

Intermediate Financial Accounting I

AcFn 302 I

Chapter 4

Statement of Financial Position and Statement of Cash Flows

Learning Objectives

At the completion of this chapter, you should be able to:

1. Explain the usefulness and limitations of statement of financial position.
2. Classify items/components in the statement of financial position
3. Explain the criteria for current and non-current classification.
4. Prepare IFRS based statement of financial position .
5. Explain the benefit of cash flow statement
6. Describe cash flow items falling under each of the operating, investing and financing activities
7. Prepare statement of cash flows under the direct format
8. Prepare statement of cash flows under the indirect format
9. Differentiate adjusting and non-adjusting events
10. Explain the way disclosures are presented for the statements

Statement of Financial Position (SoFP)



Statement of Financial Position

Statement of Financial Position, also referred to as the **balance sheet**:

1. Reports assets, liabilities, and equity at a specific date.
2. Provides information about resources, obligations to creditors, and equity in net resources.
3. Helps in predicting amounts, timing, and uncertainty of future cash flows.

Statement of Financial Position

Usefulness

- Computing rates of return.
- Evaluating capital structure.
- Assess risk and future cash flows.
- Analyze company's:
 - Liquidity
 - Solvency
 - Financial flexibility

Statement of Financial Position

Limitations

- Most assets and liabilities are reported at historical cost.
- Use of judgments and estimates.
- Many items of financial value are omitted.

Statement of financial position example (XYZ GROUP)

20X7
\$'000

20X6
\$'000

Assets

Non-current assets

Property, plant and equipment
Goodwill
Other intangible assets
Investments in associates
Investments in equity instruments

350,700	360,020
80,800	91,200
227,470	227,470
100,150	110,770
142,500	156,000
<u>901,620</u>	<u>945,460</u>

Current assets

Inventories
Trade receivables
Other current assets
Cash and cash equivalents

135,230	132,500
91,600	110,800
25,650	12,540
312,400	322,900
<u>564,880</u>	<u>578,740</u>

Total assets

<u>1,466,500</u>	<u>1,524,200</u>
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Equity and liabilities

Equity attributable to owners of the parent

Share capital
Retained earnings
Other components of equity

650,000	600,000
243,500	161,700
10,200	21,200
<u>903,700</u>	<u>782,900</u>

Non-controlling interest

<u>70,050</u>	<u>48,600</u>
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Total equity

<u>973,750</u>	<u>831,500</u>
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Non-current liabilities

Long-term borrowings
Deferred tax
Long-term provisions

120,000	160,000
28,800	26,040
28,850	52,240
<u>177,650</u>	<u>238,280</u>

Total non-current liabilities

Current liabilities

Trade and other payables
Short-term borrowings
Current portion of long-term borrowings
Current tax payable
Short-term provisions

115,100	187,620
150,000	200,000
10,000	20,000
35,000	42,000
5,000	4,800
<u>315,100</u>	<u>454,420</u>

Total current liabilities

Total liabilities

Total equity and liabilities

<u>492,750</u>	<u>692,700</u>
<u>1,466,500</u>	<u>1,524,200</u>

Minimum line items

- (a) Property, plant and equipment
- (b) Investment property
- (c) Intangible assets
- (d) Financial assets (excluding amounts shown under (e), (h) and (i))
- (e) Investments accounted for using the equity method
- (f) Biological assets
- (g) Inventories
- (h) Trade and other receivables
- (i) Cash and cash equivalents
- (j) Assets classified as held for sale
- (k) Trade and other payables
- (l) Provisions
- (m) Financial liabilities (other than (k) and (l))
- (n) Current tax liabilities and assets
- (o) Deferred tax liabilities and assets
- (p) Liabilities included in disposal groups
- (q) Non-controlling interests
- (r) Issued capital and reserves

Whether additional items are presented separately depends on judgements based on the assessment of the following factors.

- (a) Nature and liquidity of assets and their materiality.** Thus goodwill and assets arising from development expenditure will be presented separately, as will monetary/non-monetary assets and current/non-current assets.
- (b) Function within the entity.** Operating and financial assets, inventories, receivables and cash and cash equivalents are therefore shown separately.
- (c) Amounts, nature and timing of liabilities.** Interest-bearing and non-interest-bearing liabilities and provisions will be shown separately, classified as current or non-current as appropriate.

IFRS also requires separate presentation where **different measurement bases** are used for assets and liabilities which differ in nature or function. For example, it is permitted to carry certain items of property, plant and equipment at cost or at a revalued amount.

The current/non-current distinction

- An entity must present **current** and **non-current** assets & liabilities as separate classifications on the face of the statement of financial position.
- A presentation based on liquidity should only be used where it provides more relevant and reliable information, in which case all assets and liabilities must be presented broadly in order of liquidity.

In either case, the entity should disclose any portion of an asset or liability which is expected to be recovered or settled ***after more than twelve months.***

For example, for an amount receivable which is due in installments over 18 months, the portion due after more than twelve months must be disclosed.

The current/non-current distinction

- IFRS emphasizes how helpful information on the **operating cycle** is to users of financial statements.
 - The **operating cycle** of an entity is the time between the acquisition of assets for processing and their realization in cash or cash equivalents.
 - Where there is a clearly defined operating cycle within which the entity supplies goods or services, then information disclosing those net assets that are continuously circulating as **working capital** is useful.
- The liquidity and solvency of an entity is also indicated by information about the maturity dates of assets and liabilities.

