COURSE STRUCTURE

Lecture 2 – Tuesday 30 April 2024

17:30hrs to 19:30hrs

- Analysing the statement of profit or loss and the statement of financial position
    - The concept of revenue
    - Depreciation, amortisation and impairment
    - Revaluations of assets and their effect on profits and reserves
    - Provisions vs contingent liabilities
    - Events after the reporting period: are they adjusted for in the financial statements?
- Reference will be made to the published financial statements of some local companies

INCOME STATEMENTS

		Year ended 31 January			
		Group		Company	
		2023	2022	**2023**	2022
	Notes	**€'000**	€'000	**€'000**	€'000
Revenue	4	**118,238**	91,768	**62,319**	49,321
Cost of sales	23	**(74,029)**	(57,359)	**(32,242)**	(26,591)
Gross profit		**44,209**	34,409	**30,077**	22,730
Selling and distribution costs	23	**(13,277)**	(10,655)	**(8,878)**	(7,497)
Administrative expenses	23	**(14,315)**	(10,974)	**(8,517)**	(6,212)
Net impairment movement of financial assets	10	**66**	666	**331**	472
Operating profit		**16,683**	13,446	**13,013**	9,493
Finance income	26	**-**	-	**22**	35
Finance costs	27	**(1,367)**	(1,282)	**(894)**	(957)
Profit before tax		**15,316**	12,164	**12,141**	8,571
Tax income	28	**156**	264	**1,425**	1,500
Profit for the year		**15,472**	12,428	**13,566**	10,071
Basic and diluted earnings per share for the year attributable to shareholders	30	**€0.4298**	€0.3452		

21 ACADEMY

Simonds Farsons Cisk plc, Annual Report, 2022/23, pg. 74

Possible effects on the statement of profit or loss

Statement of profit or loss applying IAS 1	
Revenue	X
Cost of goods sold	(X)
Gross profit	**X**
Other operating income	X
Selling expense	(X)
General and administrative expenses	(X)
Research and development expense	(X)
Income and expenses from associates and joint ventures accounted for using equity method	X
Other operating expenses	(X)
Operating profit or loss	**X**
Finance income	X
Finance costs	(X)
Profit or loss before tax	**X**
Income tax expense	(X)
Profit or loss	**X**

Statement of profit or loss applying IFRS 18	
Revenue	X
Cost of goods sold	(X)
Gross profit	**X**
Other operating income	X
Selling expenses	(X)
General and administrative expenses	(X)
Research and development expense	(X)
Other operating expenses	(X)
Operating profit or loss	**X**
Share of profit or loss from associates and joint ventures	X
Other investment income	X
Profit before financing and income taxes	**X**
Interest expense on borrowings and lease liabilities	(X)
Interest expense on pension liabilities	(X)
Profit or loss before tax	**X**
Income tax expense	X
Profit or loss	**X**

Examples of possible changes in the classification of income and expenses

1. Net interest expense on net defined benefit liabilities will be classified in the financing category
2. Income and expenses from associates and joint ventures accounted for using equity method will be classified in the investing category
3. Gain or loss from the disposal of investment properties will be classified in the investing category
4. Interest income on cash and cash equivalents will be classified in the investing category
5. Foreign exchange differences arising from trade receivables will be classified in the operating category

https://www.footnotesanalyst.com/why-ifrs-18-is-good-news-for-investors/

Accounting for Revenue

REVENUE (IFRS 15)

- Income arising in the course of an **entity's ordinary activities**

Core principle: -

- An entity will recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity **expects to be entitled** in exchange for those goods or services

THE 5-STEP MODEL FRAMEWORK

https://www.accountinghub-online.com/revenue-recognition-the-five-steps-approach-under-ifrs15/

A CONTRACT NEEDS TO MEET THESE 5 CRITERIA: -

- The contract needs to be approved by both parties who are committed to perform their respective obligations
- Each party's rights regarding the goods or services to be transferred can be identified
- Payment terms can be identified, i.e., amount, currency, frequency, etc.
- The contract has commercial substance
- It is probable that the entity will collect the consideration to which it is entitled in exchange for the goods/services transferred

WHAT IS A PERFORMANCE OBLIGATION?

- At inception, the entity needs to identify the performance obligations in a contract

- A performance obligation is **a promise** in a contract with a customer to transfer a good or service to a customer

TIME TO THINK!

AB enters into a 12-month mobile plan with the local mobile operator GV Mobil. The terms of plan are as follows:

- AB monthly fixed fee is €100.
- AB receives a free handset at the inception of the plan.

