permit such recognition;
• reclassify items under previous Gaap but are different under IFRSs; and
• apply IFRSs in measuring all recognised assets and liabilities.

The accounting policies adopted may differ from those adopted using previous Gaap. The resulting adjustments must be charged directly to retained earnings.

The IFRS establishes two categories of exceptions to the principle that an entity’s opening balance sheet comply with each IFRS:

1. Certain paragraphs grant exemptions from some requirements of other IFRSs
2. Certain paragraphs prohibit retrospective application of some aspects of other IFRSs.

The first category includes business combinations, employee benefits, cumulative translation differences, compound financial instruments as well as fair value as deemed cost and assets and liabilities of subsidiaries, associates and joint ventures. These cover the
right to use merger accounting for past combinations, to use a previous valuation for property to be a deemed cost subsequently if the entity moves back to historic cost accounting and to provide for all actuarial gains/losses in full rather than the current ‘corridor approach’ adopted in IAS 19.

The second group prohibits retrospection to the recognition of financial assets and liabilities, to hedge accounting and to estimates.

The standard is only applicable for first-time adoption of IFRSs, so it will be relatively short lived in its application in practice.

1.10 IAS 1 Presentation of Financial Information
(revised December 2003)

Key points

The objective of IAS 1 is to prescribe the basis for presentation of general purpose financial statements. It sets out the overall framework and responsibilities for the presentation of financial statements, guidelines for their structure, and minimum requirements for the content of financial statements. IAS 1 applies to all general purpose financial statements prepared in accordance with International Financial Reporting Standards. General purpose financial statements are defined as those intended to serve users who do not have the authority to demand financial reports tailored for their own needs.

Content of financial statements

The financial statements should comprise the following:

1. Balance sheet
2. Income statement
3. Statement of changes in equity or statement of non-owner changes in equity
4. Cash flow statement
5. Explanatory notes including a summary of significant accounting policies.

There is no prescribed standard format, although examples of the minimum headings are provided in the Appendix. It does, however, set out minimum disclosures to be made on the face of the financial statements as well as in the notes. For example, an analysis of income and expenditure using a classification based on their nature or function must be disclosed. The standard also requires comparatives to be provided for all items unless a particular accounting standard specifically exempts that requirement.

The reporting currency should generally be that of the country in which the enterprise is domiciled. If a different reporting currency is adopted or a change in reporting currency made, then the reasons must be disclosed.

A reporting enterprise complying with the requirements of IFRSs is considered as providing a fair presentation of the financial statements. A statement that the financial statements comply with IFRSs and SIC interpretations is required. No statement is now permitted stating that compliance with IFRSs has been undertaken with certain specified exemptions. Full compliance is essential.
Overall considerations

Fair presentation and compliance with IFRSs
Financial statements should present fairly the financial position, performance and cash flows of the entity, and the entity should provide an explicit and unreserved statement that the statements are in compliance with IFRSs.

Inappropriate policies are not rectified either by disclosure or by notes. Entities can, in rare circumstances, depart from an IFRS (if it is regarded as misleading), but the following must be disclosed in those cases:

- management has concluded that the financial statements give a fair presentation;
- that it has complied with IFRSs etc. except from a particular requirement to achieve fair presentation;
- the title of the IFRS, nature of departure and why the normal treatment was not adopted; and
- the financial impact for each period of the departure.

If departure is not permitted, the entity should reduce the perceived misleading aspects by disclosing:

- the title of the standard, the nature of issue and the reason why it was misleading;
- the adjustments management has concluded would be appropriate.

Going concern Management must assess the ability of an entity to continue as a going concern. If there are doubts over that concept, disclosure should be made of the underlying uncertainties; however, if it is more serious, the financial statements should be prepared on a break up basis but that fact must be disclosed.

Offsetting Assets and liabilities and income and expenses should not be offset unless required or permitted by a standard or SIC.

Comparative information This should be disclosed for the previous period for all amounts disclosed in the financial statements. If the current period has been reclassified so should the comparatives, unless that is impracticable. If practical, the following should be disclosed:

- the nature of the reclassification;
- the amount of each item or class of items reclassified; and
- the reason for the reclassification.