Current assets

- An asset should be classified as a **current asset** when it:
 - ✓ Is expected to be realised in, or is held for sale or consumption in, the normal course of the entity's operating cycle; or
 - ✓ Is held primarily for trading purposes or for the short-term and expected to be realised within twelve months of the end of the reporting period; or
 - ✓ Is cash or a cash equivalent asset which is not restricted in its use.

All other assets should be classified as non-current assets.

- **Non-current assets** includes tangible, intangible, operating and financial assets of a long-term nature. Other terms with the same meaning can be used (eg 'fixed', 'long-term').

Current assets, Cont'd...

- Current assets therefore include inventories and trade receivables that are sold, consumed and realised as part of the normal operating cycle. ***This is the case even where they are not expected to be realised within twelve months.***
- Current assets will also include **marketable securities** if they are expected to be realised within twelve months after the reporting period. If expected to be realised later, they should be included in non-current assets.

Current liabilities

- A liability should be classified as a **current liability** when it:
 - ✓ Is expected to be settled in the normal course of the entity's operating cycle; or
 - ✓ Is held primarily for the purpose of trading; or
 - ✓ Is due to be settled within twelve months after the end of the reporting period; or when
 - ✓ The entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the end of the reporting period.
- **All other liabilities should be classified as non-current liabilities.**

Current liabilities, Cont'd...

- The categorisation of current liabilities is very similar to that of current assets. Thus, some current liabilities are part of the **working capital** used in the normal operating cycle of the business (ie trade payables and accruals for employee and other operating costs).
- Such items will be classed as current liabilities ***even where they are due to be settled more than twelve months after the end of the reporting period.***

Current liabilities, Cont'd...

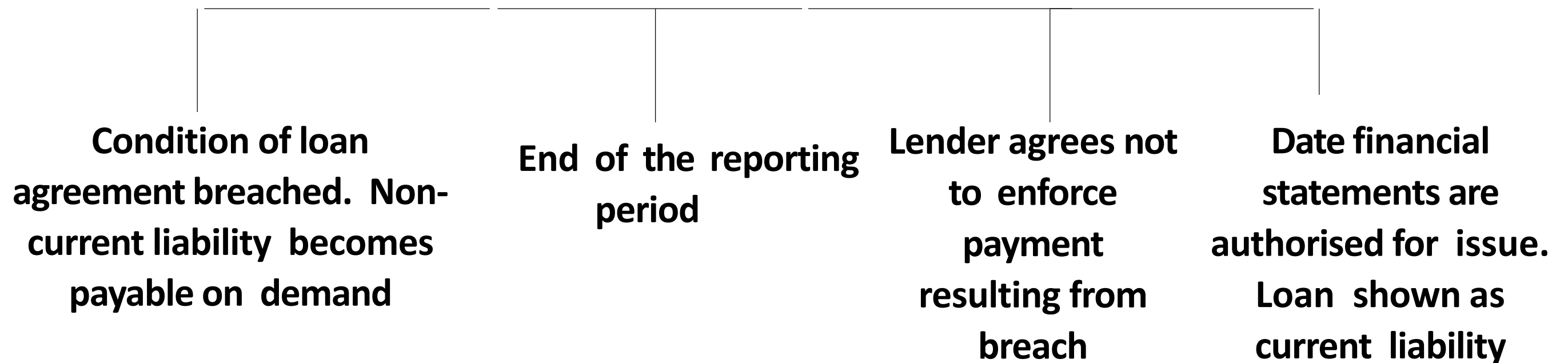
- There are also current liabilities which are not settled as part of the normal operating cycle, but which are due to be settled within twelve months of the end of the reporting period. These include:
 - bank overdrafts, income taxes, other non-trade payables and the current portion of interest-bearing liabilities.
- Any interest-bearing liabilities that are used to finance working capital on a long-term basis, and that are not due for settlement within twelve months, should be classed as ***non-current liabilities***.

A **non-current financial liability** due to be settled within twelve months of the end of the reporting period should be classified as a **current liability**, even if an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the end of the reporting period and before the financial statements are authorized for issue.

Current liabilities, Cont'd...



A **non-current financial liability** that is payable on **demand** because the entity **breached** a **condition** of its loan agreement should be classified as **current** at the end of the reporting period even if the **lender** has agreed **after the end of the reporting period**, and **before** the financial statements are **authorised for issue**, **not to demand payment** as a consequence of the breach.



However, if the **lender** has **agreed** by the **end of the reporting period** to provide a **period of grace** ending **at least twelve months after the end of the reporting period** within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as **non-current**.

Example 1

On 1 Jan 2021 an **entity invested \$1,000,000 in government bonds** in exchange for the following contractual cash flows:

- **interest fixed at 10% per year payable (in arrears) on each of 1 January 2022, 2023, 2024 and 2025; and**
- **capital is repayable in 4 equal annual instalments of \$250,000 each starting 1 January 2022.**

At 31 Dec 2021 what is the current/non-current split of the \$1,100,000 (Financial asset) ?

