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# Introduction

## The aim of this publication

In contrast to many national accounting systems[[1]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=36#sdfootnote1sym) , IFRS prescribes few specific accounting procedures. Accountants accustomed to defined charts of account, prescribed procedures, standardized financial statements and a system concerned with form over substance, often find IFRS’s principles-based approach vexing.

This publication aims to bridge this gap by presenting examples of accounting procedures for the most common transactions and events. By targeting practitioners accustomed to national accounting standards, it also seeks ease the transition from a ridged, prescriptive, rules-based system focused on procedural formalities to a system that is flexible, judgmental and concerned, above all else, with presenting economic reality faithfully, truthfully, understandably and completely.

However, since it does so primarily through example, it cannot be applied on its own. Instead, its author explicitly recommends the reader first gain an understanding of the underlying principles, standards and interpretations (either by carefully reading IFRS or by participating in training led by qualified experts). Only then, should he or she attempt to put the procedures outlined herein into practice.

## Chart of accounts

The [chart of accounts](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=41) presented in the publication is an example[[2]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=36#sdfootnote2sym) that was intentionally drafted to approximate, as closely as possible, a chart of accounts that would be mandatory under one of Continental Europe’s national accounting systems (if it were consistent with IFRS). It is not a template and would not be applicable at a particular entity without significant modification.

Important: Even with modification, this chart of accounts would only be suitable to a relatively small, national company (that is trying to produce an IFRS report on the cheap). It would be inappropriate for a multinational organization that, besides IFRS, must abide by various regulatory requirements and the national (accounting, tax, etc.) legislation of various countries. Instead of the ridged, stand-alone system implied by the example, such companies need a flexible[[3]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=36#sdfootnote3sym) , integrated system adequate to the task[[4]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=36#sdfootnote4sym) .

## Audit trail

Since IFRS prescribes no chart of account nor account numbers, it is necessary for each accounting entry to include a posting reference. For example:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | | **Journal** | |  |  |
| **Date** | **Accounts** | | | **Posting Reference** | **Dr.** | **Cr.** |
| 1/1/Y1 | Merchandise | | | 1.1.4.5.345 | 100,000 |  |
|  |  | Trade payable | | 2.1.1.1.786 |  | 100,000 |

From this reference, it is clear that 100,000 will be posted to general ledger accounts 1.1.4.5.345 and 2.1.1.1.786. What is less clear, however, is where the source documents for this entry are located. If this it is clear (for example, they are located in at the same location as the journal), the information need not be explicitly provided. If not, a “from / to” reference should be made. For example:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | | **Journal** | |  |  |
| **Date** | **Accounts** | | | **Posting Reference** | **Dr.** | **Cr.** |
| 1/1/Y1 | Merchandise | | | B5.R9.F4.S8.#123 / 1.1.4.5.345 | 100,000 |  |
|  |  | Trade payable | | B5.R9.F4.S8.#123 / 2.1.1.1.786 |  | 100,000 |

From this reference, it is clear that if one wished to examine the source document, one would visit building 5, room 9, open filing cabinet 4, look on shelf 8 where one would find the document filed under number 123.

Obviously, since IFRS does not discuss such procedural matters, each company is free to choose a classification & reference scheme that, in its own judgment, best fits it own particular circumstances.

## Structure of this publication

This publication is structured thematically, not standard by standard.

The section discussing balance sheet items assumes an order of liquidity, while the section discussing income statement items assumes a function of expense presentation. Since it is aimed at procedure, a discussion of disclosure (be it in the footnotes, management commentary or otherwise) is presented only when pertinent.

## Abbreviations and acronyms

This publication was printed in an A5 format to make it as accessible (and easily transportable) as possible. Unfortunate, such a compact page makes the use of abbreviations and acronyms unavoidable. While an effort was made to limit these to the generally accepted, occasionally the topic at hand made this impossible. If the reader should encounter an abbreviation and acronym that is not understandable, the author will gladly explain. Contact information can be found at GAAP-CZ.com.

## Caveat

All examples contained herein are derived from, and consistent with, IFRS as promulgated by the IASB[**[5]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=36#sdfootnote5sym) . It is not the intent of this publication, nor its author, to comment on IFRS as ratified by any particular state or region[**[6]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=36#sdfootnote6sym) , nor to deal with the interaction between IFRS and local / regional statute.

If the reader has any question regarding the legality and/or statutory applicability of any example contained herein, it is expressly recommended that he or she consult this issue with an expert qualified to express an opinion on the application and /or interpretation of IFRS with local/regional law.

## Important

IAS 8.7: When an IFRS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the IFRS and considering any relevant Implementation Guidance issued by the IASB for the IFRS.

IAS 8.10: In the absence of an IFRS that specifically applies to a transaction, other event or condition, management shall use its judgment …

IAS 8.12: In making the judgment described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards …

Since it is not drafted using a conceptual framework similar to IFRS, accounting law (the pronouncements of standard setting bodies in those countries where accounting standards are legislated[**[7]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=36#sdfootnote7sym) ) cannot be used (implicitly or explicitly) as a starting point for drafting an IFRS report.

As a result, converting, transforming, bridging, mapping or otherwise basing an IFRS report on procedures prescribed by national legislation would be a violation of IFRS (IAS 8.12), an error (IAS 8.41-48).

Consequently, this publication does not take national accounting statute into consideration, does not attempt to bridge the differences between legislated standards and IFRS, and EXPLICITLY STATES THAT IT CONSIDERS SUCH AN APPROACH TO BE HIGHLY UNADVISABLE.

## Interaction with tax law

While, many of the issues discussed herein have tax implications, correctly determining tax expense / deferred tax requires an in depth knowledge of both IFRS and national tax (accounting, commercial, etc.) legislation. Consequently, any but a rudimentary discussion of this issue is far beyond the scope of this general publication.

## As at

This publication is based on International Financial Reporting Standards as issued by the [**International Accounting Standards Board**](http://gaap.cz/main_page/link-to-IASB.htm) up to 1/1/2009.

[**1**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=36#sdfootnote1anc): Although IFRS 1 defines “previous GAAP” as “the basis of accounting that a first-time adopter used immediately before adopting IFRSs” if applied to national accounts, the term GAAP is often misleading.

The reason, GAAP (or Generally Accepted Accounting Principles) are (as the name implies) conventional not statutory. Rather than being the formal, written enactments of a legislative authority (having a political mandate and public accountability), GAAP (for example IFRS or US GAAP) are promulgated by independent, non-governmental organizations with no legislative authority.

Consequently, neither the terms “previous GAAP” nor “national GAAP” are used in the publication. Instead the term “national” accounting standards is used to denote the legislated standards of a particular country or region.

[2](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=36#sdfootnote2anc): IFRS not only does not define a [chart of accounts](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=41).

[**3**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=36#sdfootnote3anc): A firmly defined charts of accounts with firmly assigned account numbers is an anachronism. Today, when even the simplest European company has to draft (at minimum) three (vastly different) reports (a IFRS financial report, a set of national financial statements and a tax return) on the basis of the same dataset, it lacks any logical justification.

[**4**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=36#sdfootnote4anc): For example, XYZ International begins the manufacturing process at XYZ China. Once preliminary work is complete, the WIP is shipped to XYZ Indonesia (for another intermediate step), then to XYZ Germany (for final assembly). Then, the finished good is transferred to XYZ US (where it is sold at tradeshow) and delivered, by XYZ Brazil, to the customer based there. Obviously, keeping an IFRS book at XYZ China, XYZ Indonesia, XYZ Germany, XYZ US and XYZ Brazil does qualify as the best possible use of resources. Instead, it may be reasonable to leave this work to XYZ Czech, where it can be done in a cost effective manner, at a shared service center, located just outside Brno. On the other hand, producing a statutory / tax report in compliance with Chinese, Indonesian, German, US and Brazilian statute may just require some local knowledge and expertise (that is probably hard to find in Central Europe). Consequently, it is probably best to draft those reports locally.

[5](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=36#sdfootnote5anc): Documents promulgated by the IASB are available on its site: [eifrs.iasb.org](http://gaap.cz/main_page/link-to-IASB-IFRS.htm).

[**6**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=36#sdfootnote6anc): For example: [**Commission Regulation (EC) No 1126/2008**](http://gaap.cz/main_page/link-to-Europa-2.htm).

[**7**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=36#sdfootnote7anc): In Europe, most national accounting standards are (in whole or part) legislated. Exceptions do, however, exist. For example, UK GAAP (the pronouncements of the [**Accounting Standards Board**](http://gaap.cz/main_page/link-to-ASB.htm)) is drafted using a conceptual framework comparable to IFRS and, as a result, can be considered broadly comparable. Therefore, companies with UK GAAP procedures in place can (with relatively minor adjustment) apply them for IFRS purposes. The same is not, however, true for companies whose procedures are based, for example, on German or French accounting legislation.

# Accounting policy in general

## Examples

On 1/1/Y1, XYZ Inc. purchased 100 units of merchandise from a supplier on credit for a total of 100,000 (including delivery and related costs). On 1/15/Y1 it sold 10 units to a customer for 15,000. On 1/31/Y1 it paid the invoice. The customer paid on 2/15/Y1.

This particular level of disaggregation is only one example of how to approach IFRS[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=35#sdfootnote1sym)**.**