Where it is found to be impractical, the following should be disclosed:

- the reason for not reclassifying; and
- the nature of the adjustments that would have been made.

Structure and content

Identification of the financial statements The financial statements should be clearly identified and distinguished from other information in the same published document.

Each component should be clearly identified. In addition, the following information should be displayed prominently:

- the name of the reporting entity and any change from the preceding year;
- whether the statements cover an individual or group of entities;
The regulatory framework and the standard-setting process

- the balance sheet date or period covered;
- the presentation currency;
- the level of rounding adopted.

Reporting period There is a presumption that financial statements will be prepared annually, at a minimum. If the annual reporting period changes and financial statements are prepared for a different period, the entity should disclose the reason for the change and a warning that the corresponding amounts shown may not be comparable.

Balance sheet

The standard specifies minimum headings to be presented on the face of the balance sheet, and guidance is provided for the identification of additional line items.

Entities should present the balance sheet by separating current from non-current assets and liabilities unless a presentation based on liquidity provides information that is more reliable and relevant. If the latter, assets and liabilities must be presented broadly in order of their liquidity (or reverse order), without a current/non-current distinction.

In either case, if an asset/liability category combines amounts that will be received/settled after twelve months with assets/liabilities that will be received/settled within twelve months, note disclosure is required that separates the longer-term amounts from the amounts due to be received/settled within twelve months.

Current assets

An asset is classified as current when it satisfies any of the following criteria:

- it is expected to be realised in the entity’s normal operating cycle; or
- it is held primarily for trade; or
- it is expected to be realised within twelve months; or
- it is cash or a cash equivalent.

Non-current assets incorporate tangible, intangible and financial assets of a long-term nature.

Current liabilities

A liability is classified as current when it satisfies any of the following criteria:

- it is expected to be settled in the entity’s normal operating cycle; or
- it is held primarily for trade; or
- it is due to be settled within twelve months; or
- the entity does not have an unconditional right to defer settlement for at least twelve months.

Information to be presented on the face of the balance sheet

As a minimum, the following should be disclosed on the face of the balance sheet:

- property, plant and equipment;
- investment property;
- intangible assets;
• financial assets;
• investments accounted under the equity method;
• biological assets;
• inventories;
• trade and other receivables;
• cash and cash equivalents;
• trade and other payables;
• provisions;
• financial liabilities;
• current tax;
• deferred tax;
• minority interest;
• capital and reserves.

Additional items may be presented, if relevant to an understanding of the entity’s financial position. Deferred tax may not be reclassified as a current asset/liability if an entity adopts the current/non-current approach.

The standard does not prescribe the order or format of the balance sheet – it is merely a list of items warranting separate disclosure.

Information to be presented either on the face of the balance sheet or in the notes
Further subclassifications may be provided in the notes or on the face of the balance sheet:

• for each class of share capital: number of authorised shares, number of issued shares, par value per share, reconciliation of number outstanding over the year, any rights or restrictions, any treasury shares held and any shares reserved for options including terms and conditions;
• a description of the nature and purpose of each reserve.

Any entity without share capital or a trust should provide equivalent information to the above.

Income statement

All items of income and expense recognised in a period should be included in the income statement unless a standard or SIC requires otherwise (e.g. IAS 8, 16, 21).

IAS 1 specifies the minimum headings that must be presented on the face of the income statement, and provides guidance for the identification of additional line items. There is no particular format or order of presentation mandated.

Information to be presented on the face of the income statement
As a minimum, the following should be disclosed on the face of the income statement for the period:

• revenue;
• finance costs;
• share of profit/loss of associates and joint ventures;
• pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to discontinuing operations;
• tax expense;
• profit or loss.

The following items should be disclosed on the face of the income statement as allocations of profit:

• minority interest;
• profit/loss attributable to equity holders of the parent.

Additional items should be presented when such presentation is relevant to understanding the entity’s financial performance. However, extraordinary items are no longer permitted to be disclosed in the statement or in the notes.