GV Mobil sells the same handsets for €300 and the same monthly prepayment plans without handset for €80/month.

How should GV Mobil account for this transaction.

ANSWER (1)

Step 1

- GV Mobil needs to ***identify the contract first*** which is a 12-month plan with AB.

Step 2

- Then, GV Mobil needs to ***identify all performance obligations*** from the contract with AB:
  - Obligation to deliver a handset;
  - Obligation to deliver network services over 1 year.

Step 3

- The ***transaction price*** is €1,200 (€100 x 12 months).

Step 4

- ***Allocate that transaction price*** of €1,200 to individual performance obligations based on their relative stand-alone selling prices (or their estimates).

ANSWER (2)

Allocate the transaction price based on the relative stand-alone selling prices of the goods or services promised

Performance obligation	Stand-alone selling price (€)	% on total	Revenue (=relative selling price = 1,200*%)
Handset	300.00	23.8%	285.60
Network services	960.00 (= 80*12)	76.2%	914.40
Total	1,260.00	100.0%	1 200.00

ANSWER (3)

Step 5

- **Recognize the revenue when GV Mobil satisfies the performance obligations**.

Therefore:

- *When GV Mobil gives a handset to AB, it needs to recognise the revenue of €285.60;*

- *When GV Mobil provides network services to AB, it needs to recognise the revenue of €914.40. When will this be recognised? Revenue will be recognised as the entity satisfies its performance obligation over the 12 months. (€914.40/12 = €76.20 per month).*

PERFORMANCE OBLIGATION SATISFIED OVER TIME

When a performance obligation is satisfied over time, an entity must select either an **input method** or an **output method**, to measure progress for each performance obligation that best depicts the pattern of the entity's performance in transferring the good or service.

Output methods

- Recognise revenue on the basis of **value to the customer** of goods/services transferred, e.g. surveys of performance, appraisals of results, milestones reached, units produced

Input methods

- Recognise revenue on the basis of **entity's efforts or inputs** to the satisfaction of a performance obligation e.g. resources obtained, labour hours expended, costs incurred, time lapsed, machine hours used

TIME TO THINK!

AT Construction started a 3-year building contract on 1 January 2022. The contract has a fixed price of €500,000. AT will satisfy the performance obligation over time.

AT incurred costs to 31 December 2022 of €160,000 and the estimated remaining costs were €240,000.

AT measures the progress of contracts using an output method: work completed compared to contract price. At 31 December 2022, a surveyor valued the work completed to date at €180,000.

- **How much should be recognised as revenue?**

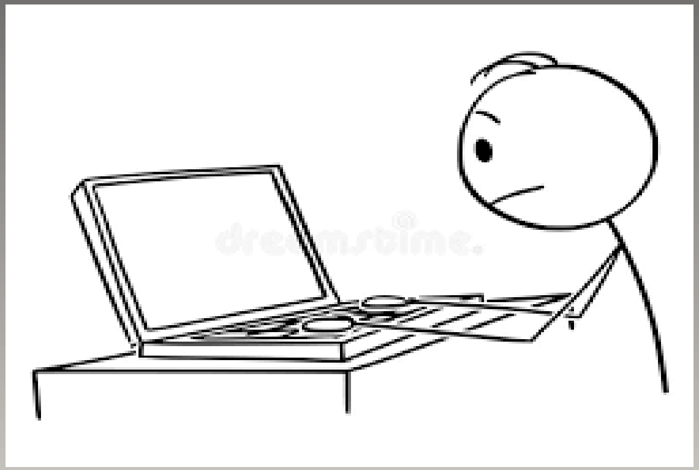
ANSWER

	€
Price	500,000
Total estimated costs: -	
Incurred to date	(160,000)
Estimated future	(240,000)
Expected profit	**100,000**

Progress = Work certified/total price = €180,000/€500,000 = **36%**

Revenue (36% x €500,000) €180,000

Accounting for Tangible Assets



PPE NOTE IN FINANCIAL STATEMENTS

15. PROPERTY, PLANT AND EQUIPMENT CONTINUED

			The Company		
	Land and buildings €'000	Plant and quipment €'000	Furniture, fixtures and fittings €'000	Motor vehicles €'000	Total €'000
Cost					
Balance at 1 January 2019	4	205	127	42	378
Additions	–	25	55	–	80
Balance at 31 December 2019	**4**	**230**	**182**	**42**	**458**
Balance at 1 January 2020	4	230	182	42	458
Additions	–	22	8	–	30
Balance at 31 December 2020	**4**	**252**	**190**	**42**	**488**
Depreciation					
Balance at 1 January 2019	–	150	103	42	295
Depreciation for the year	1	21	5	–	27
Balance at 31 December 2019	**1**	**171**	**108**	**42**	**322**
Balance at 1 January 2020	1	171	108	42	322

