# PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS UNDER INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) - AN OVERVIEW

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# Chapter I

## HISTORY OF ACCOUNTING

### Early History

Ancient economic thought of the Near East facilitated the creation of accurate records of the quantities and relative values of agricultural products, methods that were formalized in trading and monetary systems by 2000 BC. Simple accounting is mentioned in the Christian Bible (New

Testament) in the Book of Matthew, in the Parable of the Talents. The Islamic Quran also mentions simple accounting for trade and credit arrangements.

**Luca Pacioli and the birth of modern accountancy**

Luca Pacioli (1445 - 1517), also known as Friar Luca dal Borgo, is credited for the "birth" of accountancy. His Summa de arithmetica, geometrica, proportioni et proportionalita (Summa on arithmetic, geometry, proportions and proportionality, Venice 1494), was a textbook for use in the abbaco schools of northern Italy, where the sons of merchants and craftsmen were educated. It was a compendium of the mathematical knowledge of his time, and includes the first printed description of the method of keeping accounts that Venetian merchants used at that time, known as the double-entry accounting system.

**Post-Pacioli**

The first known book in the English language on accounting was published in London, England by John Gouge (or Gough) in 1543. It is described as A Profitable Treatyce called the Instrument or Boke to learn to know the good order of the kepyng of the famous reconynge, called in Latin, Dare and Habere, and, in English, debtor and Creditor

**Origin in India**

Ancient India is a prime example of a culture whose accounting practices merit more attention due to their complexity and innovation. Looking back at Indian history, one finds that the art and practice of accounting were present in India even in Vedic times The Rig-Veda has references to accounting and commercial terms like kraya (sale), Vanij (merchant), sulka (price). As Prof. Max Mueller observed

There is very clear evidence of the highly developed Hindu accounting tradition in “Arthashastra” written by Kautilya (also known as Chanakya and Vishnugupta) around 300 B.C. When literally translated, it means ‘Scripture of Wealth’. Though it focuses on creation and management of wealth, it is a masterpiece covering a wide range of topics like statecraft, politics, warfare, law, accounting systems, taxation, fiscal policies, civil rules, internal and foreign trade etc.

# Chapter II

## HISTORY AND DEVELOPMENT OF ACCOUNTING STANDARDS

### Financial Accounting Standards Board

The impetus for the Financial Accounting Standards Board dates back to the economic boom of the 1920s, the stock market crash of 1929, and the Great Depression that followed. By the mid-1930s, both the financial community and the federal government had responded to the obvious need for uniform accounting standards, particularly for the financial statements of publicly traded corporations. The New York Stock Exchange and what is now the American Institute of Certified Public Accountants (AICPA) ventured preliminary guidelines in the jointly published Audits of Corporate Accounts of 1934. The congressional Securities Act of 1933 and the Securities Exchange Act of 1934 threatened to supersede such efforts by establishing the U.S. Securities and Exchange Commission (SEC), which was authorized, among other functions, to prescribe standards for the preparation of financial reports. In 1938, however, the SEC voted to forgo this prerogative and allow the private sector to regulate its accounting practices

The AICPA's Committee on Accounting Procedure (CAP) assumed the financial accounting standard-setting role in 1939. The AICPA shifted this responsibility to its Accounting Principles Board (APB), equipped with its own research staff, in 1959. Even so, the APB's main contribution—Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises, published in 1970—was criticized as achieving too little, too late. In 1971, a special committee of the AICPA suggested that the association turn over the standard-setting role to an autonomous body. In 1973, therefore, the Financial Accounting Standards Board within the Financial Accounting Foundation was established. Soon thereafter, the SEC ratified the FASB's role in promulgating financial accounting and reporting "principles, standards, and practices."

### International Accounting Standards

Some of the most significant dates in the history of international accounting standards from the 1960s to 2005 are given below.

**1966**

In 1966, there was a proposal to establish an International Study Group comprising the Institute of Chartered Accountants of England & Wales (ICAEW), American Institute of Certified Public Accountants (AICPA) and Canadian Institute of Chartered Accountants (CICA).

**1967**

In February 1967 the Accountants International Study Group (AISG) was formed and they began to publish papers on important topics every few months .Many of these papers led the way for the standards that followed, when in March 1973 it was finally agreed to establish an international body writing accounting standards for international use.

**1973**

In June 1973 the International Accounting Standards Committee (IASC) came into existence, with the stated intent that the new international standards it released must "be capable of rapid acceptance and implementation world-wide". The IASC survived for 27 years, until 2001, when the organisation was restructured and the International Accounting Standards Board (IASB) came into existence.

Between 1973 and 2000 the International Accounting Standards Committee (IASC) released a series of standards called 'International Accounting Standards' in a numerical sequence that began with IAS 1 and ended with IAS 41 Agriculture which was published in December 2000.

IASB stated that they would adopt the body of standards issued by the Board of the International Accounting Standards Committee (which would continue to be designated 'International Accounting Standards' but any new standards would be published in a series called International Financial Reporting Standards (IFRS)

**1997**

The Standing Interpretations Committee (SIC) was established in 1997 to consider contentious accounting issues that needed authorative guidance to stop widespread variation in practice.

**2002**

The European Council of Ministers realizing the benefits of a truly international standards, approved a regulation on 6th June, 2002 that would require all EU companies listed on a regulated market to prepare accounts in accordance with International Accounting Standards for accounting periods beginning on or after 1 January 2005

**2003**

The first IFRS was published in June 2003 (IFRS 1: First-time Adoption of International Financial Reporting Standards).

**2005**

Listed companies in the UK were required to present their financial statements using the international accounting standards adopted by the EU for periods commencing on or after 1 January 2005.

**Other international accounting standards**

**International Public Sector Accounting Standards (IPSAS)**

IPSAS are accounting standards for application by national governments, regional (e.g., state, provincial, territorial) governments, local (e.g., city, town) governments and related governmental entities (e.g., agencies, boards and commissions). IPSAS standards are widely used by intergovernmental organizations. IPSAS do not apply to government business enterprises.

IPSAS are issued by IPSASB (International Public Sector Accounting Standards Board).

**Islamic Financial Services Board (IFSB),**

The Islamic Financial Services Board (IFSB), which is based in Kuala Lumpur, serves as an international-standard setting body of regulatory and supervisory agencies that have vested interest in ensuring the soundness and stability of the Islamic financial services industry, which is defined broadly to include banking, capital market and insurance. In advancing this mission, the IFSB promotes the development of a prudent and transparent Islamic financial services industry through introducing new, or adapting existing international standards consistent with

Islamic Shari'ah principles, and recommend them for adoption.

The 178 members of the IFSB include 42 regulatory and supervisory authorities as well as International Monetary Fund, The World Bank, Bank for International Settlements, Islamic Development Bank, Asian Development Bank, and 130 market players and professional firms operating in 34 jurisdictions.

IFSB has published standards 1 to 7 so far

## Chapter III

## ACCOUNTING STANDARDS IN INDIA

### 1. Accounting Standards Board (ASB)

The Institute of Chartered Accountants of India (ICAI) being a member body of the IASC, constituted the Accounting Standards Board (ASB) on 21st April, 1977, with a view to harmonize the diverse accounting policies and practices in use in India. After the vowed adoption of liberalization and globalization as the corner stone's of Indian economic policies in early '90s, and the growing concern about the need of effective corporate governance of late, the Accounting Standards have increasingly assumed importance. While formulating accounting standards, the ASB takes into consideration the applicable laws, customs, usages and business environment prevailing in the country. The ASB also gives due consideration to International Financial Reporting Standards (IFRSs)/ International Accounting Standards (IASs) issued by IASB and tries to integrate them, to the extent possible, in the light of conditions and practices prevailing in India. ICAI has issued 32 Accounting standards so far and has announced that it will fully converge to IFRS by 2011.

The Accounting Standards will be mandatory from the respective date(s) mentioned in the Accounting Standard(s). The mandatory status of an Accounting Standard implies that while discharging their attest functions, it will be the duty of the members of the Institute to examine whether the Accounting Standard is complied with in the presentation of financial statements covered by their audit. In the event of any deviation from the Accounting Standard, it will be their duty to make adequate disclosures in their audit reports so that the users of financial statements may be aware of such deviation.

Ensuring compliance with the Accounting Standards while preparing the financial statements is the responsibility of the management of the enterprise. Statutes governing certain enterprises require of the enterprises that the financial statements should be prepared in compliance with the Accounting Standards, e.g., the Companies Act, 1956 (section 211), and the Insurance Regulatory and Development Authority (Preparation of Financial Statements and Auditor's Report of Insurance Companies) Regulations, 2000.

Financial Statements cannot be described as complying with the Accounting Standards unless they comply with all the requirements of each applicable Standard

**2. Companies (Accounting Standard) Rules, 2006**

Accounting standards are also notified by Central Government in exercise of the powers conferred by clause (a) of sub-section (1) of section 642 of the Companies Act, 1956 , read with sub-section (3C) of section 211 and sub-section (1) of section 210A of the said Act, in consultation with National Advisory Committee on Accounting Standards. Central Government notified Accounting Standards in Companies (Accounting Standard) Rules, 2006 by notification o. G.S.R. 739 (E), dated 7$^{th}$ December, 2006[AS 1 to 7 and 9 to 29 of ICAI]. It also issued Companies (Accounting Standards) Amendment Rules, 2008 by notification no. G.S.R. No. 212 (E), dated 27$^{th}$ March, 2008 making some modification in existing rules so as to harmonize them with accounting standards issued by ICAI. These standards are applicable to preparation of general purpose financial statements for accounting periods commencing on or after 7-12-2006

**3. Sec 145 of Income Tax Act, 1961- Method of Accounting**

Sec 145 (2) has empowered The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assessees or in respect of any class of income.

Vide Notification S.O.69 (E) dated 25.01.1996, the Central Government has notified the following accounting standards to be followed by all assessees following the mercantile system of accounting, namely

Accounting standard I- Disclosure of Accounting policies

Accounting Standard II relating to disclosure of prior period and extraordinary items and changes in accounting policies

**4. Accounting Standards for Local Bodies, issued by the Council of the Institute of Chartered Accountants of India.**

The term 'Local Body' may be defined as a local self-government at the third tier of governance in an administrative and geographical vicinity, e.g., a municipal corporation, a municipality or a panchayat. In many cases, the Local Bodies delegate their functions such as building of schools, city roads, parks, running transport services, providing water supply etc., to some other bodies that may or may not be controlled by the Local Bodies, e.g. development authorities, boards, parastatals. Such bodies may be constituted, in partnership with private sector or otherwise, directly or indirectly by or on behalf of a Local Body to promote or carry out some specific objective(s) or function(s) of the Local Bodies. Such bodies may be constituted under a statute. The term 'Local Body' would also encompass such bodies.

The Accounting standards issued so far include:

1. Accounting Standard for Local Bodies (ASLB) 3- Revenue from Exchange Transactions

(Based on corresponding IPSAS 9)

2. Accounting Standard for Local Bodies (ASLB) 4- Borrowing Costs (Based on corresponding IPSAS 5)

**5. Cost Accounting Standards**

Institute of Cost and Works Accountants of India [ICWAI] has issued seven Accounting standards which are recommendatory in nature and every member of the institute is expected to honour the same.

Cost Auditors have to adopt and encourage the adoption of the standards, wherever applicable, in maintenance of Cost Accounting Records Rules under Section 209(1)(d) and report deviations, if any, in the Audit Reports under Section 233B

**So far ICWAI has issued CAS 1 TO 7. CAS 8 TO 12 are in draft stage**

# Chapter IV

## NEED FOR IFRS

A single set of accounting standards would have the following benefits:

a) Ease to standardize training and assure better quality of accounting profession

b) It would also permit international capital to flow more freely

c) It would enable companies to develop consistent global practices on accounting problems.

d) It would be beneficial to regulators as a complexity associated with needing to understand various reporting regimes would be reduced.

e) It would enhance comparability between financial statements of various companies across the globe

f) It would reduce time and resources required to prepare different set of accounts for companies listed in various exchanges of the world and for companies having global group companies.

### India and IFRS

Accounting Standards in India are issued by Accounting Standard Board (ASB) of Institute of Chartered Accountants of India and are largely based on IFRS. However, India has not been able to keep pace with the amendment and additions made in IFRS from time to time. This is largely because of its sensitivity to local conditions including the conflicting legal and economic environment. However, with the opening of Indian economy in near past, the convergence to IFRS has become unavoidable. Keeping this in view, ASB decided to form an IFRS task force in August 2006. Based on the recommendation of this task force, the Council of ICAI, in its 269th meeting decided to fully converge with IFRS from the accounting periods commencing on or after 1st April 2011. At initial stage, this convergence will be mandatory for listed and other public interest entities like banks, insurance companies, NBFCs, and large sized organizations with high turnover or annual income.

**Why this convergence?**

Converging with IFRS will have multiple benefits for Indian entities especially those who aspire to go global. Some of the benefits of convergence with IFRS are explained below:

**a) Accessibility to foreign capital markets**

The force of globalization has enabled the concept of 'open economy' and increasing numbers of countries has opened doors for foreign investment and foreign capital. Many Indian entities expanding and making their presence felt in international arena. Huge amount of capital commitment are required in this process for which entities have to list their shares in various stock exchanges around the world. Majority of stock exchanged either require or permit IFRS complaint accounts. Adaptation of IFRS will enable Indian entities to have access to international capital markets.

**b) Reduced Cost**

At present when Indian entities list their securities abroad they have to make another set of accounts which are acceptable in that country. Convergence with IFRS will eliminate this need for preparation of dual financial statements and thereby reduce the cost of raising capital from foreign markets.

**c) Enhance Comparability**

If the Financial statements of Indian entities are made in lines of IFRS, they will have greater comparability and will enable foreign companies to have broader and deeper understanding of the entities relative standing. This will also facilitate mergers, amalgamation and acquisition decisions.

**d) Boon for multinational group entities**

Entities in India may have a holding, subsidiary or associate company in some other nation. Compliance with IFRS for all group entities will enable the company management to have all the financial statements of the group in one reporting platform and hence will facilitate the consolidation process.

**e) New Opportunities for the professionals**

Migration to IFRS will not only be beneficial for Indian corporates, it will also be a boon to Indian accounting and other associated fields. India is a country with immense human resource. With knowledge of IFRS Indian professional can immerge as leading accounting service provider around the globe. This convergence will also open the flood gate of opportunities for valuers and actuaries as IFRS is fair value based accounting standard.

## Chapter V

## IASC FOUNDATION CONSTITUTION

The International Accounting Standards Committee (IASC) was formed in 1973 through an agreement made by professional accountancy bodies from Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and Ireland, and the United States of America. Additional sponsoring members were added in subsequent years, and in 1982 the sponsoring "members" of the IASC comprised all of the professional accountancy bodies that were members of the International Federation of Accountants (IFAC).

Accounting standards were set by a part-time, volunteer **IASC Board** that had 13 country members and up to 3 additional organisational members. Each member was generally represented by two "representatives" and one "technical advisor". The individuals came from a wide range of backgrounds – accounting practice, business (particularly multinational businesses), financial analysis, accounting education, and national accounting standard-setting.

The Board also had a number of observer members (including representatives of IOSCO, FASB, and the European Commission) who participated in the debate but did not vote

**The New Structure: Background and Chronology**

After nearly 25 years of achievement, IASC concluded in 1997 that to continue to perform its role effectively, it must find a way to bring about convergence between national accounting standards and practices and high-quality global accounting standards. To do that, IASC saw a need to change its structure. In late 1997 IASC formed a Strategy Working Party to re-examine its structure and strategy. (Jacques Manardo, Deloitte Touche Tohmatsu Global Managing Partner-Strategic Clients, was a member of that group.)

The Strategy Working Party published its Report, in the form of a Discussion Paper, in December 1998. After soliciting comments, the Working Party published its Final Recommendations in November 1999.