Information to be presented either on the face of the income statement or in the notes
Where material, the nature and amount of income and expenses should be disclosed separately. Examples include inventory writedowns, restructurings, disposals of plant etc., discontinuing operations, litigation settlements etc.

Income and expenses should not be offset unless another IAS requires or permits such offset, or the amounts to be offset arise from the same events and are not material.

Expenses should be analysed either by nature (raw materials, staff costs, depreciation etc.) or by function (cost of sales, selling, administration etc.) either on the face of the income statement or in the notes. If an entity categorises by function, additional information on the nature of expenses, including depreciation, amortisation and employee benefit expense, should be disclosed. The choice of method should be the one that provides the most reliable and relevant information to the entity.

An entity should disclose, either on the face of the income statement or the statement of changes in equity, or in the notes, the amount of dividends recognised as distributions to equity holders during the period, and the related amount per share.

Statement of changes in equity
IAS 1 requires the presentation of a statement of changes in equity as a separate component of the financial statements, showing:

• the profit or loss for the period;
• each item of income or expense, and gain or loss, that is recognised directly in equity and the total of those items; and
• the effects of changes in accounting policies or material errors in accordance with IAS 8.

Either within this statement or separately in the notes, the entity is required to disclose:

• capital transactions;
• the balance of accumulated profits at the beginning and at end of the period, and the movements for the period; and
a reconciliation between the carrying amount of each class of equity capital, share
premium and each reserve at the beginning and end of the period, disclosing each
movement.

**Cash flow statement**

IAS 1 refers to IAS 7 *Cash Flow Statements* (1992) for presenting the cash flow statement.

**Notes**

**Structure**

The notes should:

- present information about the basis of preparation of the financial statements and the
  specific accounting policies adopted;
- disclose information required by IFRSs not included on the face of the primary
  statements; and
- provide additional information that is relevant to understanding the financial
  statements.

Notes should be presented in a systematic manner, and each item cross-referenced to the
primary statements.

**Accounting policies**

The notes, as a minimum, should disclose the significant accounting policies adopted;
narrative descriptions or detailed analyses of items shown on the face of the financial
statements; information required or encouraged by other IASs; and other disclosures
necessary for an understanding and the fair presentation of the financial statements.

The accounting policies section should describe the measurement basis adopted in
preparing the financial statements and each specific accounting policy that is necessary
for an understanding of the financial statements.

An entity should disclose, in the summary of significant accounting policies or other
notes, the judgements, apart from those involving estimates, that management has made
in the process of applying the entity’s accounting policies that have the most significant
effect on the amounts recognised in the financial statements.

**Key sources of estimation uncertainty**

An entity should disclose in the notes information about the key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities. Details of their nature and carrying amount at the balance sheet date should also be provided.

**Other disclosures**

In the notes, disclosures should include:

- dividends proposed or declared before the accounts have been authorised and related
  amounts per share;
- the amount of any cumulative preference dividends not recognised.
If not disclosed elsewhere, the following should be included:

- the domicile and legal form of the entity; country of incorporation and address of registered office if different from the principal place of business;
- a description of the nature of the entity’s operations and principal activities;
- the name of the parent and ultimate parent of the group.

**Review of performance and financial position**  IAS 1 encourages the management to include a review of the financial performance and position of the enterprise and to discuss the principal uncertainties that it faces. Such a review would be similar in content to the Management Discussion & Analysis (MD&A) in the United States, and the Operating and Financial Review (OFR) in the United Kingdom and Ireland. The review would include a discussion of dividend policy, changes in the operating environment, funding and risk management policies.

**SIC 29 Disclosure – Service Concession Arrangements**  Comprehensive disclosures are required in respect of service concession arrangements both in the financial statements of the concession operator and the concession provider. These are similar to the rules on PFI contracts that are covered in the ASB’s accounting standard on reporting substance (FRS 5).

**Guidance on implementing IAS 1**

This guidance accompanies, but is not part of, IAS 1.