IHI plc Annual Report & Financial Statements 2020 pg. FS61

https://www.corinthiagroup.com/wp-content/uploads/2021/04/Corinthia-Annual-Report-2020.pdf

TANGIBLE NON-CURRENT ASSETS AND DEPRECIATION

Tangible non-current assets (property, plant and equipment (PPE)) are: -

- held for use in the **production or supply** of goods or services, for **rental** to others, or for **administrative purposes**; and
- expected to be used during **more than one period**

Land or a building, or part of a building, or both, held by the owner or by the lessee **to earn rentals or for capital appreciation** or both is referred to as **investment property.** This property is not used in the production or supply of goods or services or for administrative purposes or to sell in the ordinary course of business.

CRITERIA FOR RECOGNISING AN ASSET

The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

it is probable that future economic benefits associated with the item will flow to the entity	the cost of the item can be measured reliably

THE COST OF A TANGIBLE ASSET

- Is the cost just the purchase price? **No …**
- Cost includes:
  - The purchase price of the asset;
  - Any import duties and non-refundable purchase taxes;
  - Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management;
  - The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.

SUBSEQUENT MEASUREMENT

- Once recognised, a tangible asset can be accounted for under one of the following 2 methods:

Cost	Revaluation

REVALUATION

- Where an item of PPE is revalued, **all other assets in the same class** should also be revalued

- Revaluations should be made with sufficient regularity to ensure the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period

REVALUATION RESERVE: AN EXAMPLE

	Notes	31 December 2020 €'000	31 December 2019 €'000
Equity and liabilities			
Equity			
Capital and reserves attributable to owners of IHI:			
Issued capital	24	**615,685**	615,685
Revaluation reserve	25	**20,365**	27,538
Translation reserve	26	**(27,071)**	475
Reporting currency conversion difference	28	**443**	443

Part of Equity

IHI plc Annual Report & Financial Statements 2020 pg. FS37

https://www.corinthiagroup.com/wp-content/uploads/2021/04/Corinthia-Annual-Report-2020.pdf

DEPRECIATION

- All tangible non-current assets are depreciated except **land.**
- We need to depreciate an asset (or component) to its **residual value** over the asset's **useful life.**

- **Useful life** is:
- The period over which an asset is expected to be available for use by an entity; or
- The number of production or similar units expected to be obtained from the asset by an entity.

DEPRECIATION IN THE FINANCIAL STATEMENTS: AN EXAMPLE

Depreciation is calculated using the straight-line method to allocate the cost or revalued amounts of the assets to their residual values over their estimated useful lives, as follows:

	Years
Freehold buildings	50
Hotel plant and equipment	2 - 15
Furniture, fixture and fittings	3 - 10
Motor vehicles	5

Freehold land is not depreciated as it is deemed to have an indefinite life. Assets in the course of construction and payments on account are not depreciated.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

IHI plc Annual Report & Financial Statements 2020 pg. FS45

https://www.corinthiagroup.com/wp-content/uploads/2021/04/Corinthia-Annual-Report-2020.pdf

RESIDUAL VALUE

Residual value is defined as:

The estimated amount that an entity would currently obtain from disposal of the asset

- after deducting estimated costs of disposal
- if it were at the age and condition expected at the end of its useful life

TIME TO THINK!