The IASC Board approved the proposals unanimously in December 1999, and the IASC member bodies did the same in May 2000. A new IASB Constitution took effect 1 July 2000. It would operate under a new International Accounting Standards Committee Foundation (IASCF).

On 1 April 2001, the new IASB took over from the IASC the responsibility for setting International Accounting Standards.

**Key Differences between IASC and IASB**

The IASB differs from the IASC Board, its predecessor body, in several key areas:

Unlike the IASC Board, the IASB does not have a special relationship with the international accounting profession. Instead, IASB is governed by a group of Trustees

of diverse geographic and functional backgrounds who are independent of the accounting profession.

Unlike the members of the IASC Board, members of the IASB are individuals who are appointed based on technical skill and background experience rather than as representatives of specific national accountancy bodies or other organizations.

Unlike the IASC Board, which only met about four times a year, the IASB Board usually meets each month. Moreover, the number of technical and commercial staff working for IASB has increased significantly as compared with IASC. (Similar to IASC, the headquarters of the IASB is located in London, the United Kingdom.)

The interpretive body of the IASC (SIC), has been replaced by the International Financial Reporting Interpretations Committee (IFRIC).

**Overview of the Restructured IASB**

The IASB is organised under an independent Foundation named the International Accounting Standards Committee Foundation (IASCF). That Foundation is a not-for-profit corporation created under the laws of the State of Delaware, United States of America, on 8 March 2001. Components of the new structure:

**1. International Accounting Standards Board** – has sole responsibility for establishing International Financial Reporting Standards (IFRSs).

**2. IASC Foundation** – oversees the work of the IASB, the structure, and strategy, and has fundraising responsibility.

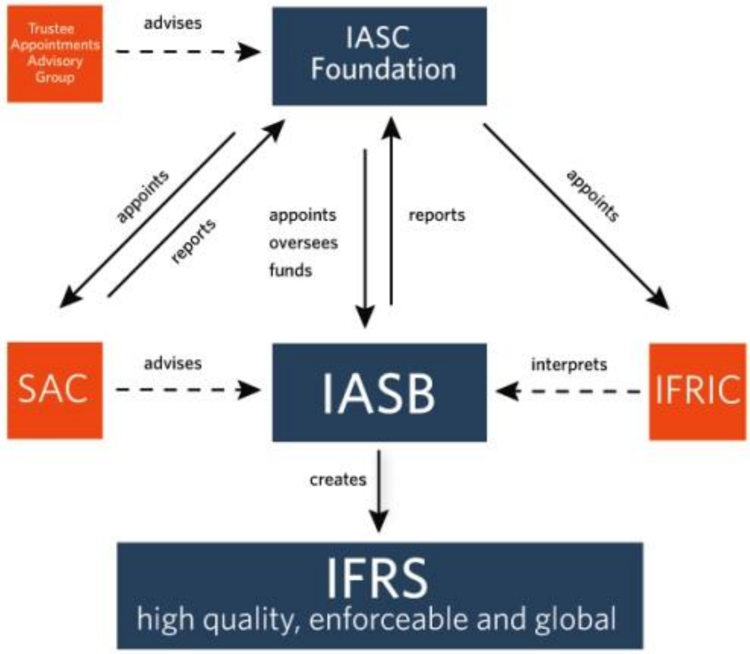
**3. International Financial Reporting Interpretations Committee (IFRIC)** – develops interpretations for approval by the IASB.

**4. Standards Advisory Council (SAC)** – advises the IASB and the IASCF.

**5. Working Groups** – expert task forces for individual agenda projects.

**6. Monitoring Board of Public Authorities-** effective 01.02.2009

**Diagrammatic representation of the bodies associated with IFRS**




## Chapter VI

## FRAMEWORK FOR THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

The IASB Framework was approved by the IASC Board in April 1989 for publication in July 1989, and adopted by the IASB in April 2001.

**Purpose of the framework**

The purpose of the Framework is:

(a) To assist the Board of IASC

in the development of future International Accounting Standards and in its review of existing International Accounting Standards;

in promoting harmonization of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by International Accounting Standards;

(b) To assist national standard-setting bodies in developing national standards;

(c) To assist preparers of financial statements in applying International Accounting Standards and in dealing with topics that are not yet the subject of an International Accounting Standard;

(d) To assist auditors in forming an opinion as to whether financial statements conform with International Accounting Standards;

(e) To assist users of financial statements in interpreting the information contained in financial statements prepared in conformity with International Accounting Standards; and

(g) To provide those who are interested in the work of IASC with information about its approach to the formulation of International Accounting Standards.

**Scope of Framework**

**The scope of the Framework is to explain**

**(a) The objective of financial statements**;

The financial statement of any enterprise should serve at its minimum the following objectives

I. To provide information regarding financial position, performance and changes in financial performance of an entity

II. To show the results of stewardship of management

III. To provide information regarding the liquidity of the entity

However, the financial statements need not provide all information that an user may require to arrive at decision as they contain only financial information and not the non financial information.

**(b) The qualitative characteristics that determine the usefulness of information in financial statements;**

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are

i. **Understandability-** users with reasonable knowledge of the business and economic activities may be able to comprehend the financial statements.

ii. **Relevance-** The users should find the information contained in the financial statements as a useful relevant tool in taking important economic decisions on the basis of past evaluations and projecting future predictions on past basis.

iii. **Reliability** - Information in financial statements is reliable if it is free from material error and bias and can be depended upon by users to represent events and transactions faithfully. Information is not reliable when it is purposely designed to influence users' decisions in a particular direction.

iv. **Comparability** - Users must be able to compare the financial statements of an enterprise over time so that they can identify trends in its financial position and performance. Users must also be able to compare the financial statements of different enterprises. Disclosure of accounting policies is essential for comparability. [F.39-42]

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

**Elements of Financial Statements**

**(1) Assets:**

**Definition:** It is resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow.

**Recognition:** When it is probable that future economic benefits will flow to and the asset has cost or value that can be reliably measured

**(2) Liabilities:**

**Definition:** It is the present obligation of an entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

**Recognition:** When it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be reliably measured.

**(3) Equity**

**Definition**: it is the residual interest in the asset of the entity after deducting all its liability.

**(4) Income**

**Definition:** Income is the increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities those results in increase in equity, other than those relating to contribution from equity participants. It encompasses both revenue and gains.

**Recognition:** When an increase in the future economic benefits related to an increase in an asset or decrease in a liability has arisen that can be reliably measured.

**(5) Expenses**

**Definition:** It is the decrease in economic benefits during the accounting period in the form of outflows or depletion of assets or incurrence of liabilities those results in decrease in equity, other than those relating to contribution to equity participants. It encompasses both losses and expenses that arise in the course of ordinary activity of the entity.

**Recognition:** When an decrease in the future economic benefits related to an decrease in an asset or increase in a liability has arisen that can be reliably measured

**Measurement of the Elements of Financial Statements**

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

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

- Historical cost

- Current cost
- Net realisable (settlement) value
- Present value (discounted)

Historical cost is the measurement basis most commonly used today, but it is usually combined with other measurement bases. The Framework does not include concepts or principles for selecting which measurement basis should be used for particular elements of financial statements or in particular circumstances. The qualitative characteristics do provide some guidance, however.

**(d) Concepts of capital and capital maintenance**.

The concept of capital maintenance is concerned with how an entity defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of profit because it provides the point of reference by which profit is measured; it is a prerequisite for distinguishing between an entity's return on capital and its return of capital; only inflows of assets in excess of amounts needed to maintain capital may be regarded as profit and therefore as a return on capital. Hence, profit is the residual amount that remains after expenses (including capital maintenance adjustments, where appropriate) have been deducted from income. If expenses exceed income the residual amount is a loss.

**Users of financial statement and their information needs**

The Framework notes that financial statements cannot provide all the information that users may need to make economic decisions. For one thing, financial statements show the financial effects of past events and transactions, whereas the decisions that most users of financial statements have to make relate to the future. Further, financial statements provide only a limited amount of the non-financial information needed by users of financial statements.

While all of the information needs of these user groups cannot be met by financial statements, there are information needs that are common to all users, and general purpose financial statements focus on meeting these needs.

**Responsibility for Financial Statements**

The management of an enterprise has the primary responsibility for preparing and presenting the enterprise's financial statements.

| | |
|---|---|
| **Investors** | Risk inherent in, and return provided by, their investments.<br><br>Such Information is needed for decision making and to determine their return |
| **Employees** | stability and profitability of their employers<br><br>Information which enables them to assess the ability of the enterprise to provide remuneration, retirement benefits and employment opportunities. |
| **Lenders** | Whether loans repayments and interest will be paid when due and to access their security |
| **Suppliers and other trade creditors** | Whether amounts owing to them will be paid when due. |
| **Customers** | Continuance of an enterprise, especially when they have a long-term involvement with, or are dependent on, the enterprise. |
| **Government and their agencies** | Allocation and utilization of resources and the activities of the enterprise<br><br>To regulate the activities of enterprises, determine taxation |

| | |
|---|---|
| | policies and as the basis for national income and similar statistics. |
| **Public** | Contribution to the local economy<br><br>Trends and recent developments in the prosperity of the enterprise and the range of its activities. |

**LIST OF IFRS:**

| Sl. No. | IFRS / IAS / IFRIC / SIC | Number of IFRS / IAS / IFRIC / SIC | Name of IFRS / IAS / IFRIC / SIC |
|---|---|---|---|
| 1 | IFRS | 1 | First - time Adoption of International Financial Reporting Standards |
| 2 | IFRS | 2 | Share-based Payment |
| 3 | IFRS | 3 | Business Combinations |
| 4 | IFRS | 4 | Insurance Contracts |
| 5 | IFRS | 5 | Non-current Assets Held for Sale and Discontinued Operations |
| 6 | IFRS | 6 | Exploration for and evaluation of Mineral Resources |
| 7 | IFRS | 7 | Financial Instruments: Disclosures |
| 8 | IFRS | 8 | Operating Segments |
| 9 | IAS | 1 | Presentation of Financial Statements |

| Sl. No. | IFRS / IAS / IFRIC / SIC | Number of IFRS / IAS / IFRIC / SIC | Name of IFRS / IAS / IFRIC / SIC |
|---|---|---|---|
| 10 | IAS | 2 | Inventories |
| 11 | IAS | 11 | Statement of Cash Flows |
| 12 | IAS | 8 | Accounting Policies, Changes in Accounting Estimates and Errors |
| 13 | IAS | 10 | Events After the Reporting Period |
| 14 | IAS | 11 | Construction Contracts |
| 15 | IAS | 12 | Income Taxes |
| 16 | IAS | 16 | Property, Plant and Equipment |
| 17 | IAS | 17 | Leases |
| 18 | IAS | 18 | Revenue |
| 19 | IAS | 19 | Employee Benefits |
| 20 | IAS | 20 | Accounting for Government Grants and Disclosure of Government Assistance |
| 21 | IAS | 21 | The Effects of Changes in Foreign Exchange Rates |
| 22 | IAS | 23 | Borrowing Costs |
| 23 | IAS | 24 | Related Party Disclosures |
| 24 | IAS | 26 | Accounting and Reporting by Retirement Benefit Plans |

| Sl. No. | IFRS / IAS / IFRIC / SIC | Number of IFRS / IAS / IFRIC / SIC | Name of IFRS / IAS / IFRIC / SIC |
|---|---|---|---|
| 25 | IAS | 27 | Consolidated and Separate Financial Statements |
| 26 | IAS | 28 | Investments in Associates |
| 27 | IAS | 29 | Financial Reporting in Hyperinflationary Economies |
| 28 | IAS | 31 | Interests In Joint Ventures |
| 29 | IAS | 32 | Financial Instruments: Presentation – Disclosure provisions superseded by IFRS 7 effective 2007 |
| 30 | IAS | 33 | Earnings Per Share |
| 31 | IAS | 34 | Interim Financial Reporting |
| 32 | IAS | 36 | Impairment of Assets |
| 33 | IAS | 37 | Provisions, Contingent Liabilities and Contingent Assets |
| 34 | IAS | 38 | Intangible Assets |
| 35 | IAS | 39 | Financial Instruments: Recognition and Measurement |
| 36 | IAS | 40 | Investment Property |
| 37 | IAS | 41 | Agriculture |
| 38 | IFRIC | 1 | Changes in Existing Decommissioning, Restoration and Similar Liabilities |
| 39 | IFRIC | 2 | Members' Shares in Co-operative Entities and Similar Instruments |

| Sl. No. | IFRS / IAS / IFRIC / SIC | Number of IFRS / IAS / IFRIC / SIC | Name of IFRS / IAS / IFRIC / SIC |
|---|---|---|---|
| 40 | IFRIC | 4 | Determining Whether an Arrangement Contains a Lease |
| 41 | IFRIC | 5 | Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds |
| 42 | IFRIC | 6 | Liabilities Arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment |
| 43 | IFRIC | 7 | Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies |
| 44 | IFRIC | 8 | Scope of IFRS 2 |
| 45 | IFRIC | 9 | Reassessment of Embedded Derivatives |
| 46 | IFRIC | 10 | Interim Financial Reporting and Impairment |
| 47 | IFRIC | 11 | IFRS 2: Group and Treasury Share Transactions |
| 48 | IFRIC | 12 | Service Concession Arrangements |
| 49 | IFRIC | 13 | Customer Loyalty Programmes |
| 50 | IFRIC | 14 | IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction |
| 51 | IFRIC | 15 | Agreements for the Construction of Real Estate |
| 52 | IFRIC | 16 | Hedges of a Net Investment in a Foreign Operation |
| 53 | IFRIC | 17 | Distributions of Non-cash Assets to Owners |

| Sl. No. | IFRS / IAS / IFRIC / SIC | Number of IFRS / IAS / IFRIC / SIC | Name of IFRS / IAS / IFRIC / SIC |
|---|---|---|---|
| 54 | IFRIC | 18 | Transfers of Assets from Customers |
| 55 | SIC | 7 | Introduction of the Euro |
| 56 | SIC | 10 | Government Assistance – No Specific Relation to Operating Activities |
| 57 | SIC | 12 | Consolidation – Special Purpose Entities |
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# Chapter VII

## PRESENTATION OF FINANCIAL STATEMENTS UNDER IFRS

### 7.1 INTRODUCTION

*IAS 1: Presentation of Financial Statements* prescribes the basis for preparation of General Purpose Financial Statements of entities complying with the IFRS. The purpose of the IAS 1 is to prescribe standards such that the financial statement presented under the IFRS is comparable with the:

- Entities financial statements of the previous period and;
- Financial statements of another entity

IAS 1 not only sets out the overall requirements for the presentation of financial statements, but also provides guidelines for their structure and minimum requirement for their contents. However, it does not prescribe any fixed format for presentation of Financial Statements though it includes a sample of illustrative financial statement structure in its *Guidance on Implementing IAS 1*which is optional.

**Evolution of IAS 1**

*IAS 1: Presentation of Financial Statements* was originally issued by IASC in September 1997. It replaces *IAS 1 Disclosure of Accounting Policies, IAS 5 Information to be Disclosed in Financial Statements* and *IAS 13 Presentation of Current Assets and Current Liabilities.* Thereafter a revised IAS 1 was issued in December 2003 and finally in September 2007. However, it cannot be said that even currently the IAS 1 has evolved to its desired form as IASB is in process of revising IAS 1 yet again.

**Scope of IAS 1**

IAS 1 applies to preparation and presentation of **General Purpose Financial Statement.** General Purpose Financial Statement are defined in paragraph 7 as those intended to meet the needs of users who are not in position to require an entity to prepare reports tailored to their particular information needs.

IAS 1 can be applied by all type of undertakings, including profit oriented and not-for-profit entities, public and private entities. However, not for profit entities may be required to change the descriptions used for the financial statements and line items within their financial statements. This standard applies to both Consolidated Financial Statements and Separate Financial Statements as defined in *IAS 27 Consolidated and Separate Financial Statements.* However, it does not apply to the structure of condensed interim Financial Statements prepared in accordance with IAS 34 *Interim Financial Reporting*

**Purpose of Financial Statements**

IAS 1 as revised till date refers to Financial Statements as structured representation of the financial performance and financial position of entity. Paragraph 9 of IAS 1 state that the objective of Financial Statements is to provide information about the entities financial position, its performance, and its cash flows, which is the utilized by the wide range of end users in making economic decisions. Moreover, it also shows results of management's stewardship of the resources entrusted to it.