- **\$350,000** ccurrent (ie \$100,000 due on 01/01/2022 and \$250,000 due on 01/01/2022)
- **\$750,000** non-current (ie \$250,000 due on 01/01/2023; \$250,000 due on 01/01/2024; and \$250,000 due on 01/01/2025)

Example 2

At 31 December 2022 an entity was **in breach of a covenant** in a loan that is otherwise repayable 3 years later.

- the breach entitles (but does not oblige) the bank to require immediate repayment.

At 31 Dec 2022 the loan is a **current liab** b/c at 31 Dec. 2022 the entity does **not have** an **unconditional right to defer** settlement for at least 12 months.

RQD: Would your answer be different if: in Jan 2023, before the entity's 2022 FS were approved for issue, the bank formally agreed not to demand early repayment of the loan?

Statement of Cash Flows (SoCF)



Introduction

- **Statements of Cash Flows** are a useful addition to the financial statements because it is recognised that accounting profit is not the only indicator of a company's performance.
- It has been argued that '**profit**' does not always give a useful or meaningful picture of a company's operations.
- Readers of a company's financial statements might even be **mislead by a reported profit figure**.
 - (a) Shareholders might believe that if a company makes a profit after tax, of say, \$100,000 then this is the amount which it could afford to **pay as a dividend**. Unless the company has **sufficient cash** available to stay in business and also to pay a dividend, the shareholders' expectations would be wrong.
 - (b) Employees might believe that if a company makes profits, it can afford to **pay higher wages** next year. This opinion may not be correct: the ability to pay wages depends on the **availability of cash**.

Introduction, Cont'd...

(C) Survival of a business entity depends not so much on profits as on its **ability to pay its debts when they fall due**. Such payments might include 'revenue' expenditures such as material purchases, wages, interest and taxation etc, but also capital payments for new non-current assets and the repayment of loan capital when this falls due (for example on the redemption of debentures).

From these examples, it may be apparent that a company's performance and prospects depend not so much on the 'profits' earned in a period, but more realistically on liquidity or cash flows.

Purpose of the Statement of Cash Flows

- To provide relevant information about the ***cash receipts*** and ***cash payments*** of an enterprise during a period.
 - **assessing the *amounts, timing, and uncertainty* of cash flows.”**
- The statement provides answers to the following questions:
1. Where did the **cash come from?**
 2. What was the **cash used for?**
 3. What was the **change in the cash balance?**

Definitions

- The standard gives the following definitions, the most important of which are **cash** and **cash equivalents**.
 - **Cash** comprises cash on hand and demand deposits.
 - **Cash Equivalents** are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.
 - **Cash Flows** are inflows and outflows of cash and cash equivalents.
 - **Operating Activities** are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
 - **Investing Activities** are the acquisition and disposal of non-current assets and other investments not included in cash equivalents.
 - **Financing Activities** are activities that result in changes in the size and composition of the equity

Cash and cash equivalents

- The standard expands on the definition of cash equivalents:
 - ✓ *they are not held for investment or other long-term purposes, but rather to meet short-term cash commitments.*
 - ☞ To fulfil the above definition, an investment's **maturity date should normally be within three months from its acquisition date.**
- It would usually be the case then that equity investments (ie shares in other companies) are **not** cash equivalents. An exception would be where preferred shares were acquired with a very close maturity date.

Cash and Cash Equivalents

- **Bank Overdrafts** are usually repayable on demand and are treated as part of an entity's total cash management system. In these circumstances an overdrawn balance will be included in cash and cash equivalents. Such banking arrangements are characterized by a balance which fluctuates between overdrawn and credit.
- **Movements** between different types of cash and cash equivalent are not included in cash flows. The investment of surplus cash in cash equivalents is part of cash management, not part of operating, investing or financing activities.

Presentation of a statement of cash flows

- IFRS requires statements of cash flows to report cash flows during the period classified by **operating**, **investing** and **financing** activities.
- The manner of presentation of cash flows between operating, investing and financing activities **depends on the nature of the entity**.
- By classifying cash flows between different activities in this way, users can see the impact on cash and cash equivalents of each one, and their relationships with each other. We can look at each in more detail.

Operating Activities

- This is perhaps the key part of the statement of cash flows because it shows whether, and to what extent, companies can **generate cash from their operations**.
- It is these operating cash flows which must, in the end pay for all cash outflows relating to other activities, ie paying loan interest, dividends and so on.
- Most of the components of cash flows from operating activities will be those items which **determine the net profit or loss of the entity**, ie they relate to the main revenue-producing activities of the entity.
- The standard gives examples of cash flows from operating activities, including.
 - 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**

Certain items may be included in the net profit or loss for the period which do *not* relate to operational cash flows, for example the profit or loss on the sale of a piece of plant will be included in net profit or loss, but the cash flows will be classed as Investing.