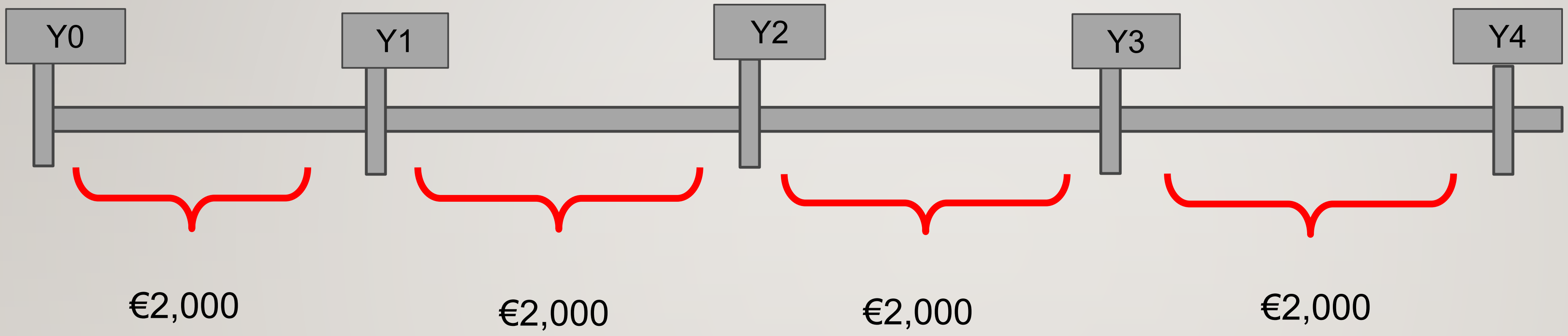
ABC Ltd purchases a machine for €10,000.

It estimates that the machine will last for 4 years and have a residual value at the end of the 4 years of €2,000.

How much is the depreciation expense of the machine per annum?

ANSWER

The depreciation would be calculated as follows:



Cost	€10,000
Residual Value	(€2,000)
Depreciable Amount	€ 8,000

This amount would be written off over the 4-year useful life.

Hence, charge a depreciation expense to the Statement of Profit or Loss of €2,000 per annum

DERECOGNITION OF A TANGIBLE ASSET

An asset is derecognized from the statement of financial position when:

1. It is sold
2. When no future economic benefits are expected from its use or disposal

Accounting for Intangible Assets

INTANGIBLE ASSETS IN THE FINANCIAL STATEMENTS: AN EXAMPLE

12. INTANGIBLE ASSETS

	The Group						
	Goodwill €'000	Brands €'000	Brand design fee and other rights €'000	Concessions €'000	Operating contracts €'000	Others €'000	Total €'000
Cost							
At 1 January 2019	30,982	22,721	9,558	463	23,334	2,427	89,485
Business combinations (Note 39)	1,215	2,400	-	-	-	-	3,615
Additions	-	-	194	-	-	731	925
At 31 December 2019	32,197	25,121	9,752	463	23,334	3,158	94,025
At 1 January 2020	32,197	25,121	9,752	463	23,334	3,158	94,025
Additions	-	-	27	-	-	63	90
Write off	-	-	(710)	-	-	-	(710)
Exchange differences	-	-	(3)	-	-	-	(3)
At 31 December 2020	**32,197**	**25,121**	**9,066**	**463**	**23,334**	**3,221**	**93,402**
Amortisation							
At 1 January 2019	15,114	1,500	8,129	330	14,198	1,853	41,124
Impairment	-	1,693	-	-	-	-	1,693
Amortisation for the year	-	-	586	40	1,167	379	2,172
At 31 December 2019	15,114	3,193	8,715	370	15,365	2,232	44,989

IHI plc Annual Report & Financial Statements 2020 pg. FS56

https://www.corinthiagroup.com/wp-content/uploads/2021/04/Corinthia-Annual-Report-2020.pdf

INTANGIBLE ASSETS

An intangible asset is an **identifiable non-monetary asset without physical substance**.

Examples include**: -**

- Purchased brands
- Trademarks
- Software
- Music rights
- Movies
- Logos

INTERNALLY GENERATED ASSETS (SELF-CREATED)

The standards **prohibit recognition of some internally generated assets**, e.g.

- Goodwill;
- Brands;
- Customer lists;
- Publishing titles; and
- Similar assets to above.

Why?

- These are not capable of being distinguished from the development of the business as a whole.

RESEARCH AND DEVELOPMENT COSTS

- **Research expenses** – always expensed in the P/L
- **Development costs** - can be capitalised from the point where all 6 criteria are met: -
  - **P**robable economic benefits
  - **I**ntention to complete the project
  - **R**esources available to complete the project
  - **A**bility to use or sell the item
  - **T**echnologically feasible
  - **E**xpenses on the project can be identified
- Costs can only be recognised as an asset from the point all 6 criteria are met, up to the date that the project is complete

SUBSEQUENT MEASUREMENT

- Once recognised, an intangible asset can be accounted for under one of the following 2 methods:

Cost	Revaluation

NOTE: - In order to use the revaluation method, an **active market** must exist.
It is extremely rare to find active markets for intangible assets and as a result, use of the revaluation model for intangible assets is very rare!