IAS 1 defines a complete set of Financial Statements to be comprised of the following:

i. A statement of financial position as at the end of the period; (this was in earlier versions of IAS 1 referred to as 'Balance Sheet')

ii. A statement of comprehensive income for the period;

  - Components of profit or loss may be presented either as part of single statement of comprehensive income or in separate income statement

  - When an income statement is prepared it should be displayed immediately before the statement of comprehensive income

iii. A statement of changes in equity for the period;

iv. A statement of cash flows for the period; (earlier referred to as cash flow statement)

v. Notes, comprising a summary of significant accounting policies and other explanatory information; and

vi. A statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

The complete set may be for interim or annual period. Moreover, the titles may differ from those specified here for instance a 'statement of financial position' may be referred to as 'Balance Sheet'. Nevertheless, the titles of all the above mentioned components should be written with equal prominence and must be distinguished from other statements which management may decide to prepare at its discretion or under any regulatory requirements but which are out of the scope of IFRS.

Accounting policies may be presented as a separate statement or incorporated within notes. The notes are as important as any of the other four primary statements. Notes present the information which may be presented on the face of the statement of financial position or statement of comprehensive income or in notes. Beside these all those information which cannot be presented anywhere in the primary statements are disclosed through notes.

An entity may present additional information on a voluntary basis like report of financial review by management, environmental report or value added statement however, these statements and reports are out of scope of IFRS.

## 7.2 BASIS OF PREPARATION OF FINANCIAL STATEMENTS

### 1. Fair Presentation and compliance with IFRSs

It is required under IAS 1 that financial statements should *fairly* present the entity's financial position, financial performance and cash flows. Appropriate and consistent application of the Framework and IFRS is presumed to result in financial statements that give a fair presentation, which refers to faithful representation of the effects of transactions, other events and conditions. Paragraph 17 of IAS 1 states that *in virtually all circumstances* the use of IFRS will result in fair presentation. A fair presentation also requires an entity:

i. to select and apply accounting policies in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

ii. to present information in a manner it provides relevant, reliable, comparable and understandable information

iii. to go beyond IFRS disclosure requirements in order to enable users to understand and assess the effects of significant unusual events, transactions or accounting treatments which may otherwise not be fully understood.

However, it should be noted that an entity cannot rectify an inappropriate accounting policy either by disclosure of the accounting policy used or by giving explanatory notes.

Under IFRS all entities complying with IFRS should make an explicit and unreserved statement of such compliance in the notes. This statement should not be made by the entity unless they comply with all the requirements of the IFRS. The requirement to comply in full with all IFRS and its interpretations is designed to prevent selective application of the standards and publication of so-called 'IFRS-lite' financial statements. Financial statements that do not comply with any one or more of specific standards are not IFRS-compliant. If an accounting matter is not a subject of any particular IFRS, management must consider the appropriateness of such treatment in the light of “The Framework”, other accepted practices and policies adopted.

**Departure from IFRS under exceptional circumstances**

The application of IFRS requirements in full, possibly supplemented by additional disclosures, will lead to a fair presentation of an entity's financial situation in virtually all circumstances. However, management can rebut this presumption in extremely rare circumstances if it believes that applying a particular IFRS requirement would be misleading. A departure from an IFRS is not permitted where it is made only in order to comply with national accounting and/or legal requirements. Departures from IFRS are very seldom seen in practice as the requirements and disclosures are very extensive. These disclosures make users aware that the entity has not complied with IFRS in all material respects. They give sufficient information to enable users to make an informed judgment as to whether the departure is necessary, and to calculate the adjustments that would be required to comply with the standard.

The purpose of such extensive disclosure is to enable the users of the financial statements to access the impact the compliance with IFRS would have had on the financial statements. The following disclosures should be made where management adopts to override IFRS requirements:

i. management's statement that the financial statements are presented fairly (despite the departure from a standard);

ii. a statement that the financial statements comply with IFRS in all other material respects;

iii. a statement that the financial statements depart from an IFRS, and identification of the standard;

iv. the nature of the departure and the reason for it;

v. the treatment normally required and the treatment actually adopted; and

vi. the financial impact of the departure on assets, liabilities, equity, net profit or loss and cash flows for each period presented.

Moreover, when assessing the need to depart from the requirements of any IFRS it is essential the management must consider the following:

- why the objective of the requirement cannot be made; and
- how the circumstances of the entity differs from those of the other entities who comply with IFRS.

After making these assessments, if there is a legitimate reason for departure from IFRS and the entity makes a departure, the financial statements would be regarded as compliant. In view of the strict criteria for departure from a requirement of an IFRS, IAS 1 includes a rebuttable presumption that if other entities in similar circumstances comply with a requirement, the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of financial statement as stated in the *Framework. [IAS 1 BC30]*. It may happen in extremely rare circumstances that the management concludes that the compliance with IFRS would be misleading, however, as per the regulatory requirements the management may not be permitted to depart from the IFRS. In such circumstances, the entity should disclose the following:

i. the title of the IFRS in question

ii. the nature of the requirement

iii. the reason for management concluding that that complying would be misleading for each period presented, the adjustments to each item in the financial statements that management has concluded would be necessary to achieve a fair presentation.

**2. Going Concern**

In normal circumstances, an entity prepares its financial statements on the going concern basis. An entity is a going concern if the management has neither the intention nor the need to liquidate or to cease its operations within at least 12 months from the Statement of Financial Position date. Management has to make an assessment of entities ability to continue as going concern at each reporting date. While making assessment, it the management is aware of any material uncertainties that exist the management should disclose such uncertainties that may cast significant doubt on the entity's ability to continue as a going concern.

Where the entity ceases to be a going concern, management should prepare the financial statements on a different basis such as on liquidation basis and the fact should be disclosed and the basis of preparation followed should be described. The reasons why the entity is no longer considered a going concern should also be disclosed.

**A Case Study:**

Entity X has incurred losses during the last five years of its operation, and its net worth has become negative. The entity has breached its loan covenants and is also in the process of negotiating with the banks for extension of terms of its loans. These factors raise substantial doubt that the entity will be able to continue as a going concern.

**Solution**

The Management of the entity A should disclose details of the uncertainty existing. Besides explaining the uncertainties the management should also give details of the actions proposed to address the situation. Management should also disclose the possible effects on the financial position. If it is it is impracticable to measure them, the fact should be disclosed. Additionally, management should state whether the financial statements include any adjustments that might result from the outcome of these uncertainties. In particular, if bank borrowings have been disclosed as non-current in the assumption that discussions with the bank will result in an extension of the loan facilities, details of this fact should be disclosed.

Sometimes it may happen that the management of the entity may decide to liquidate the entity after the reporting date but before the financial statements are authorized for issue. In such cases, also the management shall prepare the entity's financial statements on a basis other than going concern basis.

**3. Accrual basis of accounting**

All financial statements except the statement of cash flows should be made by entity using accrual basis of accounting. The accrual basis of accounting has been defined in the *Framework.* It means that that the effect of the transactions and other events are recognised when they occur and not when the cash or other equivalent is received or paid and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. In other words, the entity recognises the elements of financial statements i.e. assets, liabilities, equity, income and expense when they satisfy the recognition criteria specified in the *Framework.*

**4. Materiality and Aggregation**

As per IAS 1, each material class of similar items should be presented separately in the financial statements. Immaterial items, however, should be aggregated with amounts of similar nature and function. Information is regarded as material if it might reasonably affect evaluations and decisions in respect of the reporting entity, or if its omission or misstatement could influence user's economic decisions. Information is also considered material where the nature and circumstances of the transaction or event are such that users of the financial statements should be made aware of them. For example, a related party transaction should be reported even if the amount involved is insignificant. When evaluating whether an item is material, each case must be judged by its size and nature. The assessment should be made in the context of the financial statements as a whole and in relation to relevant financial statement components while making assessment qualitative as well as quantitative factors should be assessed and the sensitivity of an item to adjustment should be considered.

**A Case Study:**

Entity X reclassifies a plant, from PPE used for industrial purposes to PPE used for administrative purposes. As a result, of which the related depreciation expense was previously part of cost of sales and has subsequently been reclassified to administrative expenses. The asset's carrying value and depreciation expense for the period is not material as compared to overall entity.

The entities statement of Comprehensive Income shows the following:

| | |
|---|---|
| Revenue | Rs. 40,00,000 |
| Cost of sales | Rs. 39,95,000 |
| Gross profit | Rs. 5,000 |

Depreciation reclassified from cost of sales to administrative expenses was Rs. 8,000

**Solution**

In the above case, the management of the entity X should disclose the change in classification. The information is material as the entity has reported a 'gross profit' of RS. 5000 as a result of the reclassification rather than a 'gross loss' of Rs. 3000 which would have been presented has not the reclassification taken place. The presentation of a gross loss rather than a gross profit might alter the users' perception of the entity's performance.

**5. Offsetting**

Generally under IFRS, offsetting, or netting, of assets with liabilities or income with expenses is prohibited unless it is explicitly permitted or required by any another standard. Instances where the other IFRS permits offsetting would be

IAS 12 requires that the tax liability and tax asset should be offset where there is a legally enforceable right of offset and settlement is on net basis

IAS 20 permits offsetting of a capital grants against asset as an alternative to setting up of deferred credit.

Similarly, IAS 32 states that a financial asset and liability should be offset against each other, to present net amount in the Statement of Financial Position only when an enterprise has a currently enforceable right to set off the recognised amounts and intends to either settle on net basis or simultaneously settle the liability and realize the asset.

Offsetting, is only permitted where it reflects the substance of the transaction or other events otherwise it detracts the users to understand the transaction undertaken and to access the future cash flows of the entity. However, offsetting does not include the deduction of amounts representing an impairment of assets. Similarly, reporting the carrying amount of assets net of accumulated depreciation and amortization is not regarded as an instance of offsetting. There is no requirement to disclose the gross amount of accounts receivable and the related provision for bad and doubtful accounts. However, the valuation allowance against such accounts should be included in the carrying amount. Moreover, the transactions that are in the ordinary course of business which do not generate revenue, but which are incidental to the main revenue-generating activities, may be presented on a net basis only if such presentation reflects the substance of the transaction. However, where the transactions are of such size or significance, separate disclosure should be given in order to give a fair presentation.

In some cases netting off of with related expense arising out of same transaction is permitted. For example, gains/ losses on sale of noncurrent assets are reported after deducting carrying value and selling expenses from proceed. Moreover, expenditure directly related to a recognised provision that is reimbursed under the contractual arrangements with a third party may be netted against the reimbursement.

**6. Frequency of Reporting**

IFRS does not prescribe any fixed time period for or the frequency of financial reporting. However, it states that entity should present a complete set of account at least annually. It further requires that entity reporting for shorter or longer periods than one year should disclose the following:

The reason for using shorter or longer period; and

Te fact that the amounts presented in financial statements are not entirely comparable.

**A Case Study:**

An entity in the business of publishing weekly magazines wants to report on the weekly basis rather than for 1 year. Can it do so under IFRS?

**Solution:**

Yes, it is not precluded from doing so under IFRS provided it discloses the fact with reasons for doing so.

**7. Comparative Information**

Except when IFRSs permit or require otherwise, an entity shall disclose comparative information in respect of the previous period for all amounts reported in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements. In other words, a minimum an entity will be required to present at least two of each statement. However, in case where an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements it will be required to present an additional statement of financial position as at the beginning of the earliest comparative period. To illustrate this, suppose an entity's reporting period in 31$^{st}$ March, 2009. It reclassifies an item in its financial statements that requires it to reclassify retrospectively. In such a case entity would be required to make three statements of financial position viz. as at 31$^{st}$ March, 2009, as at 31$^{st}$ March 2008 and as at1$^{st}$

April 2007 (which is corresponding to statement of financial position as at31$^{st}$ march, 2007). It will make only two set of other statements and related notes.

**8. Consistency of preparation**

A change in presentation and classification of items from one period to the next is permitted only when it is a result of:

- a significant change in the nature of the entity's operations;
- identification of a more appropriate presentation; or
- the requirements of a new IFRS or SIC.

Where such changes are made, the corresponding figures for prior periods should also conform to the new presentation. The nature of reclassification, the amount of each item or class of items reclassified and reasons for the reclassification should also be disclosed.

An entity should disclose the reason for not reclassifying comparative information if it is impossible or economically unreasonable to determine comparable amounts for previous periods. The nature of changes that would have been made if the reclassification had been practicable should also be given.

Changes on the basis of a more appropriate presentation should only be made where the benefit of the alternative presentation is clear. The term ‘appropriate’ here would be demonstrated if the financial statements prepared are more ‘relevant’ and ‘reliable’. Such changes will therefore be infrequent.

## 7.3 STATEMENT OF FINANCIAL POSITION

Statement of Financial Position is a statement that presents assets, liabilities and shareholder’s equity (net worth) at given point of time. The Statement of Financial Position presents the ‘snapshot’ of entities resources and claims to resources at a particular time. The other titles which are popularly used for this statement is Balance Sheet, Statement of Financial Condition or Statement of Assets and Liabilities. This statement is also sometimes described as ‘stock’ statement because it reflects the balances of the entity's accounts at a moment in time. Contrary to this, other basic financial statements are described as 'flow' statements as they reflect summarized results of transaction over a period of time

**Structure and Content of Financial Statements in General**

IFRS prescribes the following details to be always displayed in the heading of the Statement of Financial Position:

- the financial statements
- the reporting enterprise
- whether the statements are for the enterprise or for a group
- the date or period covered
- the presentation currency
- the level of precision (thousands, millions, etc.)

**Elements Recognized in the Statement of Financial Position**

The elements of financial statements are the broad classifications and groupings which convey the substantive financial effects of transactions and events on the position or performance of the reporting entity. To be included in the financial statements the transaction or event should meet the definition, recognition, and measurement criteria set out in Framework or other IFRSs.

**ASSETS**

**Definition**: It is resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow.

**Recognition:** When it is probable that future economic benefits will flow to and the asset has cost or value that can be reliably measured

In other words, four important characteristics must be present for an asset to be recognised in the Statement of Financial Position are:

- The asset must provide probable future economic benefit that enables it to provide future net cash inflows.
- The entity is able to receive the benefit and restrict other entities access the benefit.
- The event that provide the entity with the right to benefit has occurred
- The asset is capable of being measured reliably.

**Future Economic Benefit**

Paragraph 53 of the *Framework* stats that 'the future economic benefit embodied in an asset is the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity'. This potential to contribute may take the form of convertibility into cash or equivalent, or reduce cash out flows or it may enhance the productivity of the operating activities of the entity. Therefore, the future economic benefits in an asset may flow to entity in many ways. For example:

- Most assets like machineries, plants etc. are used by entity to produce goods or services which are sold to the customers to and hence economic benefits flow to the entity.
- Assets like Financial Instruments may be exchanged for cash or other assets
- Assets like cash and bank balances may be used by entity to settle a liability.
- Assets may be distributed to the owners of the equity.

**Past Event**

The assets are the results of the past event or the past transaction. However, generally assets are either purchased or produced by the entity itself sometimes they may be procured by other means like government grants. Future transaction or events expected to occur in future does not give rise to an asset for example an intention to purchase or produce does not create an asset.

**Reliability of measurement**

Assets to be recognised should be capable of being reliably measured. The measurement is said to be reliable when it is free from material error and bias and users can depend upon it for making informed economic decisions. Some times IFRS permits the use of estimates if estimates give fair representations.