**Illustrative financial statement structure**

The standard sets out the components of financial statements and minimum requirements for disclosure on the face of the balance sheet and the income statement as well as for the presentation of changes in equity. It also describes further items that may be presented either on the face of the relevant financial statement or in the notes. This guidance provides simple examples of ways in which the requirements of the standard for the presentation of the balance sheet, income statement and changes in equity might be met. The order of presentation and the descriptions used for line items should be changed, when necessary, in order to achieve a fair presentation in each entity’s particular circumstances.

The illustrative balance sheet shows one way in which a balance sheet distinguishing between current and non-current items may be presented. Other formats may be equally appropriate, provided the distinction is clear.

Two income statements are provided, to illustrate the alternative classifications of income and expenses, by nature and by function. Two possible approaches to presenting changes in equity are also illustrated.

The examples are not intended to illustrate all aspects of IFRSs; nor do they comprise a complete set of financial statements, which would also include a cash flow statement, a summary of significant accounting policies and other explanatory notes.
### Part A – Illustrative financial statement structure

**XYZ GROUP – BALANCE SHEET AS AT 31 DECEMBER 2002**

(in thousands of currency units)

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Non-current assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Goodwill</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Other intangible assets</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Investments in associates</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Available-for-sale investments</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>Current assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inventories</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Trade receivables</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Other current assets</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>EQUITY AND LIABILITIES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Equity attributable to equity holders of the parent</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share capital</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Other reserves</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>Minority interest</strong></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>Total equity</strong></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>Non-current liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term borrowings</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Deferred tax</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Long-term provisions</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>Total non-current liabilities</strong></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>Current liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade and other payables</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Short-term borrowings</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Current portion of long-term borrowings</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Current tax payable</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Short-term provisions</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>Total equity and liabilities</strong></td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>
### XYZ GROUP – INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2002

(illustrating the classification of expenses by function)

(in thousands of currency units)

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>(X)</td>
<td>(X)</td>
</tr>
<tr>
<td>Gross profit</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Other income</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Distribution costs</td>
<td>(X)</td>
<td>(X)</td>
</tr>
<tr>
<td>Administrative expenses</td>
<td>(X)</td>
<td>(X)</td>
</tr>
<tr>
<td>Other expenses</td>
<td>(X)</td>
<td>(X)</td>
</tr>
<tr>
<td>Finance costs</td>
<td>(X)</td>
<td>(X)</td>
</tr>
<tr>
<td>Share of profit of associates</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>Profit before tax</strong></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>(X)</td>
<td>(X)</td>
</tr>
<tr>
<td><strong>Profit for the period</strong></td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

Attributable to:
- Equity holders of the parent | X | X |
- Minority interest            | X | X |

### XYZ GROUP – INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2002

(illustrating the classification of expenses by nature)

(in thousands of currency units)

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Other income</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Changes in inventories of finished goods and work in progress</td>
<td>(X)</td>
<td>X</td>
</tr>
<tr>
<td>Work performed by the entity and capitalised</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Raw material and consumables used</td>
<td>(X)</td>
<td>(X)</td>
</tr>
<tr>
<td>Employee benefits expense</td>
<td>(X)</td>
<td>(X)</td>
</tr>
<tr>
<td>Depreciation and amortisation expense</td>
<td>(X)</td>
<td>(X)</td>
</tr>
<tr>
<td>Impairment of property, plant and equipment</td>
<td>(X)</td>
<td>(X)</td>
</tr>
<tr>
<td>Other expenses</td>
<td>(X)</td>
<td>(X)</td>
</tr>
<tr>
<td>Finance costs</td>
<td>(X)</td>
<td>(X)</td>
</tr>
<tr>
<td>Share of profit of associates</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>Profit before tax</strong></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>(X)</td>
<td>(X)</td>
</tr>
<tr>
<td><strong>Profit for the period</strong></td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

Attributable to:
- Equity holders of the parent | X | X |
- Minority interest            | X | X |
### XYZ GROUP – STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2002
(in thousands of currency units)