AMORTISATION OF INTANGIBLE ASSETS

- **Finite life intangibles** are intangible assets where the useful life is known
- These intangibles should be amortised over their useful life
- Amortisation should start when the **asset is ready for use**

IMPAIRMENT OF INTANGIBLE ASSETS

- Assets for which there is **no foreseeable limit** to the period over which it will generate cash flows are not amortised but tested for impairment at least **annually**

Accounting for Impairment

WHEN TO IMPAIR AN ASSET

An asset is impaired when:-

- its **carrying amount exceeds its recoverable amount**

What is the carrying amount?

- Amount at which the asset is recognised in the balance sheet

What is the recoverable amount?

Higher of:

- Fair value less costs to sell (FV less costs to sell) or
- Value in Use (VIU)

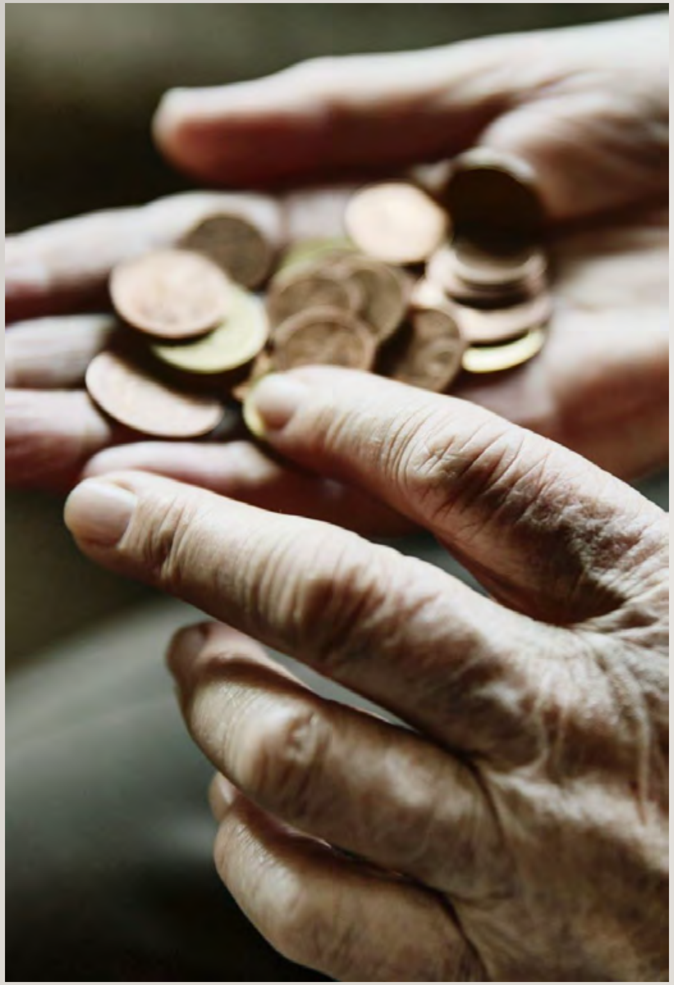
FAIR VALUE LESS COSTS TO SELL

Fair value is “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date”

What are costs to sell?

The costs that would be incurred in disposing of the assets such as:

- Legal costs
- Stamp duty
- Cost of removing the asset
- Other directly attributable costs



VALUE IN USE

VIU IS THE PRESENT VALUE OF THE FUTURE CASH FLOWS EXPECTED TO BE DERIVED FROM AN ASSET

TIME TO THINK!

€5,000

Carrying Amount at Year End

Lower of

Old Carrying Amount

€7,000

Recoverable Amount

€5,000

Higher of

Fair Value less Costs to Sell

€4,000

Value in Use

€5,000

We need to impair the asset by €2,000

IS AN IMPAIRMENT TEST CARRIED OUT EVERY YEAR?

An impairment test is carried out when there is

an **indicator of impairment**

BUT

The following must be tested for impairment annually:

1. Intangible assets with indefinite life, e.g. trademark
2. Intangible assets not yet available for use, e.g. development costs
3. Purchased Goodwill

Accounting for Provisions, Contingent Liabilities and Contingent Assets

WHAT IS A PROVISION?

A provision is a LIABILITY of uncertain timing or amount.

Examples of provisions include liabilities for warranties, lawsuits, customer refunds, onerous (loss-making) contracts, and plant closures and restructurings.

When should a provision in the financial statements be recognised?

A provision should be recognised when ALL of the following criteria are met:

- There is a **present obligation** as a result of a past event;
- There is a **probable outflow** of economic benefits;
- The amount payable can be **estimated reliably**.