**Nexus of Asset and Expenses**

Generally, there is a nexus between incurrence of expenses and generating of asset though it is not essential that that the two events coincides. Thus, when entity incurs an expenditure it may happen that it does not give rise to an asset for example expenses incurred during the research phase of development of intangible asset may not be recognised in the asset. Similarly, an item may satisfy the definition of assets even in the absence of related expenditure as in the case of government grants or donations received by the entity.

**Physical Form**

Physical Form is not essential to the existence of an asset. The intangible assets like copyrights, goodwill etc. are recognised as assets despite the absence of physical form.

**Legal right of ownership**

Most assets are associated with legal right including right of ownership. However, it is not essential for existence of asset. For example, self-generated know how from which the entity can derive future economic benefit by keeping it secret.

**Classification of Asset for presentation in statement of financial position**

IAS 1 states that an entity should make a distinction between current and non current assets and liabilities, except when the presentation based on liquidity provides information that is more reliable and relevant. An item is classified as current when it satisfies any of the following requirements:

- it is expected to be realized, or is held for sale or consumption in, the entity's normal operating cycle;
- it is expected to be realized within twelve months of the reporting date;
- it is held basically for trading purpose; or
- it is unrestricted cash or cash equivalent

All other assets that do not satisfy any of the above criteria should be classified as non-current assets. If current asset category includes an item that has the life of more than twelve month, the amount that falls into next financial year should be disclosed in the notes.

Here, it is important to understand what the normal operating cycle of an enterprise is. It is the time between the acquisition of material entering into a process and its realization in cash or its equivalent. Assets like inventories and trade receivable should be classified as current assets in a classified statement of financial position even if these assets are not expected to be realized within twelve months of the statement of financial position date. However, marketable security, even though more liquid than inventories and receivable, should not be classified as current until that are expected to realize within twelve months.

**A Case Study:**

An entity operates in the aircraft building industry and is involved in building aircrafts for local and export clients. The average operating cycle is 20 months, based on the length of time it takes to build an aircraft. Management presents a classified statement of financial position to distinguish the entity's current and non-current assets and liabilities. The entity holds a held-to-maturity investment that is to mature in15 months.

**Solution**

The held –to-maturity investment should be classified as non-current. The concept of operating cycle does not apply to financial assets such as held-to-maturity investments. Management should therefore classify the investment according to the 12-month benchmark. The length of the entity's operating cycle of 20 months is not relevant to the investment's classification.

In the above example, had it been trade receivables instead of HTM investment, entity could have classified it as current assts rather than non current despite the fact that it would be realized twelve months after the reporting date.

However, an entity that does not present a classified statement of financial position should present its assets and liabilities broadly in order of increasing or decreasing liquidity. Normally, entities in the banking and insurance industry tend not to use a current non-current classified statement of financial position A financial institution's assets and liabilities can usually be realized or settled within the near future. The most useful approach to the classification of assets and liabilities is therefore to group them by the nature and list them in the approximate order of their liquidity or maturity.

An entity may also choose to present its assets and liabilities in a mixed method wherein some items are classified as current or non- current whereas other are presented according to increasing or decreasing order of liquidity if this presentation is more reliable and relevant.

**Items of Current Assets**

Only assets that meet the definition of a current asset should be classified as current. All others should be classified as non-current assets. Therefore, current asset would include:

i. **Inventories**

IAS 2 defines inventory as assets held for sale in the ordinary course of business, in the process of production for sale, or in the form of materials or supplies to be consumed in production or in rendering services. The basis of valuation and method of pricing should be disclosed and in case of manufacturing concern the break up regarding the raw materials, work-in-progress and finished goods should be disclosed either in the face of statement of financial position or in the notes.

**ii. Receivables**

It includes account receivables i.e. amount due from customers in the ordinary course of business, receivables from related companies, officers and employees of the company. Trade receivables and prepayments should be classified as current assets because they will be realized in the entity's operating cycle whereas Related party receivables should be classified as current only when there is both the ability and intention to realize those amounts within the next twelve months. If the expected realization of receivables exceeds twelve months from the reporting date, this should be disclosed. Allowances due to expected lack of collectibility and any amount pledged or discounted should be stated clearly.

### iii. Prepaid Expenses

These are assets created by prepayment of cash or incurrence of a liability which expires and convert to expenses with passage of time, use or on happening of certain events. Often this is aggregated with other amounts, as the amount involved is generally not very material.

### iv. Trading Investments

This includes investments those are held for generating a profit from short-term fluctuations and derivatives..

### v. Cash and Cash Equivalents

This includes cash on hand, undeposited checks, money orders, drafts, deposits in banks etc. Cash equivalent as per IAS 7 is 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. Therefore, the money market instruments like treasury bills, commercial papers and money market funds are all example of cash equivalent.

## Non Current Assets

All assets that do not satisfy the criteria of the current assets will be presented a non-current assets. It includes tangible, intangible, operating and financial assets of a long-term nature. Some of the examples of non current assets are as follows:

i. Held-to-maturity investments
ii. Investment Properties
iii. Property, plant and equipments
iv. Intangible Assets
v. Assets held for disposal
vi. Other Assets

## LIABILITIES

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

**Recognition: A liability** is recognised in the statement of financial position when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably

In other words, the following characteristics must be present in a liability to be recognised in a statement of financial position:

- There is a present obligation which is settled by the probable future by the entity by probable future transfer of an asset on demand or on a particular date or on happening of certain event
- This obligation is not optional for the entity and hence cannot be avoided
- The event that creates the obligation has already taken place
- The amount required to settle the obligation could be reliably measured.

**Present Obligation**

Existence of an obligation is the moot point that gives rise to a liability. The term obligation signifies a duty or responsibility to act in a certain way. This obligation may be contractual or statutory. IFRS also in some cases recognises 'constructive obligation', which may arise because of normal business practices, customs, and desire to maintain good business relations or act in equitable manner.

The present obligation should not be confused with future commitment. Therefore, if an entity makes a future commitment for purchase of an asset at a future date, it does not give rise to a present obligation and hence no liability arises. The liability arises only when the assets are delivered or entity enters into irrevocable agreement to acquire the asset.

**Outflow of resources**

As we have seen in the definition, the settlement of a liability involves outflow of resources containing economic benefits. This settlement may take various forms like payment of cash, transfer of other assets, provision of services, replacement of the obligation by other obligation, or conversion of obligation to equity. Beside this, an obligation may in some exceptional cases be settled by extinguishment by the other party.

**Reliability of measurement**

A liability to be recognised in the statement of financial position should be reliably measurable. This does not necessarily mean exact measurement should be possible. The measurement is said to be reliable when it is free from material error and bias and users can depend upon it for making informed economic decisions. Some liabilities (normally called provisions) may require use of substantial degree of estimation. They are recognised despite the estimation required if they fulfill other criteria.

**Current and non-current distinction for presentation in statement of financial position**

An entity shall classify a liability as current when it satisfies any of the following criteria:

- it expects to settle the liability in its normal operating cycle; or
- it holds the liability primarily for the purpose of trading; or
- the liability is due to be settled within twelve months after the end of the reporting period; or
- The entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

An entity shall classify all liabilities, other than those meeting one of the criteria set out above as non-current.

An entity classifies its financial liabilities as current when they are due to be settled within twelve months after the reporting period, even if:

- the original term was for a period longer than twelve months; and

- An agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting period and before the financial statements are authorized for issue.

**A Case Study:**

On 1st January 2002 entity X has entered into a facility arrangement with a financial institution to ensure the availability of X's bank financing for next 7 years. What will be the classification of this loan facility in the statement of financial position as on 31$^{st}$ March 2008 in the following situations?

a) There is no rearrangement?
b) There is an arrangement to refinance the amount of loan for another 7 years after the maturity date and arrangement is completed on 5$^{th}$ May 2008 and the financial statements are authorized for issue on 30$^{th}$ June, 2008;
c) There is an arrangement to refinance the amount of loan for another 7 years after the maturity date and arrangement is completed on 20$^{th}$ March 2008.

**Solution:**

The loan arrangement will be classified as follows:

a) In current Liabilities
b) In current liabilities
c) In noncurrent liabilities

If an entity expects, and has the discretion, to refinance or roll over an obligation for at least twelve months after the reporting period under an existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. However, it should be noted that when refinancing or rolling over the obligation is not at the discretion of the entity (e.g. there is no agreement for refinancing), the potential to refinance is not considered and the obligation is classified as current.

**A Case Study:**

Entity A's management has entered into a facility arrangement with a financial institution to ensure the availability of A's bank financing over the long term. The committed facility has a scheduled maturity and the lender is not able to cancel unilaterally. This facility does not expire within the next 12 months.

**Solution**

Entity A should classify the borrowing as a non-current liability as the borrowing can be rolled over at the entity's discretion. Conversely, where an entity does not have the discretion to refinance its borrowings, amounts due should be classified as current liabilities.

When an entity breaches a provision of a long-term loan agreement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorization of the financial statement for its presentation. This is so because, at the end of the reporting period, the entity does not have an unconditional right to defer its settlement for at least twelve months after that date

However, when an entity breaches a provision under a long-term loan agreement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as non-current 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 reporting period, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

**A case study**

An entity's long-term financing became payable on demand because certain conditions included in the financing agreement were breached. Management is negotiating with the relevant financial institution to get a waiver on the breach of the conditions. The negotiation was still ongoing on the day the financial statements were issued.

a) Can an entity classify borrowings as non-current liabilities on the basis of negotiations in progress with the lender on the reporting date?
b) Does the answer to this change if the negotiation is completed before the financial statements are approved?

**Solution**

a) No, the negotiation with the lender was not completed at the reporting date. A period of grace for at least twelve months after the reporting date was yet to be agreed by the lender. The borrowing is classified as a current liability.
b) No, the classification will remain as current as the negotiation is not complete by the reporting date.

In respect of loans classified as current liabilities, if the following events occur between the end of the reporting period and the date the financial statements are authorized for issue, those events are disclosed as non-adjusting events in accordance with IAS 10 *Events after the Reporting Period*:

a) refinancing on a long-term basis;
b) rectification of a breach of a long-term loan agreement; and
c) the granting by the lender of a period of grace to rectify a breach of a long-term loan agreement ending at least twelve months after the reporting period.

**EQUITY**

Equity is the third element that is dealt in the statement of financial position. It has been defined in the framework as the residual interest in the asset of the entity after deducting all its liabilities. It presents the cumulative net results of the past transactions and other events affecting the entity since the day one of its inception. Equity capital and reserves should be analyzed showing separately the various classes of paid-in capital, share premium and reserves. Depending on the materiality and significance of the analysis, much of the details can be presented in the notes rather than on the face of the statement of financial position. Minority interests in consolidated financial statements shall be presented as a component of equity, separately from the parent shareholders' equity.

**Information to be presented in the statement of financial position**

As a minimum, the statement of financial position shall include line items that present the following amounts:

a) property, plant and equipment;
b) investment property;
c) intangible assets;
d) financial assets (excluding amounts shown under (e), (h) and (i) below);
e) investments accounted for using the equity method;
f) biological assets;
g) inventories;
h) trade and other receivables;
i) cash and cash equivalents;
j) the total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;
k) trade and other payables;
l) provisions;
m) financial liabilities (excluding amounts shown under (k) and (l) above);
n) liabilities and assets for current tax, as defined in IAS 12 *Income Taxes*;
o) deferred tax liabilities and deferred tax assets, as defined in IAS 12;
p) liabilities included in disposal groups classified as held for sale in accordance with IFRS 5;
q) minority interest, presented within equity; and
r) issued capital and reserves attributable to owners of the parent.

IAS 1does not prescribes the order or format in which an entity presents item. It simply lists items that are sufficiently different in nature or function to warrant separate presentation in the statement of financial position. In addition:

- line items are included when the size, nature or function of an item or aggregation of similar items is such that separate presentation is relevant to an understanding of the entity's financial position; and
- the descriptions used and the ordering of items or aggregation of similar items may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity's financial position (e.g. a financial institution may amend the above descriptions to provide information that is relevant to the operations of a financial institution).

**Presentation of additional line items**

An entity shall present additional line items, headings and sub-totals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position. This judgment to present additional items separately on the basis of an assessment of the nature and liquidity of assets, the function of assets within the entity and the amounts, nature and timing of liabilities.

In other words, the use of different measurement bases for different classes of assets suggests that their nature or function differs and, therefore, that an entity presents them as separate line items. For example, different classes of property, plant and equipment can be carried at cost or at revalued amounts in accordance with IAS 16, Property, Plant and Equipment.

**Presentation of deferred tax asset or liability**

When an entity presents current and non-current assets, and current and non-current liabilities, as separate classifications in its statement of financial position, it shall not classify deferred tax assets (liabilities) as current assets (liabilities).

**IFRSs dealing mainly with assets and liabilities**

- *Frame work*: definition and recognition of assets and liabilities
- IAS 1: Presentation of Financial Statements
- IAS 2: Inventories
- IAS 8: Accounting policies, changes in Accounting Estimates and Errors
- IAS 10: Events after Reporting Date
- IAS 16: Plant, Property and Equipment
- IAS 17: Leases
- IAS 27: Consolidated and Separate Financial Statement
- IAS 28: Investment in Associates
- IAS 31: Interest in Joint Venture
- IAS 32: Financial Instrument : Presentation
- IAS 36: Impairment of Assets
- IAS 38: Intangible Assets
- IAS 39: Financial Instrument: Recognition and Measurement
- IAS 40: Investment Property
- IAS 41: Agriculture
- IFRS 2: Share Based Payment
- IFRS 3: Business Combination
- IFRS 5: Non-current Assets held for sale and Discontinued Operations
- IFRS 6: Exploration for and Evaluation of Mineral Resources
- IFRS 7: Financial Instrument : Disclosures
- IFRS 8: Operating Segment

## 7.4 STATEMENT OF COMPREHENSIVE INCOME

Besides presenting the financial position of the entity at the reporting date, another most important objective of preparation and presentation of financial statements are to present the entity's financial performance during the reporting period. It is useful to assess potential changes in the economic resources that entity control in the future predict future cash flows and form judgment about the effectiveness with which the entity controls the resources. It includes all changes in net assets during a period, except those resulting from investments by owners and distributions to owners. Therefore it comprises the element of both ‘profit and loss’ and ‘other comprehensive income’. IAS 1 *Presentation of Financial Statement* also deals with the presentation requirement of Statement of Comprehensive Income. The IASB’s *Framework* states that comprehensive income is the change in entity’s net assets over the course of the reporting period arising from non owner sources. The revised IAS 1 requires all non-owner changes in equity to be presented in either on statement of comprehensive income or two statements, a separate income statement and a statement of other comprehensive income. The present form of the statement of comprehensive income has evolved in the passage of time because of continuous revisions.

Earlier IAS 1 required presentation of income statement only and all unrealized gains and losses from non- owner activities were included in statement of changes in equity rather than income statement. The present form of the statement of comprehensive income emphasizes on ‘all inclusive concept’ of reporting. The option of presenting two separate statements is given because it is fealt that presentation in a single statement is not as important as presenting non owners changes in equity from owners changes in equity.

This change in concept is of utmost importance, as the gains and losses whether realized or not influences the decision of the investor regarding the equity of the entity. Under the current IFRS, some of the unrealized gains and losses are recognised while the others are not recognised.

**Elements Recognised in the statement of comprehensive income**

The statement of comprehensive income presents the information about income and expenses of the entity which also includes gains and losses.

**INCOME:**

**Definition:** Income is the increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities those results in increase in equity, other than those relating to contribution from equity participants. It encompasses both revenue and gains. Revenue arises in the normal course of business by its ordinary activities and is referred by different names like sales, fees, commission, rent, interest, dividend, royalty etc.

**Recognition:** When an increase in the future economic benefits related to an increase in an asset or decrease in a liability has arisen that can be reliably measured. The revenue recognition in general is dealt in details in the IAS 18 *Revenue.*

**Measurement:** Revenue in normal circumstances should be measured at the fair value of the consideration received or receivable.