<table>
<thead>
<tr>
<th>Attributable to equity holders of the parent</th>
<th>Minority interest</th>
<th>Total equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>Other reserves</td>
<td>Translation reserve</td>
</tr>
<tr>
<td>X</td>
<td>X</td>
<td>(X)</td>
</tr>
<tr>
<td>X</td>
<td>X</td>
<td>(X)</td>
</tr>
<tr>
<td>X</td>
<td>X</td>
<td>(X)</td>
</tr>
</tbody>
</table>

**Balance at 31 December 2000**

Changes in accounting policy
Restated balance

**Changes in equity for 2001**
Gain on property revaluation
Available-for-sale investments:
Valuation gains/(losses) taken to equity
Transferred to profit or loss on sale
Cash flow hedges:
Gains/(losses) taken to equity
Transferred to profit or loss for the period
Transferred to initial carrying amount of hedged items
Exchange differences on translating foreign operations
Tax on items taken directly to or transferred from equity
Net income recognised directly in equity
Profit for the period

**Total recognised income and expense for the period**

Dividends
Issue of share capital
Equity share options issued

**Balance at 31 December 2001 carried forward**

---

### XYZ GROUP – STATEMENT OF RECOGNISED INCOME AND EXPENSE FOR THE YEAR ENDED 31 DECEMBER 2002
(in thousands of currency units)

<table>
<thead>
<tr>
<th>2002</th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gain/(loss) on revaluation of properties</td>
<td>(X)</td>
</tr>
<tr>
<td>Available-for-sale investments:</td>
<td></td>
</tr>
<tr>
<td>Valuation gains/(losses) taken to equity</td>
<td>(X)</td>
</tr>
<tr>
<td>Transferred to profit or loss on sale</td>
<td>X</td>
</tr>
<tr>
<td>Cash flow hedges:</td>
<td></td>
</tr>
<tr>
<td>Gains/(losses) taken to equity</td>
<td>X</td>
</tr>
<tr>
<td>Transferred to profit or loss for the period</td>
<td>(X)</td>
</tr>
<tr>
<td>Transferred to the initial carrying amount of hedged items</td>
<td>(X)</td>
</tr>
<tr>
<td>Exchange differences on translation of foreign operations</td>
<td>(X)</td>
</tr>
</tbody>
</table>
1.11 Examination questions

Question 1.1: Vincible (ACCA Diploma in International Financial Reporting and Auditing)

(The first question requires students to prepare three of the primary statements required by IAS 1 – the income statement, balance sheet, and statement of changes in equity. Although not stated as required in the question, the solution adopts a current/non-current format for the balance sheet and analysis by function in the income statement. There is not sufficient information to prepare a note re analysis by nature as required by IAS 1.

In addition, students are required to integrate final accounts preparation with an application of IFRSs – in particular, IAS 33 Earnings Per Share and IAS 31 Financial Reporting of Interests in Joint Ventures, although impairment (IAS 36), taxation (IAS 12) and revaluation of property (IAS 16) are also covered.)

The following list of account balances relates to Vincible at 30 September 2002:

<table>
<thead>
<tr>
<th>Account</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales revenue</td>
<td>473,300</td>
</tr>
<tr>
<td>Purchases</td>
<td>310,500</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>18,400</td>
</tr>
<tr>
<td>Loan stock interest</td>
<td>5,000</td>
</tr>
<tr>
<td>Dividends paid</td>
<td>15,500</td>
</tr>
<tr>
<td>Leasehold building at cost (note (ii))</td>
<td>200,000</td>
</tr>
<tr>
<td>Plant and equipment at cost (note (ii))</td>
<td>124,800</td>
</tr>
<tr>
<td>Deferred development expenditure (note (iii))</td>
<td>75,000</td>
</tr>
<tr>
<td>Joint venture (note (iv))</td>
<td>62,000</td>
</tr>
<tr>
<td>Depreciation at 1 October 2001</td>
<td></td>
</tr>
<tr>
<td>– leasehold</td>
<td>56,000</td>
</tr>
<tr>
<td>– plant and equipment</td>
<td>48,800</td>
</tr>
<tr>
<td>– development expenditure</td>
<td>15,000</td>
</tr>
<tr>
<td>Trade receivables</td>
<td>49,200</td>
</tr>
<tr>
<td>Inventory – 1 October 2001</td>
<td>27,500</td>
</tr>
<tr>
<td>Bank</td>
<td>12,100</td>
</tr>
<tr>
<td>Trade payables</td>
<td></td>
</tr>
<tr>
<td>Ordinary shares of 25 cents each</td>
<td>82,200</td>
</tr>
<tr>
<td>10% Convertible loan stock – issued 2000 (note (vii))</td>
<td>100,000</td>
</tr>
<tr>
<td>Deferred tax at 1 October 2001 (note (v))</td>
<td>11,400</td>
</tr>
<tr>
<td>Profit and loss reserve at 1 October 2001</td>
<td>13,300</td>
</tr>
</tbody>
</table>