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Daily journal, January** | | | | | | | | | | |
| **Date, item** | | | **Accounts and description** | **Posting Reference** | | **Dr.** | | | **Cr.** | |
|  | | | |  | |  | | |  | |
| 1/1/Y1, item 1 | | | |  | |  | | |  | |
|  | Merchandise, item 345 | | | 1.1.4.5.345 | | 100,000 | | |  | |
|  |  | Trade payable | | 2.1.1.1.786 | |  | | | 100,000 | |
| Purchase from ABC, supplier #786, invoice #123, due 2/1 | | | | | | | | Recorded by RM | | |
|  | | | | |  | |  | | |  |
| 1/1/Y1, item 2 | | | | |  | |  | | |  |
|  | Office supplies | | | | 1.1.5.5.14 | | 12,500 | | |  |
|  |  | Trade payable | | | 2.1.1.1.321 | |  | | | 12,500 |
| Purchase from Acme, supplier #321, invoice # 45781, due 2/1Y1 | | | | | | | | Recorded by RM | | |
|  | | | | |  | |  | | |  |
| 1/1/Y1, item 3 | | | | |  | |  | | |  |
|  | Messenger | | | | 5.3.9.1012 | | 550 | | |  |
|  |  | Petty cash | | | 1.1.1.1 | |  | | | 550 |
| Cash payment, courrier, general office. | | | | | | | | Recorded by SNM | | |
|  | | | | | | | | | | |
| - etc. - | | | | | - | | - | | | - |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Daily journal, January** | | | | | | |
| - etc. - | | | - | - | | - |
|  | | |  |  | |  |
| 1/15/Y1, item 835 | | |  |  | |  |
|  | Accounts receivable | | 1.1.3.1.250 | 15,000 | |  |
|  |  | Revenue | 4.3.2 |  | | 15,000 |
|  | Merchandise | | 5.1.4 | 10,000 | |  |
|  |  | Merchandise, item 345 | 1.1.4.5.345 |  | | 10,000 |
| Sale to DEF, customer #250, invoice # 010723, due 2/15/Y1 | | | | | Recorded by RM | |
|  | | | | | | |
| - etc. - | | | - | - | | - |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Daily journal, January** | | | | | | | | |
| - etc. - | | | - | | - | | | - |
|  | | |  | |  | | |  |
| 1/31/Y1, item 1720 | | |  | |  | | |  |
|  | Trade payable | | 2.1.1.1.786 | | 100,000 | | |  |
|  |  | Cash in bank | 1.1.1.2.5 | |  | | | 100,000 |
| Payment, invoice #123456 | | | | | | | Recorded by: PS | |
|  | | | | | | | | |
| - etc. - | | | | - | | - | | - |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Daily journal, February** | | | | | | | | |
| - etc. - | | | - | | - | | | - |
|  | | |  | |  | | |  |
| 2/15/Y1, item 2075 | | |  | |  | | |  |
|  | Cash in bank | | 1.1.1.2.5 | | 15,000 | | |  |
|  |  | Accounts receivable | 1.1.3.1.250 | |  | | | 15,000 |
| Receipt, invoice # 010723 | | | | | | | Recorded by PS | |
|  | | | | | | | | |
| - etc. - | | | | - | | - | | - |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Account** | | | | |
| **Merchandise inventory, item**3**45** | | | | |
| **Date** | **Description** | **Post. Ref.** | **Dr.** | **Cr.** |
| 1/1/Y1 | Purchase | JJ-1 / DL-1 | 100,000 |  |
| - | - | - | - | - |
| 1/15/Y1 | Sale | JJ-835 / DL-835 |  | 10,000 |
| - | - | - | - | - |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Account** | | | | |
| **Trade payables, supplier # 786** | | | | |
| **Date** | **Description** | **Post. Ref.** | **Dr.** | **Cr.** |
| 1/15/Y1 | Purchase, merchandise 345 | JJ-1 / DL-1 |  | 100,000 |
| - | - | - | - | - |
| 2/15/Y1 | Payment, invoice 123456 | JJ-1720 / DL-1720 | 100,000 |  |
| - | - | - | - | - |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Account** | | | | |
| **Trade receivables, customer # 250** | | | | |
| **Date** | **Description** | **Post. Ref.** | **Dr.** | **Cr.** |
| 1/15/Y1 | Sale | JJ-835 / DL-835 | 15,000 |  |
| - | - | - | - | - |
| 2/15/Y1 | Receipt, invoice 010723 | JF-1412 / DÚ-1412 |  | 15,000 |
| - | - | - | - | - |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Account** | | | | |
| **Merchandise revenue** | | | | |
| **Date** | **Description** | **Post. Ref.** | **Dr.** | **Cr.** |
| 1/15/Y1 | Sale | JJ-835 / DL-835 |  | 15,000 |
| - | - | - | - | - |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Account** | | | | |
| **Cost of merchandise sold** | | | | |
| **Date** | **Description** | **Post. Ref.** | **Dr.** | **Cr.** |
| 1/15/Y1  15.1.R1 | Goods sold | JJ-835 / DL-835 | 10,000 |  |
| - | - | - | - | - |

[**1**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=35#sdfootnote1anc)**:**The remainder of the examples in this publication do not generally have this level of disaggregation, unless pertinent to the topic at hand.

# Balance Sheet (Statement of Financial Position)

IFRS (IAS 1.57) explicitly states that it does not prescribe the exact content or structure of a balance sheet, merely its minimum content (IAS 1.54). Consequently, the entity adds line items and changes their organization if (IAS 1.55) whenever it is relevant to an understanding of its financial position.

## Examples

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **XYZ Inc.**  **Statement of financial position**  **As of December**3**1, 2YY5** | | | | |
|  | | | | X 1,000,000 |
|  | | | | Year**[[1]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote1sym)**: |
| **Assets** | | | |  |
|  | **Current assets** | | |  |
|  | | Cash and short-term investments | | CU**[[2]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote2sym)**: 550 |
|  | | Receivables | | 100 |
|  | | Inventory | | 150 |
|  | | Accrued & deferred assets | | 50 |
|  | **Total current assets** | | | 850 |
|  | **Long lived assets** | | |  |
|  | | Investments & financial instruments | |  |
|  | | | Equity investments (stocks) | 500 |
|  | | | Fixed income investments | 450 |
|  | | Total investments | | 950 |
|  | | Property, plant and equipment | |  |
|  | | | Land, buildings and structures | 1,500 |
|  | | | Production machinery & equipment | 3,500 |
|  | | | Administrative & sales equipment | 1,400 |
|  | | | Accumulated depreciation / | (1,900) |
|  | | Total property, plant and equipment | | 4,500 |
|  | | Intangible assets | |  |
|  | | | Patents and copyrights | 200 |
|  | | | Goodwill | 300 |
|  | | | Accumulated amortization | (100) |
|  | | Total intangible assets | | 400 |
|  | **Total long-lived assets** | | | 5,850 |
| **Total assets** | | | | 6,650 |
|  | | | |  |
| **Liabilities and equity** | | | |  |
|  | **Liabilities** | | |  |
|  | | Current liabilities | |  |
|  | | | Accounts payable | 200 |
|  | | | Accrued liabilities | 50 |
|  | | Total current liabilities | | 250 |
|  | | Long--term liabilities | |  |
|  | | | Loans outstanding | 550 |
|  | | | Obligations under capital lease | 1,150 |
|  | | | Bonds outstanding | 950 |
|  | | Total long-term liabilities | | 2,650 |
|  | **Total liabilities** | | | 2,900 |
|  | **Equity** | | |  |
|  | | Common stock at par | | 100 |
|  | | Additional paid--in capital | | 900 |
|  | | Retained earnings | |  |
|  | | | Unappropriated retained earnings | 2,300 |
|  | | | Appropriated retained earnings | 100 |
|  | | Total retained earnings | | 2,400 |
|  | | Non--controlling interest | | 20 |
|  | | Accumulated OCI | | 80 |
|  | **Total equity** | | | 3,500 |
| **Total liabilities and equity** | | | | CU 6,650 |
|  | | | |  |

### Example (IAS 1.IG 1 - 7)

|  |  |  |  |
| --- | --- | --- | --- |
| **XYZ Group**  **Statement of financial position**  **As at**3**1 December 20X7** | | | |
|  | (in thousands of currency units) | | |
|  | 31 Dec 20X7 | 31 Dec 20X6 | 31 Dec 20X5 |
| **ASSETS** |  |  |  |
| Non-current assets |  |  |  |
| Property, plant and equipment | 350,700 | 360,020 | 361,730 |
| Goodwill | 80,800 | 91,200 | 100,120 |
| Other intangible assets | 227,470 | 227,470 | 76,720 |
| Investments in associates | 100,150 | 110,770 | 120,360 |
| Available-for-sale financial assets | 142,500 | 156,000 | 120,800 |
|  | 901,620 | 945,460 | 779,730 |
| Current assets |  |  |  |
| Inventories | 135,230 | 132,500 | 125,000 |
| Trade receivables | 91,600 | 110,800 | 122,120 |
| Other current assets | 25,650 | 12,540 | 13,850 |
| Cash and cash equivalents | 312,400 | 322,900 | 328,780 |
|  | 564,880 | 578,740 | 589,750 |
| Total assets | 1,466,500 | 1,524,200 | 1,369,480 |
|  |  |  |  |
| **EQUITY AND LIABILITIES** | | |  |
| Equity attributable to equity holders of the parent | | |  |
| Share capital | 650,000 | 600,000 | 600,000 |
| Retained earnings | 243,500 | 161,700 | 118,500 |
| Other components of equity | 10,200 | 21,200 | (400) |
|  | 903,700 | 782,900 | 718,100 |
| Minority interest | 70,050 | 48,600 | 29,900 |
| Total equity | 973,750 | 831,500 | 748,000 |
| Non-current liabilities |  |  |  |
| Long-term borrowings | 120,000 | 160,000 | 180,000 |
| Deferred tax | 28,800 | 26,040 | 19,750 |
| Long-term provisions | 28,850 | 52,240 | 41,730 |
| Total non-current liabilities | 177,650 | 238,280 | 241,480 |
| Current liabilities |  |  |  |
| Trade and other payables | 115,100 | 187,620 | 113,800 |
| Short-term borrowings | 150,000 | 200,000 | 200,000 |
| Current portion of long-term borrowings | 10,000 | 20,000 | 20,000 |
| Current tax payable | 35,000 | 42,000 | 41,000 |
| Short-term provisions | 5,000 | 4,800 | 5,200 |
| Total current liabilities | 315,100 | 454,420 | 380,000 |
| Total liabilities | 492,750 | 692,700 | 621,480 |
| Total equity and liabilities | 1,466,500 | 1,524,200 | 1,369,480 |
|  |  |  |  |

# Assets

## Current assets

Current assets are assets convertible to cash (sold or consumed) within 12 months of the balance sheet date (end of the operating cycle**[[3](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote3sym)**: ).

# Cash and cash equivalents

Cash comprises currency on hand and demand bank deposits. Cash equivalents comprise very short-term investments (financial instruments with an original maturity of three months or less), financial instruments (such as stamps or coupons) that can be used in lieu of cash as mediums of exchange, or items that will (such as cash in transit) be converted to known amounts of cash in the very near future.

## Examples

## Transfer of cash into petty cash

On 1/1/Y1, XYZ transferred cash from the bank to petty cash**[[4]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote4sym)**: .