A provision should be reviewed at the end of each reporting period and adjusted to reflect the current best estimate

PROVISIONS IN THE FINANCIAL STATEMENTS: AN EXAMPLE

EQUITY AND LIABILITIES

		As at 31 January			
		Group		Company	
		2023	2022	**2023**	2022
	Notes	**€'000**	€'000	**€'000**	€'000
Capital and reserves attributable to owners of the Company					
Share capital	12	**10,800**	9,000	**10,800**	9,000
Revaluation and other reserves	14, 15	**49,409**	49,409	**46,137**	46,137
Hedging reserve	16	**27**	(100)	**27**	(100)
Retained earnings		**78,931**	70,879	**72,710**	66,564
Total equity		**139,167**	129,188	**129,674**	121,601
Non-current liabilities					
Trade and other payables	22	**4,586**	2,648	**4,586**	2,648
Lease liabilities	19	**7,205**	6,811	**171**	191
Derivative financial instruments	17	**-**	45	**-**	45
Borrowings	18	**22,563**	24,081	**22,563**	24,081
Provisions for other liabilities and charges	21	**-**	2	**-**	2
Total non-current liabilities		**34,354**	33,587	**27,320**	26,967
Current liabilities					
Trade and other payables	22	**36,392**	32,905	**22,845**	22,462
Lease liabilities	19	**1,498**	1,479	**15**	149
Current tax liabilities		**1,529**	1,751	**-**	-
Derivative financial instruments	17	**-**	110	**-**	110
Borrowings	18	**2,135**	1,903	**1,550**	1,550
Provisions for other liabilities and charges	21	**9**	9	**9**	9
Total current liabilities		**41,563**	38,157	**24,419**	24,280
Total liabilities		**75,917**	71,744	**51,739**	51,247
Total equity and liabilities		**215,084**	200,932	**181,413**	172,848

Simonds Farsons Cisk plc, Annual Report, 2022/2023 pg. 73

HOW DO WE MEASURE A PROVISION?

In measuring a provision, an entity needs to assess whether it relates to:

A large population of items

OR

A single obligation

TIME TO THINK – SINGLE OBLIGATION!

ABC Ltd faces an outstanding court case concerning a customer claiming damages for losses due to faulty components supplied by ABC Ltd.

The estimated outcome is: -

10% chance of no damages awarded

65% chance of damages of €400,000

25% chance of damages of €600,000

How should this event be treated in the financial statements of ABC Ltd?

The Accounting Tuition Room by MVP 2024

ANSWER

- Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability.
- In this case study, the most probable single likely outcome (65%) is €400,000.
- The €400,000 will be an expense for the year and recognised as a provision in balance sheet

The Accounting Tuition Room by MVP 2024

TIME TO THINK – A LARGE POPULATION OF ITEMS!

ABC Ltd is required to do a provision for product warranty claims against 100,000 units of retail goods supplied with a one-year warranty.

The estimated outcome is:

- 70% of sales will have no claim
- 20% of sales will require a €50 repair
- 10% of sales will require a €100 repair

How should this event be treated in the financial statements of ABC Ltd?

The Accounting Tuition Room by MVP 2024

ANSWER

Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities: - expected value basis

How?

70% x €0 =	0
20% x €50 =	€10
10% x €100 =	<u>€10</u>
	€20 x 100,000 = €2,000,000

This will be an expense for the year and recognised as a current liability (it is a one-year warranty scheme) in the balance sheet

The Accounting Tuition Room by MVP 2024

WHAT IS A CONTINGENT LIABILITY?

Contingent liability is defined as: -

1. a **possible obligation** that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

2. a **present obligation** that arises from past events but is not recognised because:

   i. it is **not probable** that an outflow of resources embodying economic benefits will be required to settle the obligation; or

   ii. the **amount of the obligation** cannot be measured with sufficient reliability.

DISCLOSURE NOTE FOR A CONTINGENT LIABILITY

We **disclose a note** unless the possibility of an outflow of resources embodying economic benefits is **remote.**

"38. CONTINGENT LIABILITIES

A claim in relation to brokerage fees on the sale of Lisbon Hotel to IHI p.l.c. in 2000 amounting to €1.7 million is being made by an individual against 8 defendants including IHI p.l.c. No provision has been made in these financial statements for this claim as the Company and the Group believe that it has a strong defence in respect of these claims.

A client has instituted proceedings against QPM Limited for damages sustained in relation to professional works. The directors do not expect that the cash outflow net of insurance recoveries to be material."