900,000 900,000
The following notes are relevant:

(i) The cost of the inventory at 30 September 2002 was $37.7 million (excluding joint
to venture inventory – see note (iv)).

(ii) Non-current assets:
- On 1 October 2001 Vincible’s leasehold building was revalued at $270 million by
  an independent surveyor. The lease was for a 25-year period when Vincible
  acquired it. The directors wish to incorporate the revalued amount in Vincible’s
  financial statements. The revaluation reserve will be deemed to be realised in line
  with the remaining life of the lease.
- Plant is depreciated at 20% per annum on the reducing balance basis.
- All depreciation is charged to cost of sales.

(iii) The deferred development expenditure relates to a new product. The project was
  successfully completed on 1 October 2000, and sales of the new product com-
  menced on that date. The development costs are being depreciated on a straight-line
  basis over the expected product life of 5 years. Early in the current year, a review of
  the sales figures for the new product showed that they were disappointing. In view of
  this, Vincible has estimated that the present value of the expected net future cash
  flows from sales of the new product is $30 million; however Vincible has been
  approached by a rival company with an offer of $40 million for the rights to the
  product. At this stage, Vincible intends to continue to market and sell the product.

(iv) On 1 October 2001 Vincible entered into a joint venture with two other companies.
  Each venturer contributes its own assets and pays its own expenses. The agreement
  stipulates that the joint venture will be terminated on 30 September 2005. Vincible
  is entitled to 30% of the joint venture’s total revenues. The joint venture is not a
  separate entity.

Details of Vincible’s joint venture transactions are:

<table>
<thead>
<tr>
<th>$000</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Plant and equipment at cost</td>
<td>70,000</td>
</tr>
<tr>
<td>Share of joint venture sales revenues (30% of total sales revenues)</td>
<td>(18,000)</td>
</tr>
<tr>
<td>Inventory</td>
<td>2,500</td>
</tr>
<tr>
<td>Related cost of sales excluding depreciation</td>
<td>8,000</td>
</tr>
<tr>
<td>Accounts receivable 30 September 2002</td>
<td>3,500</td>
</tr>
<tr>
<td>Accounts payable 30 September 2002</td>
<td>(4,000)</td>
</tr>
<tr>
<td>Net balance included in the above list of balances</td>
<td>62,000</td>
</tr>
</tbody>
</table>

Plant should be depreciated on a straight-line basis. It is not expected to have any
residual value at the end of joint venture.

(v) The directors have estimated the required provision for income tax for the year to
30 September 2002 is $15 million. The deferred tax provision at 30 September
2002 is to be adjusted to reflect the tax base of the company’s assets being $70 mill-
ion less than their carrying values. $28.8 million of this $70 million is attributable
 to the revaluation of the leasehold. Vincible’s rate of income tax is 25%.

(vi) The convertible loan stock is redeemable at par on 31 March 2004, or at the option
of the stockholders, it can be exchanged for ordinary shares on the basis of 60 new
shares in Vincible for each $100 of loan stock.