**EXPENSES**

**Definition:** It is the decrease in economic benefits during the accounting period in the form of outflows or depletion of assets or incurrence of liabilities those results in decrease in equity, other than those relating to contribution to equity participants. It encompasses both losses and expenses that arise in the course of ordinary activity of the entity.

In other words, we can also say that the expenses are expired costs or items that were assets but remain no longer as an asset since they have no future value**.**

**Recognition:** When a decrease in the future economic benefits related to a decrease in an asset or increase in a liability has arisen that can be reliably measured. The matching principle requires that all expenses incurred in generating revenue should be recognised in the same period in which the related revenue is recognised.

Some costs like those on raw material, wages for direct labor consumed in manufacturing process are relatively easy to identify with related revenue generating activity. These costs are included in inventory and expensed as cost to sales when products are sold or revenue from it is realized.

On the other hand, certain expenses like depreciation, amortization of intangibles and allocation of indirect expenses, are more closely related to the accounting periods. In the absence of direct and apparent relationship the expense and revenue, these expenses are allocated to the accounting periods in a rational and systematic manner to reduce subjectivity to the maximum extent possible.

There may remain costs, which can neither be identified as relating to particular revenue, nor can they be allocated on any systematic and rational basis, such costs should be expenses in the period in which they take place. These expenses include

i. the costs for which no future benefits can be perceived,
ii. cost which were recognised as assets in prior period but which has no remaining future benefits like impairment losses, and
iii. those administrative , general and selling overheads for which no rational allocation is possible

**GAINS AND LOSSES**

As per IASB's *Framework*, the gains and losses represent increases or decrease in the economic benefits and are therefore no different in nature from revenue and expenses. Hence, they are not regarded as separate element.

**Form of statement of comprehensive income**

As discussed in the earlier paragraph, the all non-owner changes in equity to be presented in either on statement of comprehensive income or two statements, a separate income statement and a statement of other comprehensive income. However, it is important to note that where an entity presents the components of profit and loss in the separate income statement, this statement should form part of complete set of financial statement and should be placed immediately before the statement of other comprehensive income.

Although IAS 1 uses the terms 'profit or loss', 'other comprehensive income' and 'total comprehensive income', an entity may use other terms provided the meaning is clear. However, IFRS prescribes the following details to be always displayed in the heading of the statement of comprehensive income:

- The name of the entity, which should be the exact name as written in the legal document that created it.
- The title of the statement
- The period covered in the statement
- The currency and the rounding off.

**Information to be presented on the face of the statement of comprehensive income**

The following information should be disclosed on the face of the statement of comprehensive income, together with any additional headings or sub-totals as may be required by individual standards or that may be required to give a fair presentation of the entity's performance

- Revenue
- Finance costs
- Share of the profit or loss of associates and joint ventures accounted for using the equity method
- Tax Expenses
- a single amount comprising the total of
  - the post-tax profit or loss of discontinued operations and
  - the post-tax gain or loss recognised on the disposal of the assets or disposal group(s) constituting the discontinued operation
- profit or loss
- each component of other comprehensive income classified by nature
- each component of other comprehensive income of associates and joint venture accounted using equity method; and
- total comprehensive income

The following items must also be disclosed on the face of the statement of comprehensive income as allocations of

- profit or loss for the period:

  a. profit or loss attributable to minority interest; and
  b. profit or loss attributable to equity holders of the parent.

- Total comprehensive income for the period as:

  - comprehensive income attributable to minority interest; and

- comprehensive income attributable to equity holders of the parent.

The above mentioned items are the minimum items, additional line items, headings and subtotals should be presented on the face of the statement when this is relevant to understanding of the entity's financial performance.

**Income Statement: Presentation and classification**

As stated earlier, the entity can present the components of the statement of comprehensive income as singe statement of comprehensive income or in two statements segregating components of profit or loss and those pertaining to other comprehensive income. Where two statements are prepared, the income for the period reported in the income statement comprises of total income less expense excluding the components of other comprehensive income. Other comprehensive income is the total of income less expenses (including reclassification adjustments) that are not recognized in profit or loss as required or permitted by other IFRS.

When an entity presents the component of profit or loss in separate statement it should be presented just before the statement of other comprehensive income. The legal name of the entity must be used to identify the financial statement and the title 'income statement' or 'profit or loss account' as deemed appropriate should be used to distinguish the statement from the other statements presented.

The period covered by the income statement should also be clearly stated. Though, normally income statement are prepared for one year, entities may be required to present income statement for period in excess of short of one year. E.g. entities may be required to prepare interim statement or newly form subsidiary may be required to prepare statement corresponding to the accounting year of the holding company. In such, exceptional circumstances, the following additional disclosure should be made

- The reason for presenting the income statement for the period other than one year, and
- The fact that the comparative information is not actually comparable.

Sometimes, entity may present financial statements for 52 weeks or weeks ending on a particular day, in such cases entity should clearly state that the financial statements are for such period. For instance 'for fifty two weeks period ending on 30$^{th}$ mach, 2008'. Normally such statements are not materially different from those presented for one year

IAS 1 requires that entity should maintain consistency in presentation and classification of item from one period to another therefore, the items of income and expenses should be uniform from one period to another. However, if certain changes are to be made in the classification, the comparative information should also be reclassified so as to maintain comparability.

**Component of income statement**

Minimum line items to be presented in income statement are:

- Revenue
- Finance costs
- Share of the profit or loss of associates and joint ventures accounted for using the equity method
- Tax Expenses
- Discontinued operations
- Profit or loss
- Minority interest
- Net profit attributable to equity holders of the parents

Entity should not classify any item of income or expense as extraordinary item in income statement or in the statement of comprehensive income.

The entities are permitted to classify the line items of expenses in two different ways for their presentation in statement of comprehensive income which are:

- Classification by nature, or
- Classification by function.

The decision to select the presentation for the analysis of expenses in the income statement depends on which method presents the information more reliably and relevant. Moreover, historical and industrial factors and nature of entity should be considered while making the choice.

**Analysis of expenses by the nature of expense method:**

Under this method an entity aggregates expenses within profit or loss according to their nature (for example, depreciation, purchases of materials, transport costs, employee benefits and advertising costs), and does not reallocate them among functions within the entity. This method is generally simple to apply as allocations of expenses to functional classifications are necessary. An example of a classification using the nature of expense method is as follows:

| | | |
|---|---|---|
| Revenue | X | |
| Other income | X | |
| Changes in inventories of finished goods and work in progress | | X |
| Raw materials and consumables used | X | |
| Employee benefits expense | X | |
| Depreciation and amortization expense | X | |
| Other expenses | X | |
| Total expenses | | (X) |
| Profits before tax | | X |

**Analysis of expenses by the function of expense method:**

This form of analysis is also called ‘cost of sales method’. Under this form of analysis entity classifies expenses according to their function as part of cost of sales or, for example, the costs of distribution or administrative activities. At a minimum, an entity discloses its cost of sales under this method separately from other expenses.

This method can provide more relevant information to users than the classification of expenses by nature, but allocating costs to functions may require arbitrary allocations and involve considerable judgment. An example of a classification using the function of expense method is as follows:

| | | |
|---|---|---|
| Revenue | X | |
| Cost of sales | (X) | |
| Gross profit | X | |
| Other income | X | |
| Distribution costs | | (X) |
| Administrative expenses | | (X) |
| Other expenses | | (X) |
| Profits before tax | | X |

One important point that should be noted here is that, when an entity classifies expenses by function, it shall disclose additional information on the nature of expenses, including depreciation and amortization expense and employee benefits expense as information on the nature of expenses is useful in predicting future cash flows.

**A Case Study**

Entity A has 5 subsidiaries. One of the subsidiaries, entity B, represents 30% of the consolidated group's results. B represents a separate business segment.

All entities in the group present a functional analysis of expenses in their separate IFRS financial statements, except for entity B, which presents an analysis by the nature of expenses.

As a functional analysis of B’s expenses has not been prepared, A’s management would like to present the consolidated income statement on a split-method basis. B’s results will be presented using a natural analysis, whereas the rest of the group’s results will be presented on a functional basis.

A’s management argues that because B’s business is from a different segment and therefore not comparable with the rest of the group, the use of a different presentation basis should be acceptable.

**Solution**

No, management cannot adopt a mix of the two types of analysis in the group’s financial statements. Management must choose which format, functional or natural, is most appropriate for the consolidated financial statements. The results of all entities within the group must be prepared on the chosen basis, which will require part of the group to convert their results from that used in their separate financial statements to that used in the consolidated financial statements.

## OTHER COMPREHENSIVE INCOME

As we know the total comprehensive income of an entity comprise of two parts: the profit or loss part and the other comprehensive income. The other comprehensive income has been defined in IAS 1 as follows:

***Other comprehensive income* comprises items of income and expense (including reclassification adjustments) that is not recognized in profit or loss as required or permitted by other IFRSs.**

The components of other comprehensive income include:

i. changes in revaluation surplus (see IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*);

ii. actuarial gains and losses on defined benefit plans recognized in accordance with paragraph 93A of IAS 19 *Employee Benefits*;

iii. gains and losses arising from translating the financial statements of a foreign operation (see IAS 21 *The Effects of Changes in Foreign Exchange Rates*);

iv. gains and losses on remeasuring available-for-sale financial assets (see IAS 39 *Financial Instruments: Recognition and Measurement*);

v. the effective portion of gains and losses on hedging instruments in a cash flow hedge (see IAS 39).

Also it should be noted that, the entity should disclose the amount of income tax relating to each component of other comprehensive income, including reclassification adjustments, either in the statement of comprehensive income or in the notes. Therefore, an entity may present components of other comprehensive income either net of related tax effects, or before related tax effects with one amount shown for the aggregate amount of income tax relating to those components.

**RECLASSIFICATION ADJUSTMENTS**

IAS 1 defines reclassification adjustments as follows:

*Reclassification adjustments are amounts reclassified to profit or loss in the current period that were recognized in other comprehensive income in the current or previous periods.* In other words, where other IFRSs requires the entity to reclassify amounts previously recognized in other comprehensive income to profit or loss, such reclassifications are referred to in IAS 1 as reclassification adjustments. IAS 1 requires an entity to disclose reclassification adjustments relating to components of other comprehensive income. A reclassification adjustment is included with the related component of other comprehensive income in the period that the adjustment is reclassified to profit or loss. For example, gains realized on the disposal of available-for-sale financial assets are included in profit or loss of the current period. These amounts may have been recognized in other comprehensive income as unrealized gains in the current or previous periods. Those unrealized gains must be deducted from other comprehensive income in the period in which the realized gains are reclassified to profit or loss to avoid including them in total comprehensive income twice.

An entity may present reclassification adjustments in the statement of comprehensive income or in the notes. An entity presenting reclassification adjustments in the notes presents the components of other comprehensive income after any related reclassification adjustments.

It should be noted that, reclassification adjustments do not arise on changes in revaluation surplus recognized in accordance with IAS 16 or IAS 38 or on actuarial gains and losses on defined benefit plans recognized in accordance with paragraph 93A of IAS 19. These components are recognized in other comprehensive income and are not reclassified to profit or loss in subsequent periods. Changes in revaluation surplus may be transferred to retained earnings in subsequent periods as the asset is used or when it is derecognized. Actuarial gains and losses are reported in retained earnings in the period that they are recognized as other comprehensive income.

**Information to be presented in the statement of comprehensive income or in the notes**

All items of income or expense that are material, an entity should disclose their nature and amount separately. Circumstances that would give rise to the separate disclosure of items of income and expense include:

- write-downs of inventories to net realisable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
- restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
- disposals of items of property, plant and equipment;
- disposals of investments;
- discontinued operations;
- litigation settlements; and
- Other reversals of provisions.

## 7.5 STATEMENT OF CHANGES IN EQUITY

IAS 1 requires an entity to present a statement of changes in equity as a separate component of the financial statements. The statement must show:

- profit or loss for the period
- each item of income and expense for the period that is recognised directly in equity, and the total of those items;
- total income and expense for the period (calculated as the sum of (a) and (b)), showing separately the total amounts attributable to equity holders of the parent and to minority interest
- for each component of equity, the effects of changes in accounting policies and corrections of errors recognised in accordance with IAS 8

The following amounts may also be presented on the face of the statement of changes in equity, or they may be presented in the notes:

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

## 7.6 STATEMENT OF CASH FLOWS

The statement of cash flows is an important primary statement. It shows a company's flow of cash. In fact, a complete set of Financial Statements should be comprised of a statement of financial position as at the end of the period, a statement of comprehensive income; statement of changes in equity; a ***statement of cash flows for the period***; notes, comprising a summary of significant accounting policies and other explanatory information; and a statement of financial position as at the beginning of the earliest comparative period when accounting policy is applied retrospectively or there is a retrospective restatement or reclassification of items in its financial statements.

The statement of cash flows shows how changes in statement of financial position and income accounts affect cash and cash equivalents, and breaks the analysis down to operating, investing, and financing activities. As an analytical tool, the statement of cash flows is useful in determining the short-term viability of a company, particularly its ability to pay bills. Even profitable entities will collapse if they do not have access to sufficient cash resources when it becomes necessary to settle a bill. Very few businesses could survive a prolonged outflow of cash.

The Statement of financial position, statement of comprehensive income and statement of changes in equity are based on accrual accounting and provide only partial information about flows of funds and cash. The profit figure usually does not have any direct relationship to the increase or decrease in the entity's bank balance over that period. Similarly, several items in the statement of comprehensive income, such as depreciation, do not involve inflow or outflow of cash. There are also many types of cash transactions, such as the proceeds of a share issue or a loan repayment which have no immediate impact on profit. This means that it would be possible for an entity to be trading at a profit and still run into liquidity problems.

The bank balance can, of course, be obtained from the statement of financial position. Comparing the statements at the beginning and end of the year will even show whether cash has increased or decreased. It is, however, difficult to identify the major causes of changes in the balance from doing so. Shareholders and other readers require a more structured presentation of the cash flows.

The cash flow statement, therefore, is intended to answer questions such as:

a) Why has the bank overdraft increased, despite the entity having had a profitable year?

b) Is the entity capable of generating funds, as opposed to profit, from its trading activities?

c) What was done with the loan that was taken out during the year?

d) Why is the company in a liquidity crisis when it has been profitable over the past few years?

**Evolution**

Cash basis financial statements were common before accrual basis financial statements when fund flow statements were prepared. In 1971, the Financial Accounting Standards Board (FASB) defined rules that made it mandatory under Generally Accepted Accounting Principles (US GAAP) to report sources and uses of funds, but the definition of "funds" was not clear. "Net working capital" might be cash or might be the difference between current assets and current liabilities. In 1987, FASB Statement No. 95 (FAS 95) mandated that firms provide cash flow statements. In 1992, the International Accounting Standards Board issued International Accounting Standard 7 (IAS 7), Cash Flow Statements, which became effective in 1994, mandating that firms provide cash flow statements.

**IAS 7 Statement of cash flows**

The objective of IAS 7 is to require the provision of information .about the historical changes in cash and cash equivalents by means of a statement of cash flows which classifies cash flows during the period according to operating, investing, and financing activities.

Information about the cash flows of an entity is useful in providing users of financial statements with a basis to assess the ability of the entity to generate and utilise cash and cash equivalents. Regardless of the type of entity's activities, entities need cash for their operations, payment of obligations etc.

**Fundamental Principle in IAS 7**

All enterprises that prepare financial statements in conformity with IFRSs are required to present a statement of cash flows. [IAS 7.1]

The statement of cash flows analyses changes in cash and cash equivalents during a period. Cash and cash equivalents comprise cash on hand and demand deposits, together with short-term, highly liquid investments that are readily convertible to a known amount of cash, and that are subject to an insignificant risk of changes in value. An investment normally meets the definition of a cash equivalent when it has a maturity of three months or less from the date of acquisition.[IAS 7.7]Equity investments are normally excluded, unless they are in substance a cash equivalent (e.g. preferred shares acquired within three months of their specified redemption date). Bank overdrafts which are repayable on demand and which form an integral part of an enterprise's cash management are also included as a component of cash and cash equivalents. [IAS 7.8]

Cash flows **exclude** transfers between ‘cash’ and ‘cash equivalents’ hence, it is essential to determine what makes up cash

### Presentation of the Statement of Cash Flows

Cash flows must be analysed between operating, investing and financing activities.