IHI plc Annual Report & Financial Statements 2020 pg. FS90

https://www.corinthiagroup.com/wp-content/uploads/2021/04/Corinthia-Annual-Report-2020.pdf

WHICH PROVISIONS ARE ALLOWED IN THE FINANCIAL STATEMENTS?

Circumstance	Recognise a Provision?
Warranties/guarantees	Accrue a provision (past event was the sale of defective goods)
Customer refunds	Accrue if the established policy is to give refunds
Onerous (loss-making) contract	Accrue a provision
Land contamination	Accrue a provision if the company's policy is to clean up even if there is no legal requirement to do so
Future operating losses	No provision (no present obligation)
Firm offers staff training	No provision (there is no obligation to provide the training)
Major overhaul or repairs	No provision (no obligation)
Restructuring by sale of an operation/line of business	Accrue a provision only after a binding sale agreement
Restructuring by closure of business locations or reorganization	Accrue a provision only after a detailed formal plan is adopted and announced publicly. A Board decision is not enough

WHAT IS A CONTINGENT ASSET?

- Arises from unplanned or other unexpected events that give rise to the possibility of an inflow of economic benefits to the entity.
- Should the company assesses the inflow of benefits to be **probable**, they disclose a contingent asset in the notes
- When the realisation of income is **virtually certain**, then the related asset is not a contingent asset and its recognition in the financial statements is appropriate.
- Should the assessment of whether the inflow of benefits will occur be **possible** or **remote**, then no disclosure should be made.

REIMBURSEMENTS

- In some cases, an insurance company or a supplier under a warranty may reimburse all or part of a company's expenditure to settle a provision.

- If so the reimbursement should be recognised only when it is **virtually certain** that reimbursement will be received if the entity settles the obligation.

- The reimbursement would be:
  - Treated as an **asset in the balance sheet** separate from the provision; and
  - Recognised in the balance sheet at an amount **not exceeding** the amount of the provision

TIME TO THINK!

A customer sues Restaurant PQ for food poisoning, €50,000. Restaurant PQ makes a counter claim against their suppliers for €60,000.

Per the legal advisers, both claims are certain to succeed.

ANSWER

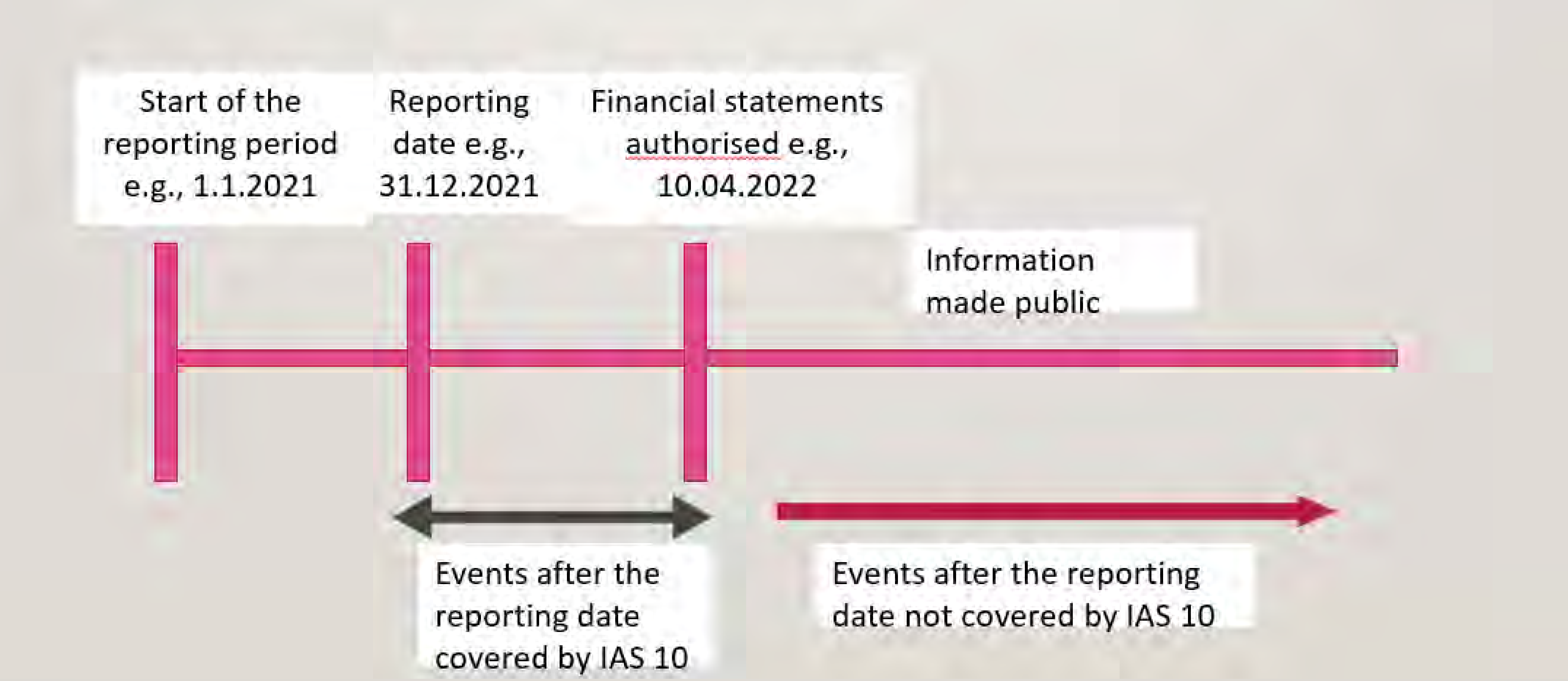
Statement of Financial Position

	€
Current Assets	
Receivables	50,000
Current Liabilities	
Provisions	50,000

Events after the reporting period

What happens when an event takes place after the year-end but before the financial statements are authorised for issue?

EXAMPLE


Start of the reporting period e.g., 1.1.2021
Reporting date e.g., 31.12.2021
Financial statements authorised e.g., 10.04.2022
Information made public
Events after the reporting date covered by IAS 10
Events after the reporting date not covered by IAS 10

ADJUSTING EVENTS

- **Adjusting events** are those events that provide evidence of conditions that ***existed*** at reporting date.

- An entity shall adjust the amounts recognised in its financial statements to reflect these adjusting events.

21 ACADEMY

TIME TO THINK!

The financial statements of ABC Co for the year ended 30 September 2020 are expected to be approved in the Annual General Meeting, which is to be held on **20 January 2021**.

On 14 October 2020, a material fraud was discovered by the bookkeeper. Funds were diverted into a fictitious supplier bank account, set up by an employee, which had been occurring for the past ten months. The employee was immediately dismissed, legal proceedings against the employee have been initiated and the employee's final wages have been withheld as part-reimbursement back to the company.

How would this issue be accounted for in the financial statements for the year ending 30 September 2020?

https://www.accaglobal.com/an/en/student/exam-support-resources/fundamentals-exams-study-resources/f8/technical-articles/subsequent-events.html

ANSWER

Fraud, error and other irregularities that occur prior to the year-end date – but which are only discovered after the year-end – are adjusting items, and therefore the financial statements would require amendment to take account of the fraudulent activity up to the year-end.

EXAMPLES OF ADJUSTING EVENTS

- the settlement after the balance sheet date of a court case confirming a liability;
- the receipt of information after the balance sheet date indicating that an asset was impaired at the balance sheet date e.g. the bankruptcy of a customer, the sale of inventories at a price lower than cost;
- the determination, after the balance sheet date, of the cost of assets purchased or proceeds sold before the balance sheet date;
- the determination after the balance sheet date of the amount of profit/bonus payments provided there was a legal or constructive obligation at the balance sheet date; and,
- the discovery of fraud or error.

NON-ADJUSTING EVENTS

Non-adjusting events are those events that happen ***after*** the reporting date that are indicative of conditions after reporting date.

An entity shall **not** adjust the amounts recognised in its financial statements for these types of events

BUT …

An entity shall **disclose** the following for each material category of non-adjusting event after the reporting period:

- the nature of the event; and
- an estimate of its financial effect, or a statement that such an estimate cannot be made.

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EXAMPLES OF NON-ADJUSTING EVENTS

- A major business combination/disposal after the balance sheet date;
- An announcement of a plan to discontinue an operation or entering into binding agreements to sell;
- Major purchases/disposals of assets or expropriations of major assets by government;
- The destruction of a major production plant by fire;
- The announcement or commencing of a major restructuring;
- Major ordinary share and potential share transactions;
- Abnormal large changes in asset prices or foreign exchange rates;
- Changes in tax rates/laws enacted or announced after the balance sheet date;
- Entering into significant commitments e.g. guarantees;
- Commencement of major litigation arising solely out of events that have occurred after the balance sheet date.

ANY QUESTIONS?