(vii) In June 2000 the directors and senior staff of Vincible were given options to purchase
50 million ordinary shares (in total) in the company. The options are exercisable on
1 July 2004 at a price of $2.40 per share. The stock market price of Vincible’s ordinary shares over the current year has been $4.00.

(viii) The directors have proposed a final ordinary dividend of 6 cents per share. Vincible discloses proposed dividends as part of shareholders’ funds.

**Required**

(a) Prepare for Vincible, in accordance with International Accounting Standards as far as the information permits:
   (i) the income statement
   (ii) the statement of changes in equity for the year to 30 September 2002, and
   (iii) a balance sheet as at 30 September 2002.

Notes to the financial statements are not required.

(b) Next, calculate the basic and diluted earnings per share for Vincible for the year to 30 September 2002.

**Question 1.2: Stilson (ACCA Accounting and Audit Practice)**

(The second question is very similar to the first in its basic requirement to publish an income statement, balance sheet and statement of changes in equity in accordance with IAS 1. However, it also incorporates the need to implement other accounting standards, particularly IAS 11 Construction Contracts, IAS 16 Property, Plant and Equipment and IAS 18 Revenue.)

The summarised list of account balances of Stilson, a publicly listed company, at 31 March 2001 is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>$000</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land and building – at cost (land $2 million) (note (i))</td>
<td>10,000</td>
<td></td>
</tr>
<tr>
<td>Plant and equipment – at cost</td>
<td>4,480</td>
<td></td>
</tr>
<tr>
<td>Depreciation 1 April 2000: – building</td>
<td>3,200</td>
<td>2,400</td>
</tr>
<tr>
<td>– plant</td>
<td>620</td>
<td>200</td>
</tr>
<tr>
<td>Trade receivables and prepayments</td>
<td>8,620</td>
<td></td>
</tr>
<tr>
<td>Inventory – 31 March 2000</td>
<td>1,900</td>
<td></td>
</tr>
<tr>
<td>Cash and bank</td>
<td>4,180</td>
<td></td>
</tr>
<tr>
<td>Trade payables and accruals</td>
<td></td>
<td>3,540</td>
</tr>
<tr>
<td>Equity shares of 25c each</td>
<td></td>
<td>5,000</td>
</tr>
<tr>
<td>8% Loan Note (issued in 1999)</td>
<td></td>
<td>5,000</td>
</tr>
<tr>
<td>Accumulated profits 1 April 2000</td>
<td></td>
<td>580</td>
</tr>
<tr>
<td>Purchases</td>
<td>16,000</td>
<td></td>
</tr>
<tr>
<td>Construction contract costs to 31 March 2001 (note (iii))</td>
<td>1,900</td>
<td>2,000</td>
</tr>
<tr>
<td>Construction contracts progress billings received (note (iii))</td>
<td></td>
<td>2,000</td>
</tr>
<tr>
<td>Sales</td>
<td>26,750</td>
<td></td>
</tr>
<tr>
<td>Interest paid</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td>Property rental</td>
<td>1,250</td>
<td></td>
</tr>
<tr>
<td>Profit on sale of property (note (i))</td>
<td></td>
<td>3,400</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>1,340</td>
<td></td>
</tr>
<tr>
<td>Interim dividend</td>
<td>2,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>51,870</td>
<td>51,870</td>
</tr>
</tbody>
</table>
The following notes are relevant:

(i) One of the company’s buildings was sold on 1 April 2000. The disposal has been recorded leaving a profit on sale of $3.4 million, which is included in the balances above. On the same date the company’s only remaining property was revalued at $12 million ($3 million is attributable to the land). The building had an estimated life of 25 years when it was acquired on 1 April 1990, and this has not changed as a result of the revaluation. The directors of Stilson wish to incorporate this value in the financial statements for the year ended 31 March 2001. Plant is depreciated at 20% per annum on cost.

(ii) Included in the sales revenues is an amount of $3 million relating to sales made under a special promotion in March 2001. These goods were sold with an accompanying voucher equal to the selling price. Five years after the sale, these vouchers will be exchanged for goods of the customer’s choosing. The profit margin on these goods is expected to be 30% of selling price, and market research estimates that 50% of the vouchers will be redeemed. The present value (at 31 March 2001) of $1 at the time the vouchers will be exchanged can be taken as 60c.