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Petty cash | | 1.1.1.1 | 5,000 |  |
|  | Cash in bank**[[5]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote5sym)**: | 1.1.1.2.x.y |  | 5,000 |

## Purchase of negotiable cash equivalents

On 1/1/Y1, XYZ purchased revenue stamps**[[6]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote6sym)**: for 1,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Revenue stamps | | 1.1.1.3.2.2 | 1,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 1,000 |

On 1/1/Y1, XYZ purchased employee meal vouchers with a nominal value of 48,750 for 50,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Meal vouchers | | 1.1.1.3.2.3 | 48,750 |  |
| Pre-paid meals**[[7]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote7sym)**: | | 1.1.5.1.x | 1,250 |  |
|  | Cash in bank | 1.1.1.2 |  | 50,000 |

Same facts except XYZ purchased employee meal vouchers with a nominal value 50,000 and paid a commission of 1,282.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Meal vouchers | | 1.1.1.3.2.3 | 50,000 |  |
| Pre-paid meals**[[8]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote8sym)**: | | 1.1.5.1.x | 1,282 |  |
|  | Cash in bank | 1.1.1.2 |  | 51,282 |

## Transfer of meal coupon to employee

Same facts except XYZ paid-out meal vouchers valued at 1 000 to an administrative employee.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Administrative payroll | | 5.3.2.3 | 1,025 |  |
|  | Pre-paid meals | 1.1.5.1.x |  | 25 |
|  | Meal vouchers | 1.1.1.3.2.2 |  | 1,000 |

## Acquisition of very-short term investment

On 3/1/Y1 XYZ acquired a certificate of deposit for 10,000. The certificate was non-cancellable for a term of 91 days, after which the entity received 10,150.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/1/Y1 / 1.3.R1 | | Post. ref. | Dr. | Cr. |
| Very S-T investment**[[9]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote9sym)**: | | 1.1.1.3.1.x | 10,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Accrued interest | | 1.1.5.2.x | 50 |  |
|  | Interest revenue | 6.1.1 |  | 50 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 5/31/Y1 / 31.5.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 10,150 |  |
|  | Very S-T investment | 1.1.1.3.1.x |  | 10,000 |
|  | Accrued interest | 1.1.5.2.x |  | 50 |
|  | Interest revenue | 6.1.1 |  | 100 |

## Restricted assets (funds)

On 1/1/Y1, XYZ borrowed 1,000,000 from its bank and agreed to pay 6,000 each month as interest and repay the principle in three years. It also agreed to maintain a minimum balance of at least 100,000 for the entire 3-year term.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 900,000 |  |
| Restricted cash | | 1.5.1.x | 100,000 |  |
|  | Long-term loan | 2.2.3.x |  | 1,000,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/31/Y1 / 31.1.R1 | | Post. ref. | Dr. | Cr. |
| Interest expense | | 6.2.1.x | 6,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 6,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y2 / 31.12.R2 | | Post. ref. | Dr. | Cr. |
| Long-term loan | | 2.2.3.x | 1,000,000 |  |
|  | Short-term loan | 2.1.1.2.x |  | 1,000,000 |
| Restricted cash | | 1.1.6.x | 100,000 |  |
|  | Restricted cash | 1.5.1.x |  | 100,000 |

# Short-term investments

Short-term investments are financial Instruments (excluding receivables) or other claims to cash with a term of less than one year (operating cycle) and/or are marketable (in that the entity intends to liquidate them within the year/cycle).

## Marketable securities

Since they generally have an objectively determinable fair value, marketable financial instruments are re-measured to fair value (market price) whenever a (annual, quarterly, monthly, etc.) financial report is produced.

### Examples

### Mark-to-market (fair value) accounting

On 2/6/Y1 XYZ Inc. purchased 500 bonds issued by ABC Co. for 1,000 each. On 3/16/Y1, it purchased 10,000 shares issued by DEF Inc. for 100 each. On 3/31/Y1, (the end of XYZ’s fiscal quarter), the bonds were trading at 960 and the stock at 104. Both investments were classified as trading (fair value through profit and loss). On 4/7/Y1, it sold both investments for 490,000 and 1,050,000 respectively.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/6/Y1 / 6.2.R1 | | Post. ref. | Dr. | Cr. |
| Marketable securities**[[10]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote10sym)**: | | 1.1.2.1.x.y | 500,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 500,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/16/Y / 16.3.R1 | | Post. ref. | Dr. | Cr. |
| Marketable securities | | 1.1.2.1.z.a | 1,000,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 1,000,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Loss | | 6.4.6 | 20,000 |  |
|  | Marketable securities | 1.1.2.1.x.y |  | 20,000 |
| Marketable securities | | 1.1.2.1.z.a | 40,000 |  |
|  | Gain | 6.3.2 |  | 40,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/7/Y1 / 7.4.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 1,540,000 |  |
|  | Gain | 6.3.2 |  | 10,000 |
|  | Marketable securities | 1.1.2.1.x.y |  | 480,000 |
|  | Gain | 6.3.2 |  | 10,000 |
|  | Marketable securities | 1.1.2.1.z.a |  | 1,040,000 |

### Mark-to-market with allowance

Same facts except a valuation allowance is used.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Loss | | 6.4.6 | 20,000 |  |
|  | Allowance | 1.1.2.1.x.(y1) |  | 20,000 |
| Allowance | | 1.1.2.1.x.(a1) | 40,000 |  |
|  | Gain | 6.3.2 |  | 40,000 |

### Other short-term (non-marketable) investments

Since they do not generally have an objectively determinable fair value (subsequent to acquisition), non-marketable financial instruments are not remeasured to fair value. Instead they are carried at present value (amortized cost).

#### Examples

#### Present value accounting

On 3/1/Y1 XYZ purchased a note for 9,629. The note had a nominal value of 10,000, paid no interest and was due 5/31/Y1.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/1/Y / 1.3.R1 | | Post. ref. | Dr. | Cr. |
| Short-term investments | | 1.1.2.2.1 | 10,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 9,629 |
|  | Discount | 1.1.2.2.(3) |  | 371 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Discount | | 1.1.2.2.(3) | 93 |  |
|  | Interest revenue**[[11]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote11sym)**: | 6.1.1 |  | 93 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 5/31/Y / 31.5.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 10,000 |  |
| Discount | | 1.1.2.2.(3) | 93 |  |
|  | Short-term investments | 1.1.2.2.1 |  | 10,000 |
|  | Interest revenue | 6.1.1 |  | 93 |

#### Amortized cost accounting

On 3/1/Y1 XYZ purchased a note for 9,629. The note had a nominal value of 10,000, paid no interest and was due 8/31/Y1. It decided to amortize the discount using the effective interest rate method.

|  |  |  |  |
| --- | --- | --- | --- |
| **P** | **Present value** | **Discount rate** | **Interest income** |
| **A** | **B = B(B+1) + D** | **C** | **D = B \* C** |
| 1 | 9,629.28 | 0.95%\* | 91.37 |
| 2 | 9,720.65 | 0.95% | 92.24 |
| 3 | 9,812.89 | 0.95% | 93.11 |
| 4 | 9,906.00 | 0.95% | 94.00 |
|  | 10,000.00 |  |  |
|  | \* 0.94888% |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Discount | | 1.1.2.2.(3) | 91 |  |
|  | Interest revenue | 6.1.1 |  | 91 |

# 

# Receivables

Receivables are claims to cash resulting from the delivery of goods or rendering of services as part of an entity’s core, on-going operations.

## Measurement

The basic rule (IAS 39.46) is that loans and receivables are discounted (using the effective interest method). The exception (IAS 39.AG79) is short-term**[[12]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote12sym)**: trade receivables (and payables) without a stated interest rate where the effect of discounting is not material.

### Examples

### Trade (account) receivable

On 4/15/Y1 XYZ sold ABC (customer # 8, invoice # 6) goods (warehouse # 79) for 10,000 on 30-day credit. The customer paid on time to bank 3, account 4.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/15/Y1 / 15.4.R1 | | Post. ref. | Dr. | Cr. |
| Accounts receivable | | 1.1.3.1.8.6 | 10,000 |  |
| Cost of goods sold | | 5.1.4 | 8,000 |  |
|  | Revenue | 4 |  | 10,000 |
|  | Goods on hand | 1.1.4.4.79 |  | 8,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 5/15/Y1 / 15.5.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2.3.4 | 10,000 |  |
|  | Accounts receivable | 1.1.3.1.8.6 |  | 10,000 |

Same facts except the company decided to record expenses for each customer / supplier separately (it sold the goods to customer 8 originally purchased the goods from supplier 12).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/15/Y1 / 15.4.R1 | | Post. ref. | Dr. | Cr. |
| Accounts receivable | | 1.1.3.1.8.6 | 10,000 |  |
| Cost of goods sold | | 5.1.4.12 | 8,000 |  |
|  | Revenue | 4.8 |  | 10,000 |
|  | Goods on hand | 1.1.4.4.12.79 |  | 8,000 |

### Rapid payment discount

Same facts except the payment terms were 2/10 net 30.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/15/Y1 / 15.4.R1 | | Post. ref. | Dr. | Cr. |
| Accounts receivable | | 1.1.3.1.8.4 | 10,000 |  |
| Cost of goods sold | | 5.1.4 | 8,000 |  |
|  | Revenue | 4 |  | 10,000 |
|  | Goods on hand | 1.1.4.4.79 |  | 8,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 5/15/Y1 / 15.5.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2.3.4 | 9,800 |  |
| Rapid payment discount | | 4.(2.1) | 200 |  |
|  | Accounts receivable | 1.1.3.1.8.4 |  | 10,000 |

Same facts except the goods were sold on 12/31/Y1 and in the company’s experience this customer took advantage of rapid payment discounts**[[13]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote13sym)**: .

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/30/Y1 / 30.1.R1 | | Post. ref. | Dr. | Cr. |
| Accounts receivable | | 1.1.3.1.8.4 | 10,000 |  |
| Cost of goods sold | | 5.1.4 | 8,000 |  |
| Rapid payment discount | | 4.(2.1) | 200 |  |
|  | Revenue | 4 |  | 10,000 |
|  | Goods on hand | 1.1.4.4.79 |  | 8,000 |
|  | Discount allowance | 1.1.3.1.(8.4) |  | 200 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/9/Y2 / 9.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2.3.4 | 9,800 |  |
| Discount allowance | | 1.1.3.1.(8.4) | 200 |  |
|  | Accounts receivable | 1.1.3.1.8.4 |  | 10,000 |

Simplified approach:**[[14]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote14sym)**:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/30/Y1 / 30.12.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2.3.4 | 9,800 |  |
| Revenue | | 4 | 200 |  |
|  | Accounts receivable | 1.1.3.1.8.4 |  | 10,000 |

### Quantity discount

On 1/4/Y1 XYZ sold DEF 10 units of merchandise # 24 for 10,000. After it purchased 100 units, the customer was entitled to a 10% discount. On the basis of its historical experience, XYZ estimated that DEF would purchase at least 1,000 units by year-end.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/4/Y1 / 4.1.R1 | | Post. ref. | Dr. | Cr. |
| Accounts receivable | | 1.1.3.1.9.3 | 10,000 |  |
| Quantity discount | | 4.(2.1) | 1,000 |  |
| Cost of goods sold | | 5.1.4 | 6,000 |  |
|  | Revenue | 4 |  | 10,000 |
|  | Discount allowance | 1.1.3.1.(4.9) |  | 1,000 |
|  | Goods on hand | 1.1.4.4.24 |  | 6,000 |

After ordering the 100**[th]** item, XYZ credited the customer’s account for the discount.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 9/15/Y1 / 15.9.R1 | | Post. ref. | Dr. | Cr. |
| Discount allowance | | 1.1.3.1.(4.9) | 10,000 |  |
|  | Accounts receivable | 1.1.3.1.9 |  | 10,000 |

The customer did not purchase 100 by year-end**[[15]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote15sym)**: .