Key principles specified by IAS 7 for the preparation of a statement of cash flows are as follows:

- Operating activities are the main revenue-producing activities of the enterprise that are not investing or financing activities. Separate disclosure is required as cash flow from operating activities is a key indicator of the extent to which the operation of the entity has generated sufficient cash flows for maintaining its operating capability etc.

- Investing activities are the acquisition and disposal of long-term assets and other investments that are not considered to be cash equivalents . Separate disclosure is important as they represent the extent to which expenditure has been made for resources intended to generate future income and cash flows.

- Financing activities are activities that alter the size and composition of equity capital and borrowing structure of the enterprise. Separate disclosure is useful in predicting claims on future cash flows by providers of capital to the entity.

- for operating cash flows, the direct method of presentation is encouraged, but the indirect method is acceptable [IAS 7.18]

### Direct and indirect method

The direct method shows each major class of gross cash receipts and gross cash payments. The statement of cash flows under the direct method would appear something like this:

Cash flow from operations

| | | |
|---|---|---|
| Cash receipts from customers | xx,xxx | |
| Cash paid to suppliers | (xx,xxx) | |
| Cash paid to employees | (xx,xxx) | |
| Cash paid for other operating expenses | (xx,xxx) | |
| Interest paid | (xx,xxx) | |
| Income taxes paid | (xx,xxx) | |
| *Net cash from operating activities* | | xx,xxx |

Cash flow from investing activities

| | | |
|---|---|---|
| Acquisition of subsidiary | (xx,xxx) | |
| Purchase of property, plant and equipment | (xx,xxx) | |
| Proceeds from sale of equipment | xx,xxx | |
| Interest received | xx,xxx | |
| Dividend received | xx,xxx | |
| *Net cash used in investing activities* | | (xx,xxx) |

Cash flow from financing activities

| | | |
|---|---|---|
| Proceeds from issue of share capital | xx,xxx | |
| Proceeds from long term borrowings | xx,xxx | |
| Payment of finance lase liabiities | xx,xxx | |

| | | |
|---|---|---|
| Dividend paid | xx,xxx | |
| Net cash used in financing activities | | (xx,xxx) |

The indirect method adjusts accrual basis net profit or loss for the effects of non-cash transactions. The operating cash flows section of the statement of cash flows under the indirect method would appear something like this:

| | | |
|---|---|---|
| Profit before taxes | | xx,xxx |
| Add back depreciation | xx,xxx | |
| Add back amortisation of goodwill | xx,xxx | |
| Increase in trade and other receivables | xx,xxx | |
| Decrease in inventories | xx,xxx | |
| Increase in trade payables | xx,xxx | |
| Cash generated from operations | xx,xxx | |
| Interest expense | xx,xxx | |
| Less Interest accrued but not yet paid | xx,xxx | |
| Interest paid | | xx,xxx |
| Income taxes paid | | xx,xxx |
| *Net cash from operating activities* | | xx,xxx |

**Foreign currency cash flows**

The exchange rate used for translation of transactions denominated in a foreign currency and the cash flows of a foreign subsidiary should be the rate in effect at the date of the cash flows.

Cash flows of foreign subsidiaries should be translated at the exchange rates prevailing when the cash flows took place.

**Investment in subsidiaries, associates and joint ventures**

In case of associates and joint ventures, where the equity method is used, the statement of cash flows should report only cash flows between the investor and the investee; where proportionate consolidation is used, the cash flow statement should include the venturer's share of the cash flows of the investee

Aggregate cash flows relating to acquisitions and disposals of subsidiaries and other business units should be presented separately and classified as investing activities, with specified additional disclosures. The aggregate cash paid or received as consideration should be reported net of cash and cash equivalents acquired or disposed of

**Other Accounting treatment**

- Interest and dividends received and paid may be classified as operating, investing, or financing cash flows, provided that they are classified consistently from period to period [IAS 7.31]

- Cash flows arising from taxes on income shall be separately disclosed and are normally classified as operating, unless they can be specifically identified with financing or investing activities [IAS 7.35]

- cash flows from investing and financing activities should be reported gross by major class of cash receipts and major class of cash payments except for the following cases, which may be reported on a net basis: [IAS 7.22-24]

- cash receipts and payments on behalf of customers (for example, receipt and repayment of demand deposits by banks, and receipts collected on behalf of and paid over to the owner of a property)

- cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short, generally less than three months (for example, charges and collections from credit card customers, and purchase and sale of investments)
- cash receipts and payments relating to fixed maturity deposits
- cash advances and loans made to customers and repayments thereof
- investing and financing transactions which do not require the use of cash should be excluded from the statementof cash flows, but they should be separately disclosed elsewhere in the financial statements [IAS 7.43]
- the components of cash and cash equivalents should be disclosed, and a reconciliation presented to amounts reported in the statement of financial position [IAS 7.45]
- the amount of cash and cash equivalents held by the enterprise that is not available for use by the group should be disclosed, together with a commentary by management [IAS 7.48]
- Additional information that may be lead to better understanding of financial statements .
- Amount of undrawn borrowing facilities available for future operating activities and to settle capital commitment.
- Aggregate amount of cash flows that represent increase in operating capacity separately from those cash flows required to maintain operating capacity
- Amount of cash flows arising from operating, investing and financing activities of each reportable segment.
- Aggregate amount of cash flows from each operating, investing and financing activities related to each joint venture reported using proportionate consolidation.

**7.7 NOTES TO THE FINANCIAL STATEMENTS**

The notes must: [IAS 1.103]

- present information about the basis of preparation of the financial statements and the specific accounting policies used;
- disclose any information required by IFRSs that is not presented on the face of the balance sheet, income statement, statement of changes in equity, or cash flow statement; and
- provide additional information that is not presented on the face of the balance sheet, income statement, statement of changes in equity, or cash flow statement that is deemed relevant to an understanding of any of them.

Notes should be cross-referenced from the face of the financial statements to the relevant note. [IAS 1.104]

IAS 1.105 suggests that the notes should normally be presented in the following order:

- a statement of compliance with IFRSs
- a summary of significant accounting policies applied, including: [IAS 1.108]
    - the measurement basis (or bases) used in preparing the financial statements
    - the other accounting policies used that are relevant to an understanding of the financial statements
- supporting information for items presented on the face of the balance sheet, income statement, statement of changes in equity, and cash flow statement, in the order in which each statement and each line item is presented
- other disclosures, including:
    - contingent liabilities and unrecognised contractual commitments
    - non-financial disclosures, such as the entity's financial risk management objectives and policies

## 7.8 INTERIM FINANCIAL STATEMENTS

Interim financial reports are financial statements covering periods of less than a full fiscal year. Most commonly such reports are prepared quarterly or semi annually .The purpose of quarterly or other interim financial reports is to provide financial statement users with more timely information for making investment and credit decisions, based on the expectation that full-year results will be a reasonable extrapolation from interim performance. Additionally, interim reports can yield significant information concerning trends affecting the business and seasonality.

- The objective of IAS 34 - Interim Financial Statement is to prescribe the minimum content of an interim financial report and the recognition and measurement principles for an interim financial report.
- This is not a mandatory statement for all enterprises. This Standard applies if an entity is required or elects to publish an interim financial report in accordance with International Financial Reporting Standards.
- Minimum components of an interim financial report are:
    - condensed statement of financial position;
    - condensed statement of comprehensive income presented either as a condensed single statement or a condensed separate income statement and a condensed statement of comprehensive income;
    - condensed statement of changes in equity;
    - condensed statement of cash flows; and
    - selected explanatory notes.
- Prescribes the comparative periods for which interim financial statements are required to be presented.
- Materiality is based on interim financial data, not forecasted annual amounts.
- The notes in an interim financial report provide an explanation of events and transactions significant to understanding the changes since the last annual financial statements.
- Same accounting policies as used in annual financial statements.
- Revenue and costs are recognised when they occur, not anticipated or deferred.
- Change in accounting policy – restate previously reported interim periods.

## 7.9 ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

Accountants need to make many accounting estimates and policy decisions when preparing financial statements. This involves deciding on depreciable lives for assets, inventory costing method, valuations of assets, valuation of retirement benefits and such other judgments. These accounting estimates are driven by an entity's accounting policy as it applies to the issues at hand. These decisions could significantly affect a company's financial statements and how users understand a company's results and financial position. It is therefore vital that the selection and application of the company's accounting policies are appropriately reasoned. Business entities need to be aware that investors increasingly demand full transparency of accounting policies and their effects.

The entity's financial reporting and results imply a degree of accuracy, continuity and certainty that can be belied by rapid changes in the financial and operating environment that produced those measures. As a result, even a technically accurate application of accounting principles may nonetheless fail to communicate important information if it is not accompanied by appropriate and clear analytic disclosures to facilitate an investor's understanding of the company's financial status, and the possibility, likelihood and implication of changes in the financial and operating status. This involves informing the users of the sensitivity of financial statements to the methods, assumptions, and estimates underlying their preparation. An entity needs to provide full explanations of accounting policies, the judgments and uncertainties affecting the application of those policies, and the likelihood that materially different amounts would be reported under different conditions or using different assumptions.

Therefore Accounting standards require information in financial statements about the accounting principles and methods used and the risks and uncertainties inherent in significant estimates.

- IAS 8 prescribes the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors
- Accounting policies are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements
- Hierarchy for choosing accounting policies:

  - IASB Standards and Interpretations, taking into account any relevant IASB implementation guidance;
  - in the absence of a directly applicable IFRS, look to the requirements and guidance in IFRSs dealing with similar and related issues; and the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the Framework for the Preparation and Presentation of Financial Statements; and
  - management may also consider the most recent pronouncements of other standard setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature, and accepted industry practices.
- Accounting policies are applied consistently to similar transactions.
- An accounting policy is changed only if required by an IFRS, or if the change results in reliable and more relevant information.
- If a change in accounting policy is required by an IFRS, the pronouncement's transition requirements are followed. If none are specified, or if the change is voluntary, the new accounting policy is applied retrospectively by restating prior periods.
- If restatement is impracticable, the cumulative effect of the change is included in profit or loss. If the cumulative effect cannot be determined, the new policy is applied prospectively.
- A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Example change in mortality rate of the employees.
- Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.
- The effect of a change in an accounting estimate, shall be recognised prospectively i.e. changes in accounting estimates are accounted for in the current year, or future years, or both and there is no restatement.

- Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that
  - was available when financial statements for those periods were authorised for issue; and
  - could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.
- Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud
- All material errors are corrected by restating comparative prior period amounts and, if the error occurred before the earliest period presented, by restating the opening statement of financial position for the earliest prior period presented.
- Omissions or misstatements of items are material if they could, individually or collectively; influence the economic decisions of users taken on the basis of the financial statements.

## 7.10 EVENTS AFTER THE REPORTING PERIOD (IAS 10)

The events that occur up to the last day of the reporting period are critical in arriving at an entity's financial results and the financial position. However, sometimes events occurring after the reporting period may provide additional information about events that occurred before and up to the end of the reporting period .This information may have an impact on the financial results and the financial position of the entity. It is imperative that those reporting period events up to a certain "cutoff date" be taken into account in preparing the financial statements.

Additionally, certain events that occur after the reporting period may not affect the financial figures but may be important enough to require disclosure in notes to the financial statements. Providing information about post– reporting period events through such disclosures helps users make informed decisions with respect to the entity, keeping in mind the impact these reporting period events may have on the financial position of the entity

- **IAS 10 Events after the Reporting Period** prescribes when an entity should adjust its financial statements for events after the reporting period and the disclosures that an entity should give about the date when the financial statements were authorised for issue and about events after the reporting period.
- Events after the end of the reporting period are those events, both favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue.
- Adjusting events – the financial statements are adjusted to reflect those events that provide evidence of conditions that existed at the end of the reporting period (such as resolution of a court case after the end of the reporting period).
- Non-adjusting events – the financial statements are not adjusted to reflect events that arose after the end of the reporting period (such as a decline in market prices after year end, which does not change the valuation of investments at the end of the reporting period). The nature and impact of such events are disclosed.
- Dividends proposed or declared on equity instruments after the end of the reporting period are not recognised as a liability at the end of the reporting period. Disclosure is required.
- Financial statements are not prepared on a going concern basis if events after the end of the reporting period indicate that the going concern assumption is not appropriate.
- An entity discloses the date its financial statements are authorised for issue.

## 7.11 FOREIGN CURRENCY TRANSLATION

Companies which have transactions in foreign currencies and foreign operations need to account for it. For example, a multinational company is exposed to some exchange risk when it generates revenues or expenses in foreign currencies. This presents challenges for users comparing period-to-period operating results. Currency exchange–rate fluctuations are expected. In order to report consolidated financial statements, companies must effectively convert multiple currencies into a single reporting currency. In recent years, major currencies such as the British pound, the Euro, and the Canadian dollar have appreciated significantly against the U.S. dollar. This trend tends to inflate the revenues and expenses of an entity reporting in U.S. dollars.

Rapid fluctuations in currency rates could impact a parent company's income statement, even if local currency results remain the same. Consider company K, a U.S. dollar (US$)–reporting parent company with a major office in UK. Assume that the Euro was the functional currency of that office, which reported Euro100 million in revenues in 2007 and in 2008. In order to report revenues in U.S. dollars, company K would be required to translate Euro into U.S. dollars using the prevailing exchange rates. Due to rise in exchange rate , the parent company would report a revenue increase solely due to the impact of foreign currency, because the subsidiary's local revenues did not change. Note that sales also yield Euro receivables, which would also be impacted by exchange rate movements, but the net impact of all financials, are combined and accumulated in other comprehensive income.

**IAS 21 -The Effects of Changes in Foreign Exchange Rates**

**Requirements**

The purpose of IAS 21 is to set out how to account for transactions in foreign currencies and foreign operations. The standard prescribes the methodology to translate financial statements into a presentation currency, i.e. the currency in which the financial statements are presented. This contrasts with the functional currency, which is the currency of the primary economic environment in which the entity operates. Key issues are the exchange rates, which should be used, and where the effects of changes in exchange rates are recorded in the financial statements.

**Functional currency** is a concept that was introduced into IAS 21, The Effects of Changes in Foreign Exchange Rates, when it was revised in 2003. The previous version of IAS 21 used a concept of reporting currency. In revising IAS 21 in 2004, the IASB's main aim was to provide additional guidance on the translation method and determining the functional and presentation currencies.

The functional currency should be determined by looking at several factors. This currency should be the one in which the entity normally generates and spends cash, and that in which transactions are normally denominated. All transactions in currencies other than the functional currency are treated as transactions in foreign currencies. The entity's functional currency reflects the transactions, events and conditions under which the entity conducts its business. Once decided on, the functional currency does not change unless there is a change in the underlying nature of the transactions and relevant conditions and events.

Foreign currency transactions should initially be recorded at the spot rate of exchange at the date of the transaction. An approximate rate can be used. Subsequently, at each end of reporting period, foreign currency monetary amounts should be reported using the closing rate. Non-monetary items measured at historical cost should be reported using the exchange rate at the date of the transaction. Non-monetary items carried at fair value, however, should be reported at the rate that existed when the fair values were determined.

Exchange differences arising on monetary items are reported in profit or loss in the period, with one exception. The exception is that exchange differences arising on monetary items that form part of the reporting entity's net investment in a foreign operation are recognised in the group financial statements, within a separate component of equity. They are recognised in profit or loss on disposal of the net investment. If a gain or loss on a non-monetary item is recognised in equity (for example, property, plant and equipment revalued under IAS 16), any foreign exchange gain or loss element is also recognised in equity.

**Other Definitions**

**Presentation currency**: The currency in which financial statements are presented.

**Exchange difference**: The difference resulting from translating a given number of units of one currency into another currency at different exchange rates.