(iii) The figures in respect of contract balances relate to a 3-year contract entered into on 1 July 2000. Details relating to this contract are:

<table>
<thead>
<tr>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract price</td>
</tr>
<tr>
<td>Estimated total contract costs</td>
</tr>
<tr>
<td>Agreed value of work completed and billed at 31 March 2001</td>
</tr>
</tbody>
</table>

Stilson’s policy is to recognise profits on long-term construction contracts from the point that they become more than 20% complete. The percentage of completion is deemed to be the agreed value of the work completed to date as a percentage of the total contract price. Contract revenue is taken as the agreed value of the work completed to date.

(iv) A provision for income tax for the year to 31 March 2001 of $2,400,000 is required. The directors declared a final dividend of 15c per share on 25 March 2001.

(v) Inventory, other than that relating to the construction contract, at 31 March 2001 was valued at a cost of $2.8 million.

Required

Prepare the income statement, the statement of changes in equity and balance sheet for Stilson for the year to 31 March 2001.

Question 1.3: S (CIMA)

S, a car dealer with a number of outlets, has expanded rapidly in recent years, but cash flow problems worsened in the year to March 2003. On 1 April 2003, the management of S decided to make three major changes to its activities.

A trainee management accountant prepared a set of draft financial statements for the year ended 31 March 2004, but unfortunately did not appreciate the need to apply the concept of ‘substance over form’ in the treatment of the various transactions involved.
The regulatory framework and the standard-setting process

**Required**

(a) Explain the meaning of the accounting concept of substance over form. You should refer to relevant International Accounting Standards in your answer.

The three major changes made by S on 1 April 2003, and the way in which they have been treated in the draft financial statements for the year ended 31 March 2004, are as follows:

1. **Change 1**: S sold all of its land and buildings on a sale and leaseback agreement to P on 1 April 2003. The terms were as follows:
   - the annual rental was agreed at $7.5 million
   - the agreed selling price was $50 million with an option for S to repurchase the land and buildings at any time in the next 10 years
   - the repurchase price was set at $50 million plus interest at bank rate plus 5% per annum from the date of the sale.

   At the time of the sale, the land and buildings had a net book value (and current market value) of $80 million. The draft financial statements have treated the transaction as a disposal of the land and buildings and record a loss on disposal of $30 million in the draft income statement.

2. **Change 2**: S decided to acquire new cars direct from the manufacturer on consignment. The terms of the trading are:
   - on delivery of the cars to S they are invoiced at 50% of the purchase price
   - the balance of the purchase price is payable when the cars are sold
   - if a car remains unsold for three months, it must be paid for or returned to the manufacturer
   - when a car is returned, the manufacturer refunds the deposit less a 20% administration fee.

   At 31 March 2004, S had 500 new cars in its inventories; all had been in inventories less than three months. The combined purchase price of the cars was $6 million. The draft financial statements omit the new cars from inventories, as they have been treated as the inventory belonging to the manufacturer. The 50% of the purchase price paid has been debited to prepayments in the draft balance sheet.

3. **Change 3**: S replaced the computerised equipment used in its repair workshops. The previous equipment was purchased outright, and had no value on disposal. The new equipment was acquired on a lease, with the following terms:
   - lease term 6 years
   - useful economic life of the equipment 5–7 years
   - six annual payments of $1.5 million paid in advance commencing on 1 April 2003 and annually thereafter
   - the interest rate implicit in the lease is 7% per annum
   - the fair value of the equipment at the inception of the lease was $7,650,296

   S will insure and maintain the equipment in good working order.
The draft financial statements record the lease payment of $1.5 million as an expense in the draft income statement.

**Required**

(b) For each of the changes above, explain how S should treat each transaction in its income statement for the year ended 31 March 2004 and its balance sheet at that date. Justify your answer by reference to relevant International Accounting Standards. Prepare any journal entries that are required to adjust the draft financial statements.