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Discount allowance | | 1.1.3.1.(4.9) | 8,750 |  |
|  | Quantity discount | 4.(2.1) |  | 8,750 |

Although XYZ’s experience was that the customer purchased at least 100 units per year, it did not record an allowance.**[[16]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote16sym)**:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 9/15/Y1 / 15.9.R1 | | Post. ref. | Dr. | Cr. |
| Quantity discount | | 4.(2.1) | 10,000 |  |
|  | Accounts receivable | 1.1.3.1.9 |  | 10,000 |

### Extended credit terms

On 4/15/Y1 XYZ sold goods**[[17]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote17sym)**: for 10,600 payment due 10/15/Y1. The goods commonly sold, on average, for 10,000 at standard credit terms.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/15/Y1 / 15.4.R1 | | Post. ref. | Dr. | Cr. |
| Accounts receivable | | 1.1.3.1 | 10,600 |  |
|  | Revenue | 4 |  | 10,000 |
|  | Deferred interest | 1.1.3.1.(1) |  | 600 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/30/Y1 / 30.6.R1 | | Post. ref. | Dr. | Cr. |
| Deferred interest | | 1.1.3.1.(1) | 250 |  |
|  | Interest revenue | 6.1.1 |  | 250 |

#### Interest only

On 6/30/Y1 XYZ sold goods valued at 10,000 for 11.600 in total. Payment was due in 24 months and the customer agreed to make quarterly interest only payments.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/30/Y1 / 30.6.R1 | | Post. ref. | Dr. | Cr. |
| Accounts receivable | | 1.1.3.1 | 11,600 |  |
|  | Revenue | 4 |  | 10,000 |
|  | Deferred interest | 1.1.3.1.(1) |  | 1,600 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 9/30/Y1 / 30.9.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 200 |  |
| Deferred interest | | 1.1.3.1.(1) | 200 |  |
|  | Accounts receivable | 1.1.3.1 |  | 200 |
|  | Interest revenue | 6.1.1 |  | 200 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y2 / 31.12.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 10,200 |  |
| Deferred interest | | 1.1.3.1.(1) | 200 |  |
|  | Accounts receivable | 1.1.3.1 |  | 10,200 |
|  | Interest revenue | 6.1.1 |  | 200 |

Same facts except the entity elected a simpler approach.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/30/Y1 / 30.6.R1 | | Post. ref. | Dr. | Cr. |
| Accounts receivable | | 1.1.3.1 | 10,000 |  |
|  | Revenue | 4 |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 9/30/Y1 / 30.9.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 200 |  |
|  | Interest revenue | 6.1.1 |  | 200 |

#### Effective interest

On 6/30/Y1 XYZ sold goods valued at 10,000. Payment was due in 24 months and the customer agreed pay 11,600. XYZ decided to apply the effective interest method on a quarterly basis.

|  |  |  |  |
| --- | --- | --- | --- |
| **P** | **Present value** | **Discount rate** | **Interest income** |
| **A** | **B = B(B+1) + D** | **C** | **D = B \* C** |
| 1 | 10,000 | 1.87%\* | 187 |
| 2 | 10,187 | 1.87% | 191 |
| - | - | - | - |
| 7 | 11,177 | 1.87% | 209 |
| 8 | 11,387 | 1.87% | 213 |
|  |  |  | 1,600 |
|  | \* 1.87257% |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/30/Y1 / 30.6.R1 | | Post. ref. | Dr. | Cr. |
| Accounts receivable | | 1.1.3.1 | 11,600 |  |
|  | Revenue | 4 |  | 10,000 |
|  | Deferred interest | 1.1.3.1.(1) |  | 1,600 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 9/30/Y1 / 30.9.R1 | | Post. ref. | Dr. | Cr. |
| Deferred interest | | 1.1.3.1.(1) | 187 |  |
|  | Interest revenue | 6.1.1 |  | 187 |

Same facts, except the customer agreed to pay 1,362 quarterly for the 8 quarters.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **P** | **Rate** | **Receivable** | **Interest** | **Payment** | **Principle** |
| **A** | **B** | **C = C(C+1) - F** | **D = B \* C** | **E** | **F = E – D** |
| 1 | 1.94% | 10,000 | 194 | 1,362 | 1,167 |
| 2 | 1.94% | 8,833 | 172 | 1,362 | 1,190 |
| - | - | - | - | - | - |
| 7 | 1.94% | 2,646 | 51 | 1,362 | 1,310 |
| 8 | 1.94% | 1,336 | 26 | 1,362 | 1,336 |
|  |  |  | 894 | 10,894 | 10,000 |
|  | \* 1.94265% | | | |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/30/Y1 / 30.6.R1 | | Post. ref. | Dr. | Cr. |
| Installment sales | | 1.2.2.4.2 | 10,894 |  |
|  | Revenue | 4 |  | 10,000 |
|  | Deferred interest | 1.2.2.4.2.(1) |  | 894 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 9/30/Y1 / 30.9.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 1,362 |  |
| Deferred interest | | 1.2.2.4.2.(1) | 194 |  |
|  | Installment sales | 1.2.2.4.2 |  | 1,362 |
|  | Interest revenue | 6.1.1 |  | 194 |

On 12/31/Y1, XYZ sold a machine made to ABC’s specifications. ABC agreed to pay 2,500 down and 1,200 per annum for 8 years. Based on its average profit margin (25%) and manufacturing costs (7,000), the sales representative calculated the sales price to be 10,000.

|  |  |  |  |
| --- | --- | --- | --- |
| **P** | **Payment** | **Rate** | **Present value** |
| **A** | **B** | **C** | **D=B/(1+C)A** |
| 0 | 2,400 | 5.50% | 2,400 |
| 1 | 1,200 | 5.50% | 1,137 |
| - | - | - | - |
| 7 | 1,200 | 5.50% | 825 |
| 8 | 1,200 | 5.50% | 782 |
|  | 12,000 |  | 10,000 |
|  |  |  |  |

Since the above selling price implied an unreasonably low discount rate (5.5%), the company determined that if the customer had borrowed from the bank, it would have paid 7.5%.

|  |  |  |  |
| --- | --- | --- | --- |
| **P** | **Payment** | **Rate** | **Present value** |
| **A** | **B** | **C** | **D=B/(1+C)A** |
| 0 | 2400 | 7.50% | 2,400 |
| 1 | 1,200 | 7.50% | 1,116 |
| - | - | - | - |
| 7 | 1,200 | 7.50% | 723 |
| 8 | 1,200 | 7.50% | 673 |
|  | 12,000 |  | 9,429 |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 2,400 |  |
| Installment sales | | 1.2.2.4.2 | 9,600 |  |
|  | Revenue | 4 |  | 9,429 |
|  | Deferred interest | 1.2.2.4.2.(1) |  | 2,571 |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **P** | **Rate** | **Net Receivable** | **Interest** | **Payment** | **Principle** |
| **A** | **B** | **C = C(C+1) - F** | **D = B \* C** | **E** | **F = E – D** |
| 0 | 7.50% | 9,429 | 0 | 2,400 | 2,400 |
| 1 | 7.50% | 7,029 | 527 | 1,200 | 673 |
| - | - | - | - | - | - |
| 7 | 7.50% | 2,646 | 2,155 | 1,200 | 1,038 |
| 8 | 7.50% | 1,336 | 1,116 | 1,200 | 1,116 |
|  |  |  | 2,571 | 12,000 | 9,429 |
|  |  | | | |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y2 / 31.12.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 1,200 |  |
| Deferred interest | | 1.2.2.4.2.(1) | 527 |  |
|  | Installment sales | 1.2.2.4.2 |  | 1,200 |
|  | Interest revenue | 6.1.1 |  | 527 |

#### Subsequent measurement

##### Allowance for doubtful accounts

Each entity is obligated (IAS 39.64) to determine whether its financial assets carried at amortized cost are impaired. It first does so individually (generally with loans), then in aggregate (generally with receivables). If objective evidence of impairment exists (for example if historical experience shows that some receivables always become uncollectible), it is obligated to record an expense against an allowance account**[[18]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote18sym)**: .

###### Examples

###### Aging schedule method

On 12/31/R1 XYZ aged its receivables.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Accounts Receivable Aging Schedule** | | | | | |
| **> 30****[[19]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote19sym):** | **30 > 60** | **60 > 90** | **90 > 180** | **180 >** | **Sum /** |
| 70,000 | 13,000 | 11,000 | 4,000 | 2,000 | 100,000 |
| x 1.43% | x 3.00 | x 25.20 | x 45.95 | x 100.00% |  |
| 1,000 | + 390 | + 2,772 | + 1,838 | + 2,000 | = 8,000 |
|  | | | | |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Uncollectible accounts | | 5.2.9 | 8,000 |  |
|  | Bad debt allowance | 1.1.3.1.(2) |  | 8,000 |

On 1/14/Y2 XYZ determined that receivable 3 with customer 8 is uncollectible.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/14/Y2 / 14.1.R2 | | Post. ref. | Dr. | Cr. |
| Bad debt allowance | | 1.1.3.1.(2) | 250 |  |
|  | Accounts receivable | 1.1.3.1.8.3 |  | 250 |

On 1/14/Y2 XYZ determined that receivable 12 with customer 72 is uncollectible.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/24/Y2 / 24.1.R2 | | Post. ref. | Dr. | Cr. |
| Bad debt allowance | | 1.1.3.1.(2) | 750 |  |
|  | Accounts receivable | 1.1.3.1.72.12 |  | 750 |

Etc.

On 6/20/Y2 customer 72 unexpectedly paid invoice 12.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/20/Y2 / 20.6.R2 | | Post. ref. | Dr. | Cr. |
| Accounts receivable | | 1.1.3.1.72.12 | 750 |  |
|  | Bad debt allowance | 1.1.3.1.(2) |  | 750 |
| Cash in bank | | 1.1.1.2 | 750 |  |
|  | Accounts receivable | 1.1.3.1.72.12 |  | 750 |

Same facts except entity elected to using a voiding entry, rather than a reversal**[[20]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote20sym)**: .

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/20/Y2 / 20.6.R2 | | Post. ref. | Dr. | Cr. |
| Bad debt allowance | | 1.1.3.1.(2) | (750) |  |
|  | Accounts receivable | 1.1.3.1.72.12 |  | (750) |
| Cash in bank | | 1.1.1.2 | 750 |  |
|  | Accounts receivable | 1.1.3.1.72.12 |  | 750 |

To save effort, some companies use the following shortcut (acceptable unless material amounts are involved).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/20/Y2 / 20.6.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 750 |  |
|  | Bad debt allowance | 1.1.3.1.(2) |  | 750 |

Throughout the year, XYZ wrote off receivables totaling 8,500, exceeding the allowance. Since the difference was not significant**[[21]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote21sym)**: , it simply added it to year 2’s allowance, which was calculated to be 9,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y2 / 31.12.R2 | | Post. ref. | Dr. | Cr. |
| Uncollectible accounts | | 5.2.9 | 9,500 |  |
|  | Bad debt allowance | 1.1.3.1.(2) |  | 9,500 |

##### Percentage of sales method

On 12/31/Y1, ABC multiplied total credit sales of 320,000 by 2.5% to estimate a bad debt expense of 8,000 for year one. During year 2, a total of 8,500 were written off. To compensate, XYZ increased its bad debt factor from the original 2.5% to 2.969%**[[22]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote22sym)**: .

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Uncollectible accounts | | 5.2.9 | 8,000 |  |
|  | Bad debt allowance | 1.1.3.1.(2) |  | 8,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y2 / 31.12.R2 | | Post. ref. | Dr. | Cr. |
| Uncollectible accounts | | 5.2.9 | 9,500 |  |
|  | Bad debt allowance | 1.1.3.1.(2) |  | 9,500 |

## Additional issues

### Loans

In contrast to receivables (where a certain level of uncollectability is assumed to be normal), loans should be made with the assumption that they will be collected. Consequently, provisions (not allowances) should be used**[[23]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote23sym)**: .

#### Examples

XYZ originates and services commercial loans. On 5/4/Y1, it originated an unsecured business loan of 10,000 (for simplicity, interest and origination fees are ignored) to ABC. On 12/31/Y1, it evaluated its loan portfolio and determined that the loan was performing.

On 11/18/Y2, it determined that ABC was experiencing significant financial difficulty and might not be able to repay the principle amount. It estimated that if ABC were liquidated, it would receive 3,000.

On 5/14/Y3, ABC was liquidated and XYZ awarded 2,000.

|  |  |  |  |
| --- | --- | --- | --- |
| 5/4/Y1 / 4.5.R1 | | Dr. | Cr. |
| Loan # 123**[[24]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote24sym)**: | | 10,000 |  |
|  | Cash in bank |  | 10,000 |

12/31/Y2 / 31.12.R2

Since the loan has not been selected for evaluation (no objective evidence of impairment exists), no entry is made.

|  |  |  |  |
| --- | --- | --- | --- |
| 11/18/Y2 / 18.11.R2 | | Dr. | Cr. |
| Loss on non-performing loan | | 7,000 |  |
|  | Provision, loan #123 |  | 7,000 |

|  |  |  |  |
| --- | --- | --- | --- |
| 11/18/Y2 / 18.11.R2 | | Dr. | Cr. |
| Provision, loan #123 | | 7,000 |  |
| Cash in bank | | 2,000 |  |
| Loss on non-performing loan | | 1,000 |  |
|  | Provision, loan #123 |  | 10,000 |

Same facts, except on 18.11.R2 XYZ determined that secured creditors had claims greater than ABC’s net assets.

Nevertheless, on 5/14/Y3, the liquidator paid out 1,000.

|  |  |  |  |
| --- | --- | --- | --- |
| 11/18/Y2 / 18.11.R2 | | Dr. | Cr. |
| Loss on non-performing loan | | 10,000 |  |
|  | Provision, loan #123 |  | 10,000 |

|  |  |  |  |
| --- | --- | --- | --- |
| 5/14/Y3 / 14.5.R3 | | Dr. | Cr. |
| Cash in bank | | 1,000 |  |
|  | Loss, non-performing loan |  | 1,000 |

#### Subscribed stock receivable

On 1/1/Y1, Mr. Smith agreed to buy shares of XYZ company. On 6/1/Y1 he bought the shares by transferring cash.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | |  | Dr. | Cr. |
| Subscribed stock | | 3.5.(2) | 1,000,000 |  |
|  | Paid in capital | 3.1 |  | 1,000,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/1/Y1 / 1.6.R1 | |  | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 1,000,000 |  |
|  | Subscribed stock / Pohl. | 3.5.(2) |  | 1,000,000 |

#### Related party loans and receivables

##### Group companies

Since IFRS applies to the consolidated entity, inter-company loans are recorded in the same manner as other loans (regardless of interest) because all inter-company profits are eliminated during consolidation. If the group company has material minority interest, the following procedure should be used.

##### Other related parties

On 1/1/Y1, XYZ Inc. lets the wife of its chairman of the board (ID number 7) 100,000 for two years at a 2% rate of interest. Both the interest and principal were to be paid at the end of two years. Since neither the nominal rate (2%) nor the implicit (1.91%) was reasonable, XYZ imputed a reasonable discount rate. XYZ did so by determining that if the wife had borrowed from a bank (without any guarantee from XYZ), she would have paid 12%.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **P** | **Rate** | **Net loan** | **Interest** | **Int. receivable** | **Amortization** |
| **A** | **B** | **C=C(C+1)+F** | **D = C x B** | **E=100,000\*2%** | **F=D-E** |
| 1 | 12% | 82,908 \* | 9,949 | 2,000 | 7,949 |
| 2 | 12% | 92,857 | 11,143 | 2,000 | 9,143 |
|  |  |  | 21,092 | 4,000 | 17,092 |
|  | | | | | |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Loan | | 1.1.2.4.1.7 | 100,000 |  |
| Deferred compensation | | 1.1.5.5.7 | 17,092 |  |
|  | Cash in bank | 1.1.1.2 |  | 100,000 |
|  | Deferred int. income | 1.1.2.4.(2) |  | 17,092 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Deferred int. income | | 1.1.2.4.1.7 | 7,949 |  |
| Interest receivable | | 1.1.5.2.1 | 2,000 |  |
| Related party comp. | | 5.3.1.3.1 | 8,546 |  |
|  | Interest income | 1.1.1.2 |  | 9,949 |
|  | Deferred compensation | 1.1.2.4.(2) |  | 8,546 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y2 / 31.12.R2 | | Post. ref. | Dr. | Cr. |
| Deferred int. income | | 1.1.2.4.1.7 | 9,143 |  |
| Interest receivable | | 1.1.5.2.1 | 2,000 |  |
| Related party comp. | | 5.3.1.3.1 | 8,546 |  |
|  | Interest income | 1.1.1.2 |  | 11,143 |
|  | Deferred compensation | 1.1.2.4.(2) |  | 8,546 |
| Cash in bank | | 1.1.1.2 | 104,000 |  |
|  | Loan | 1.1.2.4.1.7 |  | 100,000 |
|  | Interest receivable | 1.1.5.2.1 |  | 4,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Loss | | 6.4.1.2.3 | 104,000 |  |
|  | Loan | 1.1.2.4.1.7 |  | 100,000 |
|  | Interest receivable | 1.1.5.2.1 |  | 4,000 |

#### Pledging, assigning and factoring (discounting)

##### Examples

##### Pledging and assigning

XYZ borrowed 250,000 and pledged receivables in the same amount.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Cash in bank | | 1.1.1.2 | 250,000 |  |
|  | Loans | 2.1.1.2.1 |  | 250,000 |

##### Factoring (without recourse)

The factor paid 90% of face value.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Cash in bank | | 1.1.1.2 | 90,000 |  |
| Discount | | 6.4.11.1 | 10,000 |  |
| Bad debt allowance | | 1.1.3.1.(2) | 2,000 |  |
|  | Accounts receivable | 1.1.3.1.X-X9 |  | 100,000 |
|  | Bad debt expense | 5.2.9 |  | 2,000 |

Instead of discount, factor charged a 5% fee and 20% annual interest on the outstanding balance.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Cash in bank | | 1.1.1.2 | 91,711 |  |
| Interest expense | | 6.2.1 | 3,289 |  |
| Factor fee | | 6.2.2.1 | 5,000 |  |
| Bad debt allowance | | 1.1.3.1.(2) | 2,000 |  |
|  | Accounts receivable | 1.1.3.1.X-X9 |  | 100,000 |
|  | Bad debt expense | 5.2.9 |  | 2,000 |

Factor held back 6% to cover future returns obligation.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Cash in bank | | 1.1.1.2 | 84,000 |  |
| Discount | | 6.4.11.1 | 10,000 |  |
| Factor’s holdback | | 1.1.5.2.6 | 6,000 |  |
|  | Accounts receivable | 1.1.3.1.X-X9 |  | 100,000 |

Customer returned goods worth 2,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Returns and allowances | | 1.1.3.1.(3) | 2,000 |  |
|  | Factor’s holdback | 1.1.5.2.6 |  | 2,000 |

The factor recorded.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Factor’s holdback | |  | 2,000 |  |
|  | Cash in bank |  |  | 2,000 |

Right to return expired, factor paid out the remaining hold-back.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Cash in bank | | 1.1.1.2 | 4,000 |  |
|  | Factor’s holdback | 1.1.5.2.6 |  | 4,000 |

Factoring (with recourse)

As long as the conditions for transfer (IAS 38.15-37) are met and an estimate of the obligation can be made, the transfer may be recorded as a sale. Otherwise, it is a secured borrowing.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Cash in bank | | 1.1.1.2 | 90,000 |  |
| Discount | | 6.4.11.1 | 10,000 |  |
| Bad debt allowance | | 1.1.3.1.(2) | 2,000 |  |
|  | Accounts receivable | 1.1.3.1.X-X9 |  | 100,000 |
|  | Recourse obligation | 2.2.6.7.1 |  | 2,000 |

**[1](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote1anc)**: For simplicity’s sake, only a single year is presented. A Publisher balance sheet would show the prior year’s ending and beginning balances.

**[2](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote2anc)**: Currency unit (Kč, €, $, £, ¥ …)

**[3](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote3anc)**: If an entity’s operating cycle clearly differs, it may (IAS 1.69.a and 70) select a different “annual” period than 12-months. However, since this choice (IAS 1.36) must be disclosed, the reasons explained, and a disclaimer that the resulting reports are not comparable (with entities using a 12 month year) provided, it is rarely used in practice.

**[4](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote4anc)**: Under many national accounting systems (especially in countries without a common law tradition), an accounting entry may only be made if supported by an “accounting document” (a written document containing all the formalities as prescribed by law). If this rule were applied to this example, a Cash in Transit account would be required. Under IFRS, where the economic substance of transactions, events or conditions (IAS 8.7) takes precedence over their legal form (Framework 35), such a procedure would not only be irrelevant, but (since the judgment to use it is not based on “pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards”) in conflict with IFRS (IAS 8.12).

**[5](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote5anc)**: Each bank and account should have its own account number. For example, the third account at ABC (the first bank) would have number 1.1.1.2.1.3 while the sixth account at DEF (the fifth bank) would have number 1.1.1.2.5.6.

**[6](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote6anc)**: Some national accounting systems classify revenue and other stamps as pre-paid expenses. Since they are negotiable, and can be readily sold at nominal value, under IFRS they would be recognized as cash equivalents.

**[7](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote7anc)**: X is the account used to record these payments.

**[8](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote8anc)**: X is the account used to record these payments.

**[9](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote9anc)**: Since the original maturity of this investment was less than 3 months, XYZ classified the investment as a cash equivalent.

**[10](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote10anc)**: Each investment type should have its own account and each investment a sub-account. For example, shares could be 1.1.2.1.1.1, bonds 1.1.2.1.1.2. Shares of ABC (number 124) would be 1.1.2.1.1.1.124.

**[11](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote11anc)**: Since the difference between straight-line amortization and amortized cost accounting was not material, the entity elected to use the simpler method.

**[12](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote12anc)**: Although IAS 39 does not explicitly state that short-term shall be defined as 12 months or less, this is clearly its intent.

**[13](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote13anc)**: If the customer did not exploit the discount, IAS 10 (Events after the Reporting Period) would be applied.

**[14](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote14anc)**: Although occasionally used by small enterprises, this policy is not recommended.

**[15](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote15anc)**: If the amount is material, the prior quarters should be restated. If the original estimate was made in good faith, this should not be reported as a correction of an error.

**[16](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote16anc)**: Because the entity ignored its historical experience, a restatement of the relevant period must be made and the adjustment must be reported as a correction of an error (in this case, a “misuse of facts”).

**[17](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote17anc)**: To keep the examples as concise as possible, specific customer information is omitted from this and the following examples. Inventory turnover is not presented for the same reason.

**[18](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote18anc)**: In contrast to IFRS, many national accounting systems are partially (or entirely) subordinated to tax legislation. When this legislation is accrual based (taxing revenue rather than cash inflows), if often (to protect the tax base) seriously circumscribes the writing off of uncollectible accounts. As a result, this topic, while relatively minor from the financial reporting perspective, is one of the more significant differences between IFRS and many national accounting systems.

**[19](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote19anc)**: Common practice in many countries is to focus on date due. Consequently, this column may be interpreted (if inadequately labelled, as in this example) as 30 days past due, rather than 30 days old. If it seems that the amount being written off is excessive, this cultural difference, rather than a substantive reason, may be the cause.

**[20](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote20anc)**: While IFRS (IAS 39.65) explicitly requires reversal (disallowing voiding entries), since it does not explicitly outline exact procedures, the question of whether voiding entries are or are not consistent with IFRS is academic, rather than substantive.

**[21](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote21anc)**: Significant, in this context, is generally understood to mean ± 10 %.

**[22](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote22anc)**: For clarity, the example assumes that credit sales remained stable at 320,000.

**[23](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote23anc)**: Loans are commonly originated by banks, rather than industrial companies. Consequently, the following examples are abbreviated and (since the sample chart of accounts was designed for industrial, not banking) without posting references.

**[24](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=34" \l "sdfootnote24anc)**: The sample chart of accounts outlined in this publication is appropriate for industrial companies not banks or other financial service companies. Consequently, posting references are omitted from these examples.

# Inventory

Inventory comprises assets held for sale in the normal course of business[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote1sym). IFRS discusses “costs of purchase” (IAS 2.11) and “costs of conversion” (IAS 2.12-15). This academic (and highly theoretical) approach has drawbacks. Primary among them is the difficulty in converting it into day-to-day practice. Consequently, this chapter approaches this topic from the perspective of “full absorption costing”.

## Full absorption costing

Fully absorbed costs[**[2]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote2sym)comprise direct and indirect manufacturing costs. Direct costs include direct material (merchandise) and direct wages. Indirect costs (overhead) include fixed and variable production costs[**[3]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote3sym).

## Exclusions[[4]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote4sym)

### Administrative and general expenses

Salaries and other compensation of administrative employees, depreciation and rent of administrative assets, research, development, marketing, advertising and other expenses not considered production, selling or other (financial).

### Selling expenses

Salaries and commissions of sales representatives, depreciation and rent of assets used in sales, other sales related expenses.

#### Delivery and warehousing

Expenses related to the warehousing and transportation of finished goods (including work in process intended for resale).

### Abnormal amounts of wasted materials, labor or other production costs

Wastage (material, wages, etc.) that could have been avoided using readily available means.

### Idle or underutilized plant capacity

Expenses (including depreciation) related to productive assets not being currently utilized or only being partially utilized in production.

## Normal capacity

During periods of abnormally high or low production, fixed overheads are allocated to units produced using normal (average), rather than actual capacity.

## Procedures

IFRS does not prescribe particular accounting policies or procedures. The accounting entity can therefore select any policy that:

1. Includes in cost of sales all costs that pertain to production.

2. Excludes from cost of sales any costs that do not pertain to production.

As long as the entity fulfills these basic requirements, it may choose any accounting policy that avoids excessive costs or complications[**[5]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote5sym).

### Cost of sales

Profit oriented companies seek to minimize working capital by limiting inventory. Thus, although titled “Inventory”, IAS 2 primarily influences the income statement (where cost of sales is generally the single, largest expense item[**[6]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote6sym)).

#### Examples

#### Merchandise

On 12/15/Y1, XYZ purchased merchandise for 1,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/15/Y1**/**15.12.R1 | | Post. ref. | Dr. | Cr. |
| Merchandise inventory | | 1.1.4.5 | 1,000 |  |
|  | Cash | 1.1.1.1 |  | 1,000 |

Same facts except it purchased the goods on credit, paying on 1/14/Y2.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/15/Y1**/**15.12.R1 | | Post. ref. | Dr. | Cr. |
| Merchandise inventory | | 1.1.4.5 | 1,000 |  |
|  | Trade payable | 2.1.1.1 |  | 1,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/14/Y2**/**14.1.R2 | | Post. ref. | Dr. | Cr. |
| Trade payable | | 2.1.1.1 | 1,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 1,000 |

Same facts except the company decided to record each supplier and type of merchandise separately[**[7]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote7sym). It assigned number 321 to the supplier and 456[**[8]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote8sym)to the merchandise.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/15/Y1**/**15.12.R1 | | Post. ref. | Dr. | Cr. |
| Merchandise inventory | | 1.1.4.5.456 | 1,000 |  |
|  | Trade payable | 2.1.1.1.321 |  | 1,000 |

#### Perpetual method

Same facts as the first example except XYZ sold the goods for 2,000 (in cash) on 12/20/Y1.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/15/Y1**/**15.12.R1 | | Post. ref. | Dr. | Cr. |
| Merchandise inventory | | 1.1.4.5 | 1,000 |  |
|  | Cash | 1.1.1.1 |  | 1,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/20/Y1**/**20.12.R1 | | Post. ref. | Dr. | Cr. |
| Cash | | 1.1.1.1 | 2,000 |  |
|  | Revenue[**[9]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote9sym) | 4 |  | 2,000 |
| Cost of sales | | 5.1 | 1,000 |  |
|  | Merchandise inventory | 1.1.4.5 |  | 1,000 |

Same facts except the goods were sold on credit (to customer # 789) and XYZ decided to maintain a separate (IFRS[**[102]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote10sym)) account for each customer, expense and revenue (by type).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/20/Y1**/**20.12.R1 | | Post. ref. | Dr. | Cr. |
| Trade receivable | | 1.1.3.1.789 | 2,000 |  |
|  | Revenue | 4.3.2 |  | 2,000 |
| Cost of sales | | 5.1.4 | 1,000 |  |
|  | Merchandise inventory | 1.1.4.5.456 |  | 1,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/20/Y2**/**20.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 2,000 |  |
|  | Trade receivable | 1.1.3.1.789 |  | 2,000 |

Same facts except it decided to use the same level of disaggregation in its income statement.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/20/Y1**/**20.12.R1 | | Post. ref. | Dr. | Cr. |
| Trade receivable | | 1.1.3.1.789 | 2,000 |  |
|  | Revenue | 4.3.2.456 |  | 2,000 |
| Cost of sales | | 5.1.4.456 | 1,000 |  |
|  | Merchandise inventory | 1.1.4.5.456 |  | 1,000 |

Same facts except it decided use the good’s serial number (98765) rather than UPC.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/20/Y1**/**20.12.R1 | | Post. ref. | Dr. | Cr. |
| Trade receivable | | 1.1.3.1.789 | 2,000 |  |
|  | Revenue | 4.3.2.98765 |  | 2,000 |
| Cost of sales | | 5.1.4.98765 | 1,000 |  |
|  | Merchandise inventory | 1.1.4.5.98765 |  | 1,000 |

##### Supplemental comment

Obviously, devising a classification scheme with this level of disaggregation is not particularly complicated. Defining a single chart of accounts capable of supporting IFRS requirements, management’s own requirements, the requirement of tax law and (in countries with the mandate) national accounting legislation is, on the other hand, a Sisyphean task at any but the simplest[**[11]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote11sym), local company.

#### Periodic method

On 1/1/Y1, XYZ sold 2 units of merchandise type 123 at retail for 500 (in cash). On 1/2/Y1, it sold another 4 units for 1,000 (credit card sale). It continued in the same manner until 3/31/R1, when it determined cost of sales. Since it elected a periodic inventory method, it used supplemental schedule IC-123 (and a first-in, first-out assumption) for this purpose.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash | | 1.1.1.1 | 500 |  |
|  | Revenue | 4 |  | 500 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/2/Y1**/**2.1.R1 | | Post. ref. | Dr. | Cr. |
| Receivable from bank | | 1.1.3.2 | 1,000 |  |
| Credit card fee | | 5.2.11.2 | 20 |  |
|  | Revenue | 4 |  | 980 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/3/Y1**/**3.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 980 |  |
|  | Receivable from bank / Pohl. | 1.1.3.2 |  | 980 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1**/**31.3.R1 | | Post. ref.[**[12]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote12sym) | Dr. | Cr. |
| Cost of sales | | M-123 / 5.1 | 549,000 |  |
|  | Merchandise inventory | M-123 / 1.1.4.5 |  | 549,000 |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Schedule M-12**3 | | | | | | |
| **Merchandise 12**3**in warehouse** | | | | | | |
| **Date** | **Description** | **SD** | **#** | **Cost** | **WR** | **Rel.** |
|  | **In warehouse** |  |  |  |  |  |
| 1.1 | Beginning balance | PI-Y0 | 160 | 130 | 20,800 |  |
| 1.2 | Release | Rel 5 | (10) | 130 |  | (1,300) |
| - | Release | - etc. - | - | 130 |  | - |
| 5.1 | Purchase | WR 14 | 2,800 | 125 | 350,000 |  |
| - | Release | - etc. - | - | 125 |  | - |
| 14.2 | Release | Rel 27 | (5) | 125 |  | (625) |
| 15.2 | Purchase | WR 87 | 1,600 | 120 | 192,000 |  |
| 16.2 | Release | Rel 98 | (15) | 120 |  | (1,800) |
| - | Release | - etc. - | - | 120 |  | - |
| 31.3 | Q1 Subtotal |  |  |  | 562,800 | (546,000) |
|  |  |  |  |  |  |  |
|  | **In store** |  |  |  |  |  |
| 1.1 | Beginning balance | ROS (MOT) |  |  |  | (22,000) |
| 31.3 | Ending balance | ROS (MOT) |  |  |  | 19,000 |
| Q1/K1 | Cost of sales |  |  |  |  | (549,000) |
|  |  |  |  |  |  |  |
| 1.4 | - etc. - | - | - | - |  | - |
|  |  |  |  |  |  |  |

**The acronyms used**[**[13]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote13sym)**:** SD (source document), # (units received), WR (warehouse receipt), Rel (warehouse releases), PI (physical warehouse inventory taken in the presence of the auditor), Rel 5 (Warehouse Release Order # 5 signed by the warehouse supervisor and employee receiving goods), WR (Warehouse Receipt # 14 signed by the warehouse supervisor and shipper), ROS (Retail Outlet Schedule, where information from individual retail outlets assembled, collated and analyzed).