**Foreign operation**: A subsidiary, associate, joint venture, or branch whose activities are based in a country other than that of the reporting enterprise.

**Basic Steps for Translating Foreign Currency Amounts into the Functional Currency**

Steps apply to a stand-alone entity, an entity with foreign operations (such as a parent with foreign subsidiaries), or a foreign operation (such as a foreign subsidiary or branch).

1. The reporting entity determines its functional currency

2. The entity translates all foreign currency items into its functional currency

3. The entity reports the effects of such translation in accordance with paragraphs 20-37 [reporting foreign currency transactions in the functional currency] and 50 [reporting the tax effects of exchange differences].

**Reporting Foreign Currency Transactions**

- A foreign currency transaction should be recorded initially at the rate of exchange at the date of the transaction (use of averages is permitted if they are a reasonable approximation of actual).

- At the end of each reporting period: [IAS 21.23]

- Foreign currency monetary amounts should be reported using the closing rate.

- Non-monetary items carried at historical cost should be reported using the exchange rate at the date of the transaction.

- Non-monetary items carried at fair value should be reported at the rate that existed when the fair values were determined.

- Exchange differences arising when monetary items are settled or when monetary items are translated at rates different from those at which they were translated when initially recognised or in previous financial statements are reported in other comprehensive income in the period, with one exception. The exception is that exchange differences arising on monetary items that form part of the reporting entity's net investment in a foreign operation are recognised, in the consolidated financial statements that include the foreign operation, in a separate component of equity; they will be recognised in other comprehensive income on disposal of the net investment. [IAS 21.32]

- If a gain or loss on a non-monetary item is recognised directly in equity (for example, a property revaluation under IAS 16), any foreign exchange component of that gain or loss is also recognised directly in equity. [IAS 21.30]

- Prior to the 2003 revision of IAS 21, an exchange loss on foreign currency debt used to finance the acquisition of an asset could be added to the carrying amount of the asset if the loss resulted from a severe devaluation of a currency against which there was no practical means of hedging. That option was eliminated in the 2003 revision.

- When there is a change in the functional currency, the entity shall apply the translation procedure applicable to the new functional currencies prospectively.

**Translation from the Functional Currency to the Presentation Currency**

The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy are translated into a different presentation currency in the following manner:

- assets and liabilities for each statement of financial position presented (including comparatives) are translated at the closing rate at the date of that statement of financial position. This would include any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation are treated as part of the assets and liabilities of the foreign operation [IAS 21.47];

- income and expenses for each income statement (including comparatives) are translated at exchange rates at the dates of the transactions; and

- all resulting exchange differences are recognised as a separate component of equity.

- Special rules apply for translating the results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy into a different presentation currency. [IAS 21.42-43]

**Disposal of a Foreign Operation**

- When a foreign operation is disposed of, the cumulative amount of the exchange differences deferred in the separate component of equity relating to that foreign operation shall be recognised in other comprehensive income when the gain or loss on disposal is recognised. [IAS 21.48]

- Where the foreign entity reports in the currency of a hyperinflationary economy, the financial statements of the foreign entity should be restated as required by IAS 29, Financial Reporting in Hyperinflationary Economies, before translation into the reporting currency. [IAS 21.36]

- The requirements of IAS 21 regarding transactions and translation of financial statements should be strictly applied in the changeover of the national currencies of participating Member States of the European Union to the Euro - monetary assets and liabilities should continue to be translated the closing rate, cumulative exchange differences should remain in equity and exchange differences resulting from the translation of liabilities denominated in participating currencies should not be included in the carrying amount of related assets. [SIC 7]

**Tax Effects of Exchange Differences**

Gains and losses on foreign currency transactions may have tax effects. These must be accounted for using IAS 12 Income Taxes.

**Disclosure**

- The amount of exchange differences recognised in profit or loss (excluding differences arising on financial instruments measured at fair value through profit or loss in accordance with IAS 39).

- Net exchange differences classified in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period. [IAS 21.52]

- When the presentation currency is different from the functional currency, disclose that fact together with the functional currency and the reason for using a different presentation currency. [IAS 21.53]

- A change in the functional currency of either the reporting entity or a significant foreign operation and the reason therefor. [IAS 21.54]

- When an entity presents its financial statements in a currency that is different from its functional currency, it may describe those financial statements as complying with IFRS only if they comply with all the requirements of each applicable Standard (including IAS 21) and each applicable Interpretation.

**Convenience Translations**

- An entity may display its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency simply by translating all amounts at end-of-period exchange rates. This is sometimes called a convenience translation. A result of making a convenience translation is that the resulting financial information does not comply with all IFRS, particularly IAS 21. In this case, the following disclosures should be made: [IAS 21.57]

- Clearly identify the information as supplementary information to distinguish it from the information that complies with IFRS.

- Disclose the currency in which the supplementary information is displayed.

- Disclose the entity's functional currency and the method of translation used to determine the supplementary information.

## 7.12 FINANCIAL REPORTING BY GROUP ENTITIES

Accounting for business combination has undergone a through makeover in recent years. In January 2008 IASB issued revised standards, IFRS 3 *Business Combination* and revised IAS 27

*Consolidated and separate financial statement* that significantly changed the accounting for business combinations and transaction with non controlling entities. All business combinations are now treated as acquisition for the purpose of accounting irrespective of the actual form of acquisition. As a result in all business combinations it is assumed that one entity takes management control of the other entity or of its assets and liabilities. Now, it is essential to identify an acquirer in all business combinations as pooling of interest method is no more recognised under IFRS and all business combinations are accounted using purchase method.

# Chapter VIII

## FIRST TIME ADOPTION OF IFRS

### Key Principal

IFRS 1 specifies the procedures any entity applying IFRS for the first time must follow. The key principle of IFRS 1 is full retrospective application of all standards in force at the reporting date date for the first IFRS financial statements. There are fourteen optional exemptions that reduce the burden of retrospective application where the costs might exceed the benefits to users. There are five mandatory exceptions where retrospective application is not permitted.

### Key steps in first time adoption of IFRS

IFRS 1 requires companies to:

- identify the first IFRS financial statements;
- prepare an opening statement of financial position at the date of transition to IFRS;
- select accounting policies that comply, and apply those policies retrospectively to all of the periods presented in the first IFRS financial statements;
- consider whether to apply any of the 14 exemptions from retrospective application;
- apply the five mandatory exceptions from retrospective application; and
- make extensive disclosures to explain the transition to IFRS.

### Identifying the first IFRS financial statement?

The first IFRS statements are the first annual financial statement in which the entity makes an explicit and unreserved statement of compliance with IFRS. Most companies will apply IFRS 1 when they move from local GAAP to IFRS. In India, all public interest entities will be required to adopt IFRS for all accounting periods beginning on or after 1st April 2011. IFRS 1 must also be applied when a company's previous financial statements:

- Was prepared under national GAAP not consistent with IFRS in all respect. included a reconciliation of some items from a previous GAAP to IFRS;
- complied with some, but not all, IFRS in addition to a previous GAAP – for example, in areas where there is no previous GAAP guidance; or
- complied with IFRS in all respects in addition to a previous GAAP, but did not include an explicit and unreserved statement of compliance.
- Was prepared for internal use only
- Did not present financial statement for previous periods
- Complete set was not prepared.

However, IFRS 1 cannot be applied if a company previously prepared financial statements that contained an explicit and unreserved statement of compliance with IFRS. It also cannot be applied when a company prepared financial statements that included an unreserved statement of compliance with IFRS and:

- decided to stop presenting separate financial statements in accordance with a previous GAAP;
- decided to delete an additional reference to compliance with a previous GAAP; or
- the auditors' report on the previous IFRS financial statements was qualified.

**Some situations to explain when IFRS 1 can be applied**

**i. Can an offering document contain the first IFRS financial statements?**

Yes, if the financial statements included in the offering document contains an explicit and unreserved statement of compliance with IFRS it will be the first IFRS financial statements provided complete set is presented with comparative previous year information as required by IAS 1. The context in which the financial statements are prepared is not relevant to deciding whether or not they are the first IFRS financial statements. IFRS 1 should not be applied to the financial statements issued after the offering.

ii. **Can management of an existing IFRS reporter apply the exemptions of IFRS 1 to an entity's financial statements by dropping an explicit and unreserved statement of compliance with IFRS from its financial statements?**

Yes. Deleting the statement of compliance with IFRS means that the financial statements will not be IFRS financial statements, even though entity has been preparing IFRS financial statements for several years. Entity's subsequent financial statements will therefore be entity's first IFRS financial statements.

iii. **Can an entity use a new holding company to create the first IFRS financial statements**?

No. The creation of a new parent entity just to hold the group is a transaction that has no substance. The transaction should be ignored, and the first financial statements of the new parent entity should be prepared on the basis that the original parent continues as the preparer of the group financial statements.

iv. **Can management apply IFRS 1 when an entity's previous financial statements were qualified?**

No. IFRS 1 is not applied when an entity previously prepared financial statements that contained an explicit statement of compliance with IFRS, but for which the auditors' report was qualified.

v. **Can IFRS 1 be applied when an entity previously complied with some, but not all, IFRSs?**

Yes. IFRS 1 is applied when an entity's previous financial statements did not contain an explicit and unreserved statement of compliance with IFRS. The statement that the financial statements complied with some, but not all, IFRSs is not an explicit and unreserved statement of compliance.

**Preparing opening statement of financial position at date of transition**

The opening IFRS statement of financial position is the starting point for all subsequent accounting under IFRS. Companies should prepare an opening IFRS statement of financial position at ‘the date of transition to IFRS’. ‘The date of transition to IFRS’ is the beginning of the earliest period for which full comparative information is presented in accordance with IFRS. For Indian companies transiting to IFRS from 2001 and required to make comparative statements for one preceding year and having financial year from April to March, the date of transition would be $1^{st}$ April 2010 and for companies having financial year from January to December date of transition would be $1^{st}$ January 2011. The opening statement of financial statement has to be prepared as on this date however, the same need not be published in the first IFRS financial statements**.**

In preparing opening statement of financial position entity must:

**Include all the assets and liabilities that IFRS requires**

It implies that entities will have to recognise all such assets that were not recognised in earlier GAAP. Under IFRS entities might have to recognise additional assets and liabilities like defined benefit pension plans, deferred taxation, assets and liabilities under finance leases, provisions where there is a legal or constructive obligation, derivative financial instruments, acquired intangible assets, share-based payments, etc.

**Exclude any assets and liabilities that IFRS does not permit:**

Often assets and liabilities recognised under a entity’s previous GAAP will have to be derecognised like  provisions where there is no legal or constructive obligation, general reserves, internally generated intangible assets, deferred tax assets where recovery is not probable, etc.

**Classify all assets, liabilities and equity in accordance with IFRS**

In the opening statement of financial position the assets and liabilities that might be reclassified to comply with the requirement of IFRS like investments should be classified in accordance with IAS 39, some financial instruments like preference shares previously classified as equity might be required to be classified as financial liability under IFRS, any assets and liabilities that have been offset where the criteria for offsetting in IFRS are not met – for example, the offset of an insurance recovery against a provision, non-current assets held for sale will classified as such.

**Measures all items as per IFRS**

All items like receivables (IAS 18), employee benefit obligations (IAS 19), deferred taxation (IAS 12), financial instruments (IAS 39), provisions (IAS 37), impairments of property, plant and equipment and intangible assets (IAS 36), assets held for disposal (IFRS 5), share-based payments, etc. in accordance with IFRS

However, the exception to this is where one of the optional exemptions or mandatory exceptions does not require or permit recognition, classification and measurement in accordance with IFRS.

**Selecting Accounting Policies**

The first IFRS financial statements are prepared using accounting policies that comply with IFRS in force at the 'reporting date'. The reporting date is the closing reporting date for the first IFRS financial statements. These polices should be applied retrospectively to the opening IFRS statement of financial position and for all periods presented in the first IFRS financial statements. However, certain exemptions or exceptions apply to this requirement. Earlier versions of the same standard should not be applied. A company may apply a standard that has been issued at the reporting date, even if that standard is not mandatory, as long as the standard permits early adoption. The transition guidance in individual standards, and the guidance in IAS 8 for changes in accounting policies, apply to existing IFRS users and are not used by first-time adopters unless the standard or IFRS 1 requires otherwise.

A number of standards allow companies to choose between alternative policies. Companies should select the accounting policies to be applied to the opening IFRS statement of financial position carefully, with a full understanding of the implications on both the opening IFRS statement of financial position and the financial statements of future periods.

**Optional Exemption to retrospective application**

Fourteen exemptions are designed to allow companies some relief from full retrospective application so as to simplify the task of convergence. However, the application of the exemptions is also not very straightforward. Some exemptions allow for alternative ways of applying the relief and others have conditions attached An entity may elect to use one or more of the following 14 exemptions:

(a) business combinations
(b) *fair value* or revaluation as *deemed cost*
(c) employee benefits
(d) cumulative translation differences
(e) compound financial instruments
(f) assets and liabilities of subsidiaries, associates and joint ventures
(g) designation of previously recognised financial instruments
(h) share-based payment transactions
(i) insurance contracts
(j) decommissioning liabilities included in the cost of property, plant and equipment
(k) leases
(l) fair value measurement of financial assets or financial liabilities at initial recognition ;
(m) a financial asset or an intangible asset accounted for in accordance with IFRIC 12 *Service Concession Arrangements* and
(n) borrowing costs

An entity shall not apply these exemptions by analogy to other item

## Chapter IX

## SPECIMEN FINANCIAL STATEMENT PREPARED UNDER IFRS

### M/s XYZ Limited

### Consolidated Statement of Financial Position

**(All amounts in nearest '000 Rs. unless otherwise stated)**

| | | As At 31 March | |
|---|---|---|---|
| | **Schedules** | **2012** | **2011** |
| **Assets** | | | |
| | | | |
| **Non Current Assets** | | | |
| | | | |
| **Property, Plant and Equipment** | | | |
| **Intangible Assets** | | | |
| **Investment in Associate** | | | |
| **Deferred Income Tax Assets** | | | |
| **Held to Maturity Financial Assets** | | | |
| **Available for Sale Financial Assets** | | | |

| | |
|---|---|
| **Long-Term Trade and other Receivables** | |
| **Derivative Financial Instruments** | |
| **Total Non Current Assets (A)** | |
| | |
| **Current Assets** | |
| | |
| **Inventories** | |
| **Short-Term Trade and other Receivables** | |
| **Available-for-sale Financial Assets** | |
| **Derivative Financial Instrument** | |
| **Financial Asset classified as Held for Trading** | |
| **Financial Asset designated as at Fair Value through Profit or Loss Account** | |
| **Cash and Cash Equivalent** | |
| **Total Current Assets (B)** | |
| | |
| **Non Current Assets/ Disposal Group** | |

| | |
|---|---|
| **held for Sale (C)** | |
| **Total Assets (A) +(B) + (C)** | |
| | |
| **Equity** | |
| | |
| **Portion of Equity attributable to Shareholders** | |
| | |
| Equity | |
| **Non-Controlling Interests** | |
| **Total Equity (D)** | |
| | |
| **Liabilities** | |
| | |
| **Non Current Liabilities** | |
| | |
| Long Term Borrowings | |

| | |
|---|---|
| Deferred Tax liabilities | |
| Derivative Financial Instruments | |
| Retirement Benefit Obligations | |
| Provisions for other liabilities | |
| **Total Non-Current Liabilities (E)** | |
| | |
| **Current Liabilities** | |
| | |
| **Trade and other Short Term Payables** | |
| **Current Income Tax Liabilities** | |
| **Borrowings** | |
| **Derivative Financial Instruments** | |
| **Other Provisions for short term liabilities** | |
| **Total Current Liability (F)** | |
| | |
| **Liability associated with Non Current Asset/ Disposal Group Held for Sale (G)** | |
| | |

| | |
|---|---|
| **Total Liabilities (H= E+F+G)** | |
| | |
| **Total Equity and Liabilities (D+H)** | |
| | |