Investing Activities

- The cash flows classified under this heading show the extent of new investment in **assets which will generate future profit and cash flows**. The standard gives the following examples of cash flows arising from investing activities.
 - (a) Cash payments **to acquire** property, plant and equipment, intangibles and other non-current assets, including those relating to capitalised development costs and self-constructed property, plant and equipment
 - (b) Cash receipts from **sales of** property, plant and equipment, intangibles and other non-current assets
 - (c) Cash payments **to acquire** shares or debentures of other entities
 - (d) Cash receipts from **sales of** shares or debentures of other entities
 - (e) Cash **advances and loans** made to other parties
 - (f) Cash receipts from the **repayment of** advances and loans made to other parties

Financing Activities

- This section of the statement of cash flows shows the share of cash which the **entity's capital providers** have claimed during the period. This is an indicator of **likely future interest and dividend payments**. The standard gives the following examples of cash flows which might arise under this heading.
 - (a) Cash proceeds **from issuing shares**
 - (b) Cash payments to owners **to acquire or redeem** the entity's shares
 - (c) Cash proceeds **from issuing** debentures, loans, notes, bonds, mortgages and other short or long-term borrowings
 - (d) Principal **repayments** of amounts borrowed under leases
- Item (d) needs more explanation. Where the reporting entity uses an asset held under a lease, the amounts to go in the statement of cash flows as **financing activities** are repayments of the **principal (capital)** rather than the **interest**. The interest paid will be shown under **operating activities**.

Reporting Cash Flows from Operating Activities

- The standard offers a choice of method for this part of the statement of cash flows:
 - a) **Direct Method:** disclose major classes of **gross cash receipts and gross cash payments**
 - b) **Indirect Method:** **net profit or loss is adjusted** for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows

1 Using the Direct Method

- There are different ways in which the **information about gross cash receipts and payments** can be obtained.
- The most obvious way is simply to extract the information from the accounting records. This may be a laborious task, however, and converting accrual-based revenues and expenses into cash receipts & cash payments may be easier.

2 Using the Indirect Method

- This method is undoubtedly **easier** from the point of view of the preparer of the statement of cash flows. The net profit or loss for the period is adjusted for:
 - a) **Changes during the period** in inventories, operating receivables and payables
 - b) **Non-cash items**, eg depreciation, provisions, consumption of prepaid expenses, profits/losses on the sales of assets
 - c) **Other items**, the cash flows from which should be classified under investing or financing activities.

- A **proforma** of such a calculation is presented as follows and this method may be more common in the exam.

Cash Flows from Operating Activities-Indirect Method

	\$
<i>Cash flows from operating activities</i>	
Profit before taxation	X
Adjustments for:	
Depreciation	X
Foreign exchange loss	X
Investment income	(X)
Interest expense	X
	<u>X</u>
Increase in trade and other receivables	(X)
Decrease in inventories	X
Decrease in trade payables	(X)
Cash generated from operations	<u>X</u>
Interest paid	(X)
Income taxes paid	(X)
<i>Net cash from operating activities</i>	<u><u>X</u></u>

- It is important to understand why **certain items are added and others subtracted**. Note the following.
- (a) **Depreciation** is not a cash expense, but is deducted in arriving at profit. It makes sense, therefore, to eliminate it by adding it back.
 - (b) By the same logic, a **loss on a disposal** of a non-current asset (arising through underprovision of depreciation) needs to be added back and a profit deducted.
 - (c) An **increase in inventories** means less cash – you have spent cash on buying inventory.
 - (d) An **increase in receivables** means the company's debtors have not paid as much, and therefore there is less cash.
 - (e) If we **pay off payables**, causing the figure to decrease, again we have less cash.

Indirect versus Direct

- The direct method is encouraged where the necessary information is not too costly to obtain, but IFRS does not require it. In practice, the indirect method is more commonly used, since it is quicker and easier.

Interest and Dividends

- Cash flows from interest and dividends received and paid should each be **disclosed separately**. Each should be classified in a consistent manner from period to period as either operating, investing, or financing activities.
- Dividends or interest paid by the entity can be classified in **one of two ways**:
 - a) As a **financing cash flow**, showing the cost of obtaining financial resources
 - b) As a component of **cash flows from operating activities** so that users can assess the entity's ability to pay dividends or interests out of operating cash flows

Taxes on Income

- Cash flows arising from taxes on income should be **separately disclosed** and should be classified as cash flows from operating activities **unless** they can be specifically identified with specific financing and investing activities.
- Taxation cash flows are often **difficult to match** to the originating underlying transaction, so most of the time all tax cash flows are classified as arising from operating activities.

Components of Cash and Cash Equivalents

- The components of cash and cash equivalents should be disclosed and a **reconciliation** should be presented, showing the amounts in the statement of cash flows reconciled with the equivalent items reported in the statement of financial position.

Other Disclosures

- All entities should disclose, together with a **commentary by management**, any other information likely to be of importance, for example:
 - (a) Restrictions on the use of or access to any part of cash equivalents
 - (b) The amount of undrawn borrowing facilities which are available
 - (c) Cash flows which increased operating capacity compared to cash flows which merely maintained operating capacity
 - (d) Non-cash transactions

Example of a Statement of Cash Flows

- In the next section, we will look at the procedures for preparing a statement of cash flows.

STATEMENT OF CASH FLOWS (DIRECT METHOD) – YEAR ENDED 31 DECEMBER 20X7

	\$	
<i>Cash flows from operating activities</i>		
Cash receipts from customers	30,330	
Cash paid to suppliers and employees	<u>(27,600)</u>	
Cash generated from operations	2,730	
Interest paid	(270)	
Income taxes paid	<u>(900)</u>	
<i>Net cash from operating activities</i>		1,560
<i>Cash flows from investing activities</i>		
Purchase of property, plant and equipment	(900)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividends received	<u>200</u> \$m	
<i>Net cash used in investing activities</i>		(480)
<i>Cash flows from financing activities</i>		
Proceeds from issue of share capital	250	
Proceeds from long-term borrowings	250	
Dividends paid*	<u>(1,290)</u>	
<i>Net cash used in financing activities</i>		<u>(790)</u>
<i>Net increase in cash and cash equivalents</i>		290
<i>Cash and cash equivalents at beginning of period</i>		<u>120</u>
<i>Cash and cash equivalents at end of period</i>		<u>410</u>

*This could also be shown as an operating cash flow.

STATEMENT OF CASH FLOWS (INDIRECT METHOD) – YEAR ENDED 31 DECEMBER 20X7

Cash flows from operating activities

	\$	\$
Profit before taxation	3,570	
Adjustments for: Depreciation	450	
Investment income	(500)	
Interest expense	<u>400</u>	
	3,920	
Increase in trade and other receivables	(500)	
Decrease in inventories	1,050	
Decrease in trade payables	<u>(1,740)</u>	
Cash generated from operations	2,730	
Interest paid	(270)	
Income taxes paid	<u>(900)</u>	
<i>Net cash from operating activities</i>		1,560

Cash flows from investing activities

Purchase of property, plant and equipment	(900)	
Proceeds from sale of equipment	20	
Interest received	200	
Dividends received	<u>200</u>	
<i>Net cash used in investing activities</i>		(480)

Cash flows from financing activities

Proceeds from issue of share capital	250	
Proceeds from long-term borrowings	250	
Dividends paid*	<u>(1,290)</u>	
<i>Net cash used in financing activities</i>		<u>(790)</u>

Net increase in cash and cash equivalents 290

Cash and cash equivalents at beginning of period 120

Cash and cash equivalents at end of period 410

*This could also be shown as an operating cash flow

Preparation of the Statement of Cash Flows

Sources of Information

Information obtained from several sources:

- (1) comparative statement of financial position,
- (2) current Statement of Profit/Loss/income statement, and
- (3) selected transaction data.

Example: preparation of a statement of cash flows

Kane Co's statement of profit or loss for the year ended 31 December 20X2 and statements of financial position at 31 December 20X1 and 31 December 20X2 were:

KANE CO

STATEMENT OF PROFIT OR LOSS FOR THE YEAR ENDED 31 DECEMBER 20X2

	\$'000	\$'000
Sales		720
Raw materials consumed	70	
Staff costs	94	
Depreciation	118	
Loss on disposal of non-current asset	<u>18</u>	
		<u>300</u>
Operating profit		420
Interest payable		<u>28</u>
Profit before tax		392
Taxation		<u>124</u>
Profit for the year		<u>268</u>

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER

	20X2 \$'000	20X1 \$'000
Non-current assets		
Cost	1,596	1,560
Depreciation	<u>(318)</u>	<u>(224)</u>
	<u>1,278</u>	<u>1,336</u>
Current assets		
Inventory	24	20
Trade receivables	76	58
Bank (Cash)	<u>48</u>	<u>56</u>
	<u>148</u>	<u>134</u>
Total assets	<u>1,426</u>	<u>1,470</u>
Equity and liabilities		
Equity		
Share capital	360	340
Share premium	36	24
Retained earnings	<u>716</u>	<u>514</u>
	<u>1,112</u>	<u>878</u>
Non-current liabilities:		
Long-term loans	200	500
Current liabilities:		
Trade payables	<u>12</u>	<u>6</u>
Taxation	<u>102</u>	<u>86</u>
	<u>114</u>	<u>92</u>
Total equity and liabilities	<u>1,426</u>	<u>1,470</u>

Dividends paid were \$66,000

During the year, the company paid \$90,000 for a Machinery

Required: Prepare a statement of cash flows for Kane Co for the year ended 31 December, using the indirect method.

KANECO

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 20X2

	\$000	\$'000
<i>Cash flows from operating activities</i>		
Profit before tax	392	
Depreciation charges	118	
Loss on sale of tangible non-current assets	18	
Interest expense	28	
Increase in inventories (W4)	(4)	
Increase in receivables (W4)	(18)	
Increase in payables (W4)	<u>6</u>	
Cash generated from operations	540	
Interest paid	(28)	
Dividends paid	(66)	
Tax paid (W3)	<u>(108)</u>	
<i>Net cash from operating activities</i>		338
<i>Cash flows from investing activities</i>		
Payments to acquire tangible non-current assets	(90)	
Receipts from sales of tangible non-current assets (W1)	<u>12</u>	
<i>Net cash used in investing activities</i>		(78)
<i>Cash flows from financing activities</i>		
Issues of share capital	32	
Long-term loans repaid (W3)	<u>(300)</u>	
<i>Net cash used in financing activities</i>		<u>(268)</u>
Decrease in cash and cash equivalents		(8)
Cash and cash equivalents at 1.1.X2		<u>56</u>
Cash and cash equivalents at 31.12.X2		<u>48</u>

Workings

1 Assets

B/d

Addition

Depreciation charge

Disposals NBV (54 – 24)

C/d

Non-current

assets

\$'000

1,336

90

(118)

(30)

1,278

Disposal proceeds = $(30 - 18) = 12$

2. Equity

	<i>Share capital \$'000</i>	<i>Share premium \$'000</i>	<i>Retained earnings \$'000</i>
B/d	340	24	514
Share issue	20	12	
SPL			268
Dividends paid (per Q)	<u>—</u>	<u>—</u>	<u>(66)</u>
3	<u>360</u>	<u>36</u>	<u>716</u>

3. Liabilities

	<i>Long-term loans \$'000</i>	<i>Taxation \$'000</i>
B/d	500	86
SPL		124
Cash paid ⁴ (β)	<u>(300)</u>	<u>(108)</u>
C/d	<u>200</u>	<u>102</u>

4. Working capital changes

	<i>Inventories \$'000</i>	<i>Trade receivables \$'000</i>	<i>Trade payables \$'000</i>
B/d	20	58	6
Increase (decrease) (β)	<u>4</u>	<u>18</u>	<u>6</u>
C/d	<u>24</u>	<u>76</u>	<u>12</u>

Exercise (To be attempted by students)

Set out below are the financial statements of Emma Co.

STATEMENT OF PROFIT OR LOSS FOR THE YEAR ENDED 31 DECEMBER 20X2

	\$'000
Revenue	2,553
Cost of sales	<u>(1,814)</u>
Gross profit	739
Other income: interest received	25
Distribution costs	(125)
Administrative expenses	(264)
Finance costs	<u>(75)</u>
Profit before tax	300
Income tax expense	<u>(140)</u>
Profit for the year	<u>160</u>

STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER

	20X2 \$'000	20X1 \$'000
<i>Assets</i>		
Non-current assets		
Property, plant and equipment	380	305
Intangible assets	250	200
Investments	—	25
Current assets		
Inventories	150	102
Receivables	390	315
Short-term investments	50	—
Cash in hand	<u>2</u>	<u>1</u>
<i>Total assets</i>	<u>1,222</u>	<u>948</u>
	20X2	20X1
<i>Equity and liabilities</i>	\$'000	\$'000
Equity		
Share capital (\$1 ordinary shares)	200	150
Share premium account	160	150
Revaluation surplus	100	91
Retained earnings	260	180
Non-current liabilities		
Long-term loan	130	50
Environmental provision	40	
Current liabilities		
Trade payables	127	119
Bank overdraft	85	98
Taxation	<u>120</u>	<u>110</u>
<i>Total equity and liabilities</i>	<u>1,222</u>	<u>948</u>

The following information is available.

- (a) The proceeds of the sale of non-current asset investments amounted to \$30,000.
- (b) Fixtures and fittings, with an original cost of \$85,000 and a net book value of \$45,000, were sold for \$32,000 during the year.

(c) The following information relates to property, plant and equipment.

	31.12.20X2	31.12.20X1
	\$'000	\$'000
Cost	720	595
Accumulated depreciation	<u>340</u>	<u>290</u>
Net book value	<u>380</u>	<u>305</u>

- (d) On 31 December 20X2 Emma purchased a chalk quarry from which extraction will take place for five years. At the end of that time Emma will be obliged to close off the quarry and make the area safe. The cost of this has been estimated and discounted to a present value of \$40,000, which is included in the carrying amount of the quarry and shown as a provision.
- (e) 50,000 \$1 ordinary shares were issued during the year at a premium of 20c per share.
- (f) The short-term investments are highly liquid and are close to maturity.
- (g) Dividends of \$80,000 were paid during the year.

Required

10-Dec-24

Prepare a statement of cash flows for the year to 31 December 20X2.

Notes to the financial statements

Some items need to be disclosed by way of note.

Contents of notes

The notes to the financial statements will **amplify** the information given in the financial statements.

To some extent, the contents of the notes will be determined by the level of detail shown on the **face of the statements**.

Structure

The notes to the financial statements should perform the following functions.

- (a) Provide information about the **basis on which the financial statements were prepared** and which **specific accounting policies** were chosen and applied to significant transactions/events
- (b) Disclose any information, not shown elsewhere in the financial statements, which is **required by IFRSs**
- (c) Show any additional information that is relevant to understanding which is not shown elsewhere in the financial statements

Notes to the financial statements will amplify the information shown therein by giving the following:

- (a) More **detailed analysis** or breakdown of figures in the statements
- (b) **Narrative information** explaining figures in the statements
- c) **Additional information**, eg contingent liabilities and commitments

IFRS suggests a **certain order** for notes to the financial statements. This will assist users when comparing the statements of different entities.

- (a) Statement of **compliance** with IFRSs
- (b) Statement of the **measurement basis** (bases) and accounting policies applied
- (c) **Supporting information** for items presented in each financial statement in the same order as each line item and each financial statement is presented
- (d) Other disclosures, eg:
 - (i) Contingent liabilities, commitments and other financial disclosures
 - (ii) Non-financial disclosures

The order of specific items may have to be varied occasionally, but a systematic structure is still required.

Presentation of accounting policies

The accounting policies section should describe the following.

- (a) The **measurement basis** (or bases) used in preparing the financial statements
- (b) The **other accounting policies** used, as required for a proper understanding of the financial statements

This information may be shown in the notes or sometimes as a **separate component** of the financial statements.

The information on measurement bases used is obviously fundamental to an understanding of the financial statements. Where **more than one basis is used**, it should be stated to which assets or liabilities each basis has been applied.

Other disclosures

An entity must disclose in the notes:

- (a) The amount of dividends proposed or declared before the financial statements were authorised for issue but not recognised as a distribution to owners during the period, and the amount per share
- (b) The amount of any cumulative preference dividends not recognized

The notes disclosure ends by listing some **specific disclosures** which will always be required if they are not shown elsewhere in the financial statements.

- (a) The domicile and legal form of the entity, its country of incorporation and the address of the registered office (or, if different, principal place of business)
- (b) A description of the nature of the entity's operations and its principal activities
- (C) The name of the parent entity and the ultimate parent entity of the group

Comprehensive Illustration (Reading Assignment)

The accountant of Wislon Co has prepared the following list of account balances as at 31 December 20X7.

50c ordinary shares (fully paid)	\$'000	450
10% loan notes (secured)		200
Retained earnings 1.1.X7		242
General reserve 1.1.X7		171
Land and buildings 1.1.X7 (cost)		430
Plant and machinery 1.1.X7 (cost)		830
Accumulated depreciation		
Buildings 1.1.X7		20
Plant and machinery 1.1.X7		222
Inventory 1.1.X7		190
Sales		2,695
Purchases		2,152
Ordinary dividend		15
Loan note interest		10
Wages and salaries		254
Light and heat		31
Sundry expenses		113
Suspense account		135
Trade accounts receivable		179
Trade accounts payable		195
Cash		126

Notes

(a) Sundry expenses include \$9,000 paid in respect of insurance for the year ending 1 September 20X8. Light and heat does not include an invoice of \$3,000 for electricity for the three months ending 2 January 20X8, which was paid in February 20X8. Light and heat also includes \$20,000 relating to salesmen's commission.

(b) The suspense account is in respect of the following items.	\$'000
Proceeds from the issue of 100,000 ordinary shares	120
Proceeds from the sale of plant	<u>300</u>
	420
Less consideration for the acquisition of Mary & Co	<u>285</u>
	<u>135</u>

(c) The net assets of Mary & Co were purchased on 3 March 20X7. Assets were valued as follows.

Equity investments	231
Inventory	<u>34</u>
	<u>265</u>

All the inventory acquired was sold during 20X7. The equity investments were still held by Wislon at 31.12.X7. Goodwill has not been impaired in value.

- (d) The property was acquired some years ago. The buildings element of the cost was estimated at \$100,000 and the estimated useful life of the assets was fifty years at the time of purchase. As at 31 December 20X7 the property is to be revalued at \$800,000.
- (e) The plant which was sold had cost \$350,000 and had a carrying amount of \$274,000 as on 1.1.X7.
\$36,000 depreciation is to be charged on plant and machinery for 20X7.
- (f) The management wish to provide for:
 - (i) Loan note interest due
 - (ii) A transfer to general reserve of \$16,000
 - (iii) Audit fees of \$4,000
- (g) Inventory as at 31 December 20X7 was valued at \$220,000 (cost).
- (h) Taxation is to be ignored.

Required

Prepare the statement of profit & loss and other comprehensive income, statement of changes in equity and statement of financial position of Wislon Co as at 31 December 20X7. You do not need to produce notes to the statements.

Solution

- (a) Normal adjustments are needed for accruals and prepayments (insurance, light and heat, loan note interest and audit fees). The loan note interest accrued is calculated as follows.

	\$'000
Charge needed in profit or loss ($10\% \times \$200,000$)	20
Amount paid so far, as shown in list of account balances	<u>10</u>
Accrual: presumably six months' interest now payable	<u>10</u>

The accrued expenses shown in the statement of financial position comprise:

	\$'000
Loan note interest	10
Light and heat	3
Audit fee	<u>4</u>
	<u>17</u>

(b) The misposting of \$20,000 to light and heat is also adjusted, by reducing the light and heat expense, but charging \$20,000 to salesmen's commission.

(c) Depreciation on the building is calculated as $\frac{\$100,000}{50}$
= \$2,000.

The carrying amount of the building is then $\$430,000 - \$20,000 - \$2,000 = \$408,000$ at the end of the year. When the property is revalued a reserve of $\$800,000 - \$408,000 = \$392,000$ is then created.

(d) The profit on disposal of plant is calculated as proceeds \$300,000 (per suspense account) less carrying amount \$274,000, ie \$26,000. The cost of the remaining plant is calculated at $\$830,000 - \$350,000 = \$480,000$. The depreciation provision at the year end is:

\$'000

Balance 1.1.X7

222

Charge for 20X7

36

Less depreciation on disposals (350 – 274)

(76)

182

(e) Goodwill arising on the purchase of Mary & Co is:

	\$'000
Consideration (per suspense account)	285
Assets at valuation	<u>265</u>
Goodwill	<u>20</u>

This is shown as an asset in the statement of financial position. The equity investments, being owned by Wislon at the year end, are also shown on the statement of financial position, whereas Mary's inventory, acquired and then sold, is added to the purchases figure for the year.

(f) The other item in the suspense account is dealt with as follows.

	\$'000
Proceeds of issue of 100,000 ordinary shares	120
Less nominal value $100,000 \times 50c$	<u>50</u>
Excess of consideration over par value (= share premium)	<u>70</u>

(g) The transfer to general reserve increases it to \$171,000 + \$16,000 = \$187,000.

**We can now prepare the
financial statements?**

WISLON CO

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20X7

	\$'000
Revenue	2,695
Cost of sales (W1)	<u>(2,156)</u>
Gross profit	539
Other income (profit on disposal of plant)	26
Administrative expenses (W2)	<u>(437)</u>
Finance costs	<u>(20)</u>
Profit for the year	108
Other comprehensive income:	
Gain on property revaluation	<u>392</u>
Total comprehensive income for the year	<u>500</u>
Note	

The only item of 'other comprehensive income' for the year was the revaluation gain. If there had been no revaluation gain, only a statement of profit or loss would have been required.

Workings

1 *Cost of sales*

	\$'000
Opening inventory	190
Purchases (2,152 + 34)	2,186
Closing inventory	<u>(220)</u>
	<u>2,156</u>

2 *Administrative expenses*

	\$'000
Wages, salaries and commission (254 +20)	274
Sundry expenses (113 – 6)	107
Light and heat (31 – 20 + 3)	14
Depreciation: buildings	2
plant	36
Audit fees	<u>4</u>
	<u>437</u>

WISLON CO

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20X7

	\$'000	\$'000	
<i>Assets</i>			
<i>Non-current assets</i>			
Property, plant and equipment			
Property at valuation			800
Plant: cost		480	
accumulated depreciation		<u>(182)</u>	
Goodwill			<u>298</u>
Equity investments			231
<i>Current assets</i>			
Inventory		220	
Trade accounts receivable		179	
Prepayments		6	
Cash		<u>126</u>	
<i>Total assets</i>			<u>1,880</u>
<i>Equity and liabilities</i>			
Equity			
50c ordinary shares		500	
Share premium		70	
Revaluation surplus		392	
General reserve		187	
Retained earnings		<u>319</u>	
			1,468
<i>Non-current liabilities</i>			
10% loan stock (secured)			200
<i>Current liabilities</i>			
Trade accounts payable		195	
Accrued expenses		<u>17</u>	
			<u>212</u>
<i>Total equity and liabilities</i>			<u>1,880</u>

WISLON CO
STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 20X7

	<i>Share capital</i>	<i>Share premium</i>	<i>Retained earnings</i>	<i>General reserve</i>	<i>Revalu. Surplus Total</i>	
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Balance at 1.1.X7	450	—	242	171	—	863
Issue of share capital	50	70				120
Dividends			(15)			(15)
Total comprehensive income f						
or the year	108		392	500		
Transfer to reserve	—	—	(16)	16	—	—
Balance at 31.12.X7	<u>500</u>	<u>70</u>	<u>319</u>	<u>187</u>	<u>392</u>	<u>1,468</u>

Note. The total comprehensive income is analysed into its components.

Events After the Reporting Period

10-Dec-24

Definition of terms

Events after the reporting period :

. . . those events, favorable and unfavorable, that occur b/n the end of the reporting period & the date when the financial statements are authorized for issue

Two types of events (Adjusting Vs Non-Adjusting):

- (a) Adjusting events:** those that **provide evidence of conditions** that existed at the end of the reporting period and
- (b) Non-adjusting events:** those that are **indicative of conditions** that **arose** after the reporting period

Recognition and Measurement

Adjusting events are recognized in the SoFP & St. of P/L if **they occur prior to the statements being authorized**

Determining when the FS are authorized is a matter of **judgment** but depends on:

the *structure of mgmt*

statutory requirements, and

an entity's *governance & procedures*

For example: if the **BODs** must **formally approve** the **FS** before issue, then this is the point that divides the transactions b/n those recognized this year and those that are not

Recognition & Measurement

Examples of events	Adjusting events ²	Non-adjusting events
Lawsuits	Settlement of lawsuit that existed at year end—the settlement provides additional information that helps measure the impact on the financial statements.	Settlement of lawsuit that arose after year end. The lawsuit was not a condition that existed at year end.
Impairments	Bankruptcy of a customer/investee where a receivable/investment existed at year end (and there was evidence of financial distress). Normally a period of financial distress precedes the actual bankruptcy whether that financial distress is openly evident or not.	Bankruptcy of a customer where no receivable existed at year end or where a receivable existed but was fully provided for or due to an event such as an uninsured fire that occurs after year end.

Recognition & Measurement

Example of event	Adjusting event	Non-adjusting event
Bonus	Determination of bonus after year end where a present legal or constructive obligation existed at year end	Determination of bonus after year end where a present legal or constructive obligation did not exist at year end

Disclosure

The following are disclosures required:

- The **date when the FS were authorized**, including who gave the authorization
- **Where adjusting events occur, related disclosures should be updated**, as well; and
- Where **non-adjusting events occur and are material, the nature of the event & an estimate of its financial effect** (or a statement that the financial effect cannot be determined)

Disclosure: non-adjusting

Ex :as of June 30/2022 - USD:50ETB

XYZ had A/P (in USD) of \$1mn

Note 20: Events after the end of the reporting period

The FS were authorised for issue on 1 Sep. 2022 when the exchange rate was **ETB51:USD1**. The **deterioration of the exchange rate** from ETB50:USD1 at 30 June 2022 **has increased** the expected settlement amount of the USD- denominated liability by ETB1,000,000.

END

CHAPTER 4