Same facts except it measured inventory as weighted average cost (calculated quarterly).

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Schedule M-12**3 | | | | | | | | | | | | |
| **Merchandise 12**3**in** | | | | | | | | | | | | |
| **Date** | **Description** | **SD** | **#** | | | **Cost** | | **WR** | | | **Rel.** | |
|  | **In warehouse** |  |  | | |  | |  | | |  | |
| 1.1 | Beginning balance | PI-Y0 | 160 | | 132.65 | | | | 21,224 | | |  |
| 1.2 | Release | Rel 5 | (10) | | 123.42 | | | |  | | | (1,234) |
| - | Release | - etc. - | - | | 123.42 | | | |  | | |  |
| 5.1 | Purchase | WR 14 | 2,800 | | 123.42 | | | | 345,579 | | |  |
| - | Release | - etc. - | - | | 123.42 | | | |  | | |  |
| 14.2 | Release | Rel 27 | (5) | | 123.42 | | | |  | | | (617) |
| 15.2 | Purchase | WR 87 | 1,600 | | 123.42 | | | | 197,474 | | |  |
| 16.2 | Release | Rel 98 | (15) | | 123.42 | | | |  | | | (1,851) |
| - | Release | - etc. - | - | | 123.42 | | | |  | | |  |
| 31.3 | Q1 Subtotal |  |  | |  | | | | 564,277 | | | (546,998) |
|  |  |  |  | |  | | | |  | | |  |
|  | **In store** |  |  | | |  | |  | | |  | |
| 1.1 | Beginning balance | ROS (MOT) |  |  | | |  | | | (22,000) | | |
| 31.3 | Ending bal | ROS (MOT) |  |  | | |  | | | 19,000 | | |
| Q1/K1 | Cost of sales |  |  |  | | |  | | | (549,998) | | |
|  |  |  |  |  | | |  | | |  | | |
| 1.4 | - etc. - | - | - | - | | |  | | | - | | |
|  |  |  |  |  | | |  | | |  | | |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1**/**31.3.R1 | | Post. ref. | Dr. | Cr. |
| Cost of sales | | M-123 / 5.1 | 549,998 |  |
|  | Merchandise inventory | M-123 / 1.1.4.5 |  | 549,998 |

Same facts except 1/1/Y2, 09:15.47, outlet 4, register 8, one unit merchandise with a UPC of 123-456 for 250; 1/1/Y1, 11:46.13, outlet 4 register 6, one unit of the same merchandise for 250; 1/2/Y1, 16:45.26, outlet 8, register 12, two units 500;… 3/30/Y1, 12:18.28, outlet 2 register 5, one units for 250. As a large number of individual transaction occurred, XYZ decided to record both revenue and expenses periodically.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1**/**31.3.R1 | | Post. ref.[**[14]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote14sym) | Dr. | Cr. |
| Cash | | MS-123 / 1.1.1.1 | 574,542 |  |
| Cash in bank[**[15]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote15sym) | | MS-123 / 1.1.1.2 | 477,900 |  |
| Credit card fee | | MS-123 / 5.2.11.2 | 9,558 |  |
|  | Revenue | MS-123 / 4 |  | 1,062,000 |
| Cost of sales | | IC-123 / 5.1 | 531,000 |  |
|  | Merchandise inventory | IC-123 / 1.1.4.5 |  | 531,000 |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Supplemental schedule MS-12**3 | | | | | |
| **Merchandise Sales: UPC 12**3**-456** | | | | | |
| **TS** | **POS** | **UA** | **GS** | **CgS** | **BC** |
| 1.1.R1, 09:15.47 | 4/8 | 1 | 250 | 0 | 0 |
| 1.1.R1, 11:46.13 | 4/6 | 1 |  | 250 | 5 |
| 2.1.R1 16:45.26 | 8/12 | 2 |  | 500 | 10 |
| - | - | - | - | - | - |
| 30.3.Y1 12:18.28 | 2/5 | 1 | 250 | 0 | 0 |
|  |  |  | 574,542 | 477,900 | 9,558 |
|  |  |  |  |  |  |
| TS (time stamp), POS (point of sale), PM (payment method), UA (sale in units), CS (cash), CgS (charge sales), BC (bank charges) | | | | | |

#### Shrinkage

On 2/20/Y2 XYZ determined that rather than the expected 100 units at outlet 3, it had only 97. Since the loss was attributable to shoplifting (which could not be, using reasonably practical measures, completely eliminated), it classified this shrinkage as normal.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/20/Y2 / 15.2.R2 | | Post. ref. | Dr. | Cr. |
| Shrinkage | | 5.2.8.1 | 30 |  |
|  | Merchandise inventory | 1.1.4.5.123 |  | 30 |

Same facts except a customer dropped the merchandise in such a manner that it was damaged beyond repair. Since the entity sells the goods on open shelves, such losses cannot be completely eliminated.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/20/Y2 / 15.2.R2 | | Post. ref. | Dr. | Cr. |
| Shrinkage | | 5.2.8.2 | 30 |  |
|  | Merchandise inventory | 1.1.4.5.123 |  | 30 |

Same facts except an employee ran over several products with a forklift. Since it was not intentional, this shrinkage was also classified as normal.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/20/Y2 / 15.2.R2 | | Post. ref. | Dr. | Cr. |
| Shrinkage | | 6.4.1.2 | 30 |  |
|  | Merchandise inventory | 1.1.4.5.123 |  | 30 |

Same facts except the entity determined that employees stole merchandise from the warehouse. Since this loss could have been reasonably prevented, it was classified abnormal[**[16]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote16sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/20/Y2 / 15.2.R2 | | Post. ref. | Dr. | Cr. |
| Shrinkage | | 5.3.3 | 30 |  |
|  | Merchandise inventory | 1.1.4.5.123 |  | 30 |

Same facts except the purchasing manager ordered too much merchandise. Since he was not required to place this excessive order, the loss was classified abnormal

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/20/Y2 / 15.2.R2 | | Post. ref. | Dr. | Cr. |
| Shrinkage | | 5.3.3 | 30 |  |
|  | Merchandise inventory | 1.1.4.5.123 |  | 30 |

#### Periodic method

Same facts except the entity used a period method to record cost of sales.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/15/Y2 / 15.2.R2 | | Post. ref. | Dr. | Cr. |
| Shrinkage | | 5.3.3 | 30 |  |
|  | Cost of goods sold | 5.1.4 |  | 30 |

#### Cash discounts, returns and allowances, delivery and related costs

During the first quarter, DEF purchased merchandise # 234 for 9,900,000. In delivery charges is paid: freight forwarding 50,000, customs fees 75,000, non-refundable sales tax 10,000 and insurance 15,000[**[17]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote17sym). Based on historical experience, it estimated merchandise worth 200,000 would be defective (it has the right to return defective merchandise to the manufacturer for full credit). It also estimated that, by period end, it would be entitled to a quantity discount of 100,000[**[18]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote18sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/1/Y1 / 1.2.R1 | | Post. ref. | Dr. | Cr. |
| Merchandise inventory | | 1.1.4.5.234 | 9,900,000 |  |
| Freight | | 5.1.1.2.1 | 50,000 |  |
| Custom’s fees | | 5.1.1.2.2 | 75,000 |  |
| Taxes | | 5.1.1.3.1 | 10,000 |  |
| Instance | | 5.1.1.3.2 | 15,000 |  |
|  | Accounts payable | 2.1.1.1 |  | 9,900,000 |
|  | Cash | 1.1.1.1 |  | 150,000 |
| Returns and allowances | | 2.1.1.1.(1.1) | 200,000 |  |
|  | Returns and allowances | 1.1.4.(6.1) |  | 200,000 |
| Vender credits | | 2.1.1.1.(2) | 100,000 |  |
|  | Vender credits | 1.1.4.(6.2) |  | 100,000 |

On 1/31/Y1 it paid the invoice, deducting the discount.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/31/Y1 / 31.1.R1 | | Post. ref. | Dr. | Cr. |
| Accounts payable | | 2.1.1.1.3.5 | 9,900,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 9,800,000 |
|  | Vender credits | 2.1.1.1.(2) |  | 100,000 |

During the first quarter, it sold the goods for 14,850,000[**[19]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote19sym). In addition to a legal obligation to refund for defective goods, the entity also estimates that customers will return goods worth 100,000 under a general refund policy (if offers this return policy as a customer service for one year following the purchase).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Cash on hand | | 1.1.1.1 | 14,850,000 |  |
|  | Merchandise revenue | 4.3.2 |  | 14,850,000 |
| Returns and allowances | | 4.(2.2) | 300,000 |  |
|  | Returns and allowances | 1.1.5.(7.1) |  | 300,000 |
| Warranties | | 5.2.7 | 100,000 |  |
|  | Customer claims | 2.1.4.3 |  | 100,000 |
| Cost of goods sold | | 5.1.4 | 9,900,000 |  |
|  | Merchandise inventory | 1.1.4.5.234 |  | 9,900,000 |
| Returns and allowances | | 1.1.4.(6.1) | 200,000 |  |
|  | Returns and allowances | 5.1.4.(1.1) |  | 200,000 |
| Vender credits | | 1.1.4.(6.2) | 100,000 |  |
|  | Vender discounts | 5.1.4.(1.2) |  | 100,000 |

On 4/15/Y1, a customer returned defective goods purchased for 325.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/15/Y1 / 15.4.R1 | | Post. ref. | Dr. | Cr. |
| Returns and allowances | | 1.1.5.(7.1) | 300 |  |
|  | Cash on hand | 1.1.1.1 |  | 300 |
| Cash on hand | | 1.1.1.1 | 200 |  |
|  | Returns and allowances | 2.1.1.1.(1.1) |  | 200 |

On 9/30/Y1 a customer returned goods worth 150 because he changed his mind.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 9/30/Y1 / 30.9.R1 | | Post. ref. | Dr. | Cr. |
| Customer claims | | 2.1.4.3 | 150 |  |
|  | Cash on hand | 1.1.1.1 |  | 150 |

### Disclosure

|  |  |  |
| --- | --- | --- |
| **DEF Inc. Cost of Merchandise Sold Schedule For the Quarter Ended 3/31/Y1** | | |
|  | X CU10,000 | |
| Beginning merchandise inventory |  | 15 |
| Purchases | 990 |  |
| Delivery | 6.5 |  |
| Customs fees and taxes | 8.5 |  |
|  |  | 1,005 |
| Returns & allowances | (20) |  |
| Vender credits and discounts | (10) |  |
|  |  | (30) |
| Goods available for sale |  | 990 |
| Ending merchandise inventory |  | (14) |
| Cost of merchandise sold |  | 976 |
|  |  |  |

#### Delivery, supplemental example

Same facts except the supplier delivered the goods to ABC’s central warehouse and ABC paid customs fees and non-refundable taxes of 2,475,000. ABC also paid 30,000 to a shipper who transported the goods from the central warehouse to ABC’s retail outlets.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| 2/1/Y1 / 1.2.R1 | | Post. ref. | | Dr. | Cr. |
| Merchandise inventory | | 1.1.4.5.234 | 9,900,000 | |  |
|  | Accounts payable | 2.1.1.1 |  | | 9,900,000 |
| Merchandise inventory | | 1.1.4.5.234 | 2,475,000 | |  |
|  | Cash | 1.1.1.1 |  | | 2,475,000 |
| Delivery | | 5.2.3.1 | 30,000 | |  |
|  | Cash | 1.1.1.1 |  | | 30,000 |

# Manufacturing

The first following example demonstrates the simplest possible way to cost a job[**[20]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote20sym)and remain in compliance with IFRS. Due to its simplicity, it is unlikely, however, that it would be used in practice[**[21]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote21sym).

## Examples

## Pre-production phase

On 3/13/Y1, XYZ purchased raw material for 100,000 (supplier 12, invoice 157). On 3/31/Y1, it paid out direct wages of 400,000 and recorded 200,000 in productive asset depreciation. On 3/28/Y1, it pre-paid manufacturing electricity of 25,000.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| 3/13/Y1 / 13.3.R1 | | Post. ref. | Dr. | | Cr. |
| Raw materials | | 1.1.4.1 | | 100,000 |  |
|  | Trade payable | 2.1.1.1.12.157 | |  | 100,000 |

Generally, it records material the same way as merchandise (previous examples).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/28/Y1 / 28.3.R1 | | Post. ref. | Dr. | Cr. |
| Work in process | | 1.1.4.3.3 | 25,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 25,000 |

It records other variable indirect costs the same way.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Work in process | | 1.1.4.3.3 | 600,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 400,000 |
|  | Accumulated depreciation | 1.3.(2) |  | 200,000 |

It records other fixed indirect costs the same way.

## Production phase

On 4/1/Y1 XYZ began work on product # 123, which it completed on 4/4/Y1. During that time, it determined direct material of 5,000, direct labor of 15,000 and indirect production costs (fixed and variable) of 15,000 were applicable to the product. It paid out 2,000 to transport all products finished that day to a finished goods warehouse (shown in this example only).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/4/Y1 / 4.4.R1 | | Post. ref. | Dr. | Cr. |
| Finished goods | | 1.1.4.4.123 | 5,000 |  |
|  | Raw materials | 1.1.4.1 |  | 5,000 |
| Finished goods | | 1.1.4.4.123 | 35,000 |  |
|  | Work in process | 1.1.4.3.3 |  | 35,000 |
| Delivery | | 5.2.3 | 2,000 |  |
|  | Cash | 1.1.1.1 |  | 2,000 |

### Option 2

Same facts except work began on 3/28. During March it allocated material of 2,000, wages of 7,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| WIP, product | | 1.1.4.3.1.123 | 2,000 |  |
|  | Raw materials | 1.1.4.1 |  | 2,000 |
| WIP, product | | 1.1.4.3.1.123 | 16,000 |  |
|  | Work in process | 1.1.4.3.3 |  | 16,000 |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| 4/4/Y1 / 4.4.R1 | | Post. ref. | Dr. | | Cr. |
| WIP, product | | 1.1.4.3.1.123 | | 3,000 |  |
|  | Raw materials | 1.1.4.1 | |  | 3,000 |
| WIP, product | | 1.1.4.3.1.123 | | 19,000 |  |
|  | Work in process | 1.1.4.3.3 | |  | 19,000 |
| Finished goods | | 1.1.4.4.123 | | 40,000 |  |
|  | WIP, product | 1.1.4.3.1.123 | |  | 40,000 |

### Option 3

Same facts except it decided to use separate accounts for direct wages and indirect costs.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| WIP, product | | 1.1.4.3.1.123 | 2,000 |  |
|  | Raw materials | 1.1.4.1 |  | 2,000 |
| WIP, product | | 1.1.4.3.1.123 | 7,000 |  |
|  | WIP, wages | 1.1.4.3.1.1.2 |  | 7,000 |
| WIP, product | | 1.1.4.3.1.123 | 9,000 |  |
|  | WIP, indirect cost | 1.1.4.3.1.2 |  | 9,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/4/Y1 / 4.4.R1 | | Post. ref. | Dr. | Cr. |
| WIP, product | | 1.1.4.3.1.123 | 3,000 |  |
|  | Raw materials | 1.1.4.1 |  | 3,000 |
| WIP, product | | 1.1.4.3.1.123 | 8,000 |  |
|  | WIP, wages | 1.1.4.3.1.1.2 |  | 8,000 |
| WIP, product | | 1.1.4.3.1.123 | 11,000 |  |
|  | WIP, indirect cost | 1.1.4.3.1.2 |  | 11,000 |
| Finished goods | | 1.1.4.4.123 | 40,000 |  |
|  | WIP, product | 1.1.4.3.1.123 |  | 40,000 |

### Option 4

Same facts except it did not allocate indirect costs on the basis of material and wages. Instead it allocated variable costs on the basis of time spent in the manufacturing process and fixed costs on the basis of the variable.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Work in process | | 1.1.4.3.123 | 2,000 |  |
|  | Raw materials | 1.1.4.1 |  | 2,000 |
| Work in process | | 1.1.4.3.123 | 7,000 |  |
|  | WIP, wages | 1.1.4.3.1.1.2 |  | 7,000 |
| WIP, product | | 1.1.4.3.1.123 | 10,000 |  |
|  | WIP, indirect cost | 1.1.4.3.1.2 |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/4/Y1 / 4.4.R1 | | Post. ref. | Dr. | Cr. |
| Work in process | | 1.1.4.3.123 | 3,000 |  |
|  | Raw materials | 1.1.4.1 |  | 3,000 |
| Work in process | | 1.1.4.3.123 | 8,000 |  |
|  | WIP, wages | 1.1.4.3.1.1.2 |  | 8,000 |
| WIP, product | | 1.1.4.3.1.123 | 10,000 |  |
|  | WIP, wages | 1.1.4.3.1.1.2 |  | 10,000 |
| Finished goods | | 1.1.4.4.123 | 40,000 |  |
|  | WIP, product | 1.1.4.3.1.123 |  | 40,000 |

## Post-production faze (culmination of the earnings process)

On 4/16/Y1 it sold the product to customer # 402 for 80,000. Shipping of 200 was payable to supplier 86.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/16/Y1 / 16.4.R1 | | Post. ref. | Dr. | Cr. |
| Trade receivable | | 1.1.3.1.402 | 80,000 |  |
|  | Revenue | 4 |  | 80,000 |
| Direct material | | 5.1.1 | 5,000 |  |
| Direct wages | | 5.1.2 | 15,000 |  |
| Supervisor's salaries | | 5.1.3.1.1 | 2,000 |  |
| Prod. supplies: fasteners | | 5.1.3.1.6.1 | 900 |  |
| Prod. supplies: lubricants | | 5.1.3.1.6.2 | 500 |  |
| Prod. supplies: Tools | | 5.1.3.1.6.3 | 100 |  |
| Repairs and maintenance | | 5.1.3.1.2 | 250 |  |
| Electricity | | 5.1.3.1.5.1 | 450 |  |
| Natural gas | | 5.1.3.1.5.2 | 50 |  |
| Water and swage | | 5.1.3.1.5.3 | 50 |  |
| Waste removal | | 5.1.3.1.5.4 | 200 |  |
| Quality control | | 5.1.3.1.3 | 500 |  |
| Rent | | 5.1.3.2.2 | 6,000 |  |
| Depreciation | | 5.1.3.2.1 | 9,000 |  |
|  | Finished goods | 1.1.4.4.123 |  | 40,000 |
| Delivery | | 5.2.3 | 200 |  |
|  | Trade payable | 2.1.1.1.86 |  | 200 |

## Reporting[[22]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote22sym)

|  |  |  |
| --- | --- | --- |
| **XYZ Inc. Cost of Goods Manufactured schedule For the year ended December 31, Y1** | | |
| Beginning WIP inventory |  | 0 |
| Beginning raw materials | 20,000 |  |
| Purchases | 100,000 |  |
| Vender credits | (1,000) |  |
| Ending raw materials inventory | (114,000) |  |
| Direct materials |  | 5,000 |
| Direct wages |  | 15,000 |
| Supervisors´ salaries | 2,000 |  |
| Production supplies | 1,500 |  |
| Repairs and maintenance | 250 |  |
| Utilities | 750 |  |
| Quality control | 500 |  |
| Rent | 6,000 |  |
| Depreciation | 9,000 |  |
| Total manufacturing overhead |  | 20,000 |
| Ending WIP inventory |  | (0) |
| Cost of goods (products) sold |  | 40,000 |
|  |  |  |

Comparing this schedule with the journal entry makes obvious that the entity applies a different levels of materiality to its general ledger and financial report. This is normal. It would be highly uncommon for a financial report to contain as much detail as a G/L, and even more uncommon for the G/L to limit itself to the detail contained in a financial report[**[23]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote23sym).

## Reporting in more detail

Same facts except on 1/1/Y1, XYZ had two ¾ completed products in process[**[24]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote24sym). By 3/31/Y1 it finished 16, sold 17 and one was ½ complete.

|  |  |  |
| --- | --- | --- |
| **XYZ Inc. Income statement For the Quarter Ended 3/31/Y1** | | |
|  |  | X 10,000 |
| Revenue |  | 136 |
| Cost of goods sold |  | 77 |
| Gross profit |  | 59 |
| - Etc