**XYZ Limited**

**Consolidated Statement of Comprehensive Income**

**(All amounts in nearest ‘000 Rs. Unless otherwise stated)**

| | | | |
|---|---|---|---|
| | | Year Ended 31 March | |
| | **Schedules** | **2012** | **2011** |
| **Continuing Operations** | | | |
| **Sales** | | | |
| **Cost of Sales** | | | |
| **Gross Profit** | | | |
| | | | |
| **Other income** | | | |
| **Administrative Expenses** | | | |
| **Selling and Distribution Expenses** | | | |
| **Finance Costs** | | | |
| **Other Gains/(Losses)** | | | |
| | | | |
| **Operating Profit** | | | |

| | |
|---|---|
| **Share of profit from Associates** | |
| | |
| **Profit Before Income Tax** | |
| **Income Tax Expense** | |
| | |
| **Profit After Income Tax from Continued Operations** | |
| | |
| **Profit before tax for the Year from Discontinued Operations** | |
| **Income tax on Profit from Discontinued Operations** | |
| **Profit after tax from Discontinued Operations** | |
| | |
| **Total PAT for year** | |
| | |
| **Other Comprehensive Income:** | |
| **Exchange Difference on translating foreign Operations** | |
| **Available for sale financial assets** | |
| **Cash Flow Hedges** | |

| |
|---|
| **Net Investment hedges** |
| **Gains on property revaluation** |
| **Actuarial gains (losses) on employment benefit obligation** |
| **Share of other comprehensive income of associates** |
| **Income tax on other comprehensive income** |
| **Net Other Comprehensive Income** |
| **Total comprehensive Income for the year** |
| |
| **Attributable to Equity Share holders of the Company** |
| **Attributable to Non-Controlling Interest** |
| |
| **Basic Earnings from Share:** |
| **From Continued Operations** |
| **From Discontinued Operations** |
| |
| **Diluted Earnings per Share:** |

| |
|---|
| **From Continued Operations** |
| **From Discontinued Operations** |
| |
| |

**XYZ Limited**

**Consolidated Statement of Cash Flows**

**(All amounts in nearest '000 Rs. Unless otherwise stated)**

| | | |
|---|---|---|
| | Year Ended 31 March | |
| | 2012 | 2011 |
| **Cash Flows from Operating Activities** | | |
| **Cash Flows from Operations** | | |
| **Interest Paid** | | |
| **Income Tax Paid** | | |
| **Net Cash from Operating Activities (A)** | | |
| **Cash Flows from Investing Activities** | | |
| **Investment in Subsidiary** | | |
| **Investment in Associates** | | |
| **Purchase of Property, Plant and Equipment** | | |

| | |
|---|---|
| **Sale of Property, Plant and Equipment** | |
| **Loans to Associates** | |
| **Loan repayment from Associates** | |
| **Purchase of Financial Assets** | |
| **Interest received** | |
| **Dividend Received** | |
| **Net cash generated/ (used) in Investing Activities (B)** | |
| | |
| **Cash Flows from Financing Activities** | |
| **From Issue of Equity Shares** | |
| **From Issuance of Redeemable preference Shares** | |
| **Proceeds from Borrowings** | |
| **Repayments of Borrowings** | |
| **Dividend paid to Equity shareholders** | |
| **Dividend to preference share holders** | |
| **Dividend to Minority Holders** | |
| **Net Cash Generated/ used from Financing Activities (C)** | |

| | |
|---|---|
| **Net increase/ decrease in cash and cash equivalent** | |
| **Cash, Cash Equivalent in the beginning of the year** | |
| **Cash and Cash Equivalent at the end of year** | |

**XYZ Limited**

**Statement of Changes in Equity**

**(All amounts in nearest '000 Rs. Unless otherwise stated)**

| | Share Capital | Retained Earnings | Translation of foreign operations | AVS Financial Assets | Cash Flow Hedges | Revaluation Surplus | Total | Non-Controlling Interest | Total Equity |
|---|---|---|---|---|---|---|---|---|---|
| **Balance as at 1/4/10** | | | | | | | | | |
| **Changes in accounting Policy** | | | | | | | | | |
| **Restated Balance** | | | | | | | | | |
| **Changes in Equity for 10-11** | | | | | | | | | |

| | |
|---|---|
| **Dividend** | |
| **Total comprehensive income for year** | |
| **Balance as at 31/3/2011** | |
| | |
| **Changes in Equity for 11-12** | |
| **Issue of share capital** | |
| **Dividends** | |
| **Total comprehensive income for the year** | |
| **Transfer to retained Earnings** | |
| **Balance as at 31/3/12** | |

**Notes to the consolidated financial statements**

**1. About the Company**

The XYZ Public Limited Company its subsidiaries (together 'the group') manufacture, distribute and sell leather products through a chain of independent retailers. The group has manufacturing plants around the world and sells mainly in countries within the India, China, Sri Lanka and Bangladesh. It is public limited company domiciled in India. The address of its registered office is ………………The Company has its primary listing on the Bombay Stock Exchange. The Group consolidated statements were approved by the Board on ……………..

**2. Significant Accounting Policies**

The principal accounting policies applied in the preparation of these consolidated financial statements are discussed below. All the policies have been applied consistently to all the years presented. The consolidated financial statements of XYZ Public Limited Company have been prepared in accordance with International Financial Reporting Standards. Both historic cost and revaluation models have been used in accordance with principles stated in IFRSs.

**2.1 Consolidation**

**Subsidiaries**

Subsidiaries are all entities (including special purpose entities) over which the group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The purchase method of accounting is used to account for the acquisition of subsidiaries by the group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the group.

**Associates**

Associates are all entities, over which the group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting and are initially recognised at cost. The group’s investment in associates includes goodwill identified on acquisition, net of any accumulated impairment loss.

The group’s share of its associates’ post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the group’s share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the group and its associates are eliminated to the extent of the group’s interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the group.

Dilution gains and losses arising in investments in associates are recognised in the Statement of comprehensive income.

## 2.2 Foreign currency translation

Items included in the financial statements of each of the group's entities are measured in the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in 'currency' Rupees, which is the company's functional and the group's presentation currency.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are remeasured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of comprehensive income except when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges.

Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the statement of comprehensive income within 'finance income or cost'. All other foreign exchange gains and losses are presented in the statement of comprehensive income within 'other (losses)/gains – net.

Changes in the fair value of monetary securities denominated in foreign currency classified as available for sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in amortised cost are recognised in profit or loss, and other changes in carrying amount are recognised in equity. Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets such as equities classified as available for sale are included in the available-for-sale reserve in equity.

The results and financial position of all the group entities in countries that have a functional currency different from the Rupees are translated into the presentation currency as follows:

assets and liabilities for each statement of financial position presented are translated at the closing rate at reporting date;

income and expenses for each statement of comprehensive income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the rate on the dates of the transactions); and

all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is partially disposed of or sold, exchange differences that were recorded in equity are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

**2.3 Property, plant and equipment**

Items of property, plant and equipment are initially recognised at cost. As well as the purchase price, cost includes directly attributable costs and the estimated present value of any future costs of dismantling and removing items. The corresponding liability is recognised within provisions. Freehold land and buildings are subsequently carried at fair value, based on periodic (usually triennial) valuations by a professionally qualified valuer. Changes in fair value are recognised in equity (the "revaluation reserve"). An appropriate transfer is made from the revaluation reserve to the profit and loss reserve when freehold land and buildings are expensed through the income statement (e.g. through depreciation, impairment or sale). All other items of property, plant and equipment are carried at depreciated cost.

Freehold land is not depreciated. Depreciation is provided on all other items of property, plant and equipment is to write off the carrying value of items over their expected useful economic lives. It is applied at the following rates:

| | |
|---|---|
| Freehold buildings - | 5% per annum straight line |
| Leasehold land - | evenly over the length of lease |

| | |
|---|---|
| Leasehold buildings - | 5% per annum straight line |
| Plant and machinery - | 25% per annum straight line |
| Fixtures and fittings - | 20% per annum straight line |
| Computer equipment - | 40% per annum straight line |
| Motor vehicles - | 25% per annum reducing balance |

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognised within 'Other (losses)/gains – net' in the statement of comprehensive income. When revalued assets are sold, the amounts included in other reserves are transferred to retained earnings.

**2.4 Inventories**

Inventories are initially recognised at cost, and subsequently at the lower of cost and net realisable value. Cost comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. Weighted average cost is used to determine the cost of ordinarily interchangeable items.

**2.5 Intangible assets**

Goodwill represents the excess of the cost of an acquisition over the fair value of the group's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in 'intangible assets'. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Separately acquired trademarks and licences are shown at historical cost. Trademarks and licences acquired in a business combination are recognised at fair value at the acquisition date.

Trademarks and licences have a finite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of trademarks and licences over their estimated useful lives of 15 to 20 years.

**2.6 Financial assets**

The group classifies its financial assets into one of the following categories, depending on the purpose for which the asset was acquired. The group's accounting policy for each category is as follows:

**Fair value through profit or loss:** This category comprises only in-the-money derivatives. They are carried in the t at fair value with changes in fair value recognised in the statement of comprehensive income.

**Loans and receivables:** These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise principally through the provision of goods and services to customers (trade debtors), but also incorporate other types of contractual monetary asset. They are carried at cost less any provision for impairment.

**Held-to-maturity investments:** These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the group's management has the positive intention and ability to hold to maturity. These assets are measured at amortised cost, with changes through the statementof comprehensive income.

**Available-for-sale:** Non-derivative financial assets not included in the above categories are classified as availablefor- sale and comprise the group's strategic investments in entities not qualifying as subsidiaries, associates or jointly controlled entities. They are carried at fair value with changes in fair value recognised directly in equity. Where a decline in the fair value of an available-for-sale financial asset constitutes objective evidence of impairment, the amount of the loss is removed from equity and recognised in the income statement.

**2.7 Financial liabilities**

The group classifies its financial liabilities into one of two categories, depending on the purpose for which the asset was acquired. Other than financial liabilities in a qualifying hedging relationship (see below), the group's accounting policy for each category is as follows:

**Fair value through profit or loss:** This category comprises only out-of-the-money derivatives. They are carried in the statement of financial position at fair value with changes in fair value recognised in the statement of comprehensive income.

**Other financial liabilities:** Other financial liabilities include the following items:

• Trade payables and other short-term monetary liabilities, which are recognised at amortised cost.

• Bank borrowings, certain preference shares and the debt element of convertible debt issued by the group are initially recognised at the amount advanced net of any transaction costs directly attributable to the issue of the instrument. Such interest bearing liabilities are subsequently measured at amortised cost using the effective interest rate method, which ensures that any interest expense over the period to repayment is at a constant rate on the balance of the liability carried in the statement of financial position. "Interest expense" in this context includes initial transaction costs and premia payable on redemption, as well as any interest or coupon payable while the liability is outstanding.

### 2.8 **Non-current assets/ disposal groups held for sale**

Non-current assets (or disposal groups) are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell if their carrying amount is to be recovered principally through a sale transaction rather than through continuing use.

### **2.9 Equity**

Ordinary shares are classified as equity. Mandatorily redeemable preference shares are classified as liabilities. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction from the proceeds.

### 2.10 Trade Payables and short term borrowings

Trade payables and other short term borrowings unless designated as at Fair Value through profit or loss account are recognised initially at fair value and subsequently measured at amortized cost using the effective interest method.

### 2.11 Borrowings

Borrowings include Preference shares, which are mandatorily redeemable on a specific date. Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the statement of comprehensive income over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date

### 2.12 Current and deferred income tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised directly in equity. In this case, the tax is also recognised in equity. The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the reporting date in the countries where the company's subsidiaries and associates operate and generate taxable income.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the group and it is probable that the temporary difference will not reverse in the foreseeable future.

**2.13 Employee Benefits**

**Pension Plans**

Group companies operate various pension schemes. The schemes are generally funded through payments to insurance companies. The group has both defined benefit and defined contribution plans. A defined contribution plan is a pension plan under which the group pays fixed contributions into a separate entity. The group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. A defined benefit plan is a pension plan that is not a defined contribution plan. Typically defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation.

The liability recognised in the statement of financial position in respect of defined benefit pension plans is the present value of the defined benefit obligation at the reporting date less the fair value of plan assets, together with adjustments for unrecognised past-service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of government bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in the statement of recognised income and expense (SORIE) in the period in which they arise. Past-service costs are recognised immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period. For defined contribution plans, the group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The contributions are recognised as employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

**Other post-employment obligations**

All the entities in the group provide post-retirement healthcare benefits to their retirees. The entitlement to these benefits is usually conditional on the employee remaining in service up to retirement age and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment using the same accounting methodology as used for defined benefit pension plans. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in the SORIE in the period in which they arise. These obligations are valued annually by independent qualified actuaries.

**Termination benefits**

Termination benefits are payable when employment is terminated by the group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The group recognizes termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy.

Benefits falling due more than 12 months after the reporting date are discounted to their present value.

**Profit-sharing and bonus plans**

The group recognizes a liability and an expense for bonuses and profit-sharing, based on a formula that takes into consideration the profit attributable to the company's shareholders after certain adjustments. The group recognizes a provision where contractually obliged or where there is a past practice that has created a constructive obligation.

### 2.14 Provisions

Provisions for environmental restoration, restructuring costs and legal claims are recognised when: the group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Restructuring provisions comprise lease termination penalties and employee termination payments. Provisions are not recognised for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

### 2.15 Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the group's activities. Revenue is shown net of value-added tax, returns, rebates and discounts and after eliminating sales within the group. Revenue is recognised only when the amount of revenue can be reliably measured and it is probable that future economic benefits will flow to the entity. The amount of revenue is not considered to be reliably measurable until all contingencies relating to the sale have been resolved. Revenue is recognised from sales of goods – wholesale and retail, Sales of services, Interest income, Royalty income and Dividend income.

## ABOUT THE AUTHOR

**CA. Rajkumar S. Adukia**

- B.Com (Hons.), LL.B, AICWA, FCA, ACS
- Graduated from Sydenham College of Commerce & Economics and received a Gold Medal for highest marks in Accountancy & Auditing in the Examination.
- Passed the Chartered Accountancy and Cost Accountancy Course in 1983 and was among the top rank holders in both the courses.
- Involved in the activities of the Institute since 1984 as a convenor of Kalbadevi CPE study circle.
- Was Chairman of the Western Region of Institute of Chartered Accountants of India in 1997
- Have been actively involved in various committees of ICAI.
- Became Member of the Central Council in 1998 and ever since worked towards knowledge sharing, professional development and enhancing professional opportunities for members.

**WORK EXPERIENCE**

- Founder member of Adukia & Associates and along with a team of able partners and dedicated professionals pursued professional goals in a reputable manner for over twenty five years

**OTHER PROFESSIONAL INTERESTS**

- Written numerous articles on most aspects of finance-accounting, auditing, taxation, valuation, public finance. Articles appear regularly in financial papers like Business India, Financial Express, Economic Times and professional and business magazines.
- Authored books on vast range of topics including Internal Audit, Bank Audit, SEZ, CARO, PMLA, Anti-dumping, Income Tax Search, Survey and Seizure, etc.
- Frequent speaker on trade and finance at seminars and conferences organized by the Institute of Chartered Accountants of India, various chambers of Commerce, income tax offices and other professional associations.
- Lectured at the S.P. Jain Institute of Management, Intensive Coaching Classes for Inter & Final CA students and Direct Taxes Regional Training Institute of CBDT.
- Developed and delivered short courses, seminars and workshops on changes and opportunities in trade and finance.
- Extensive experience as a speaker, moderator and panelist at workshops and conferences held for both students and professionals across the country and abroad.
- Delivered lectures abroad at forums of International Federation of Accountants and traveled very extensively abroad for professional work.
- Coordinated with various professional institutions, associations' universities, University Grants Commission and other educational institutions.
- Participated with accountability and standards-setting organizations in India and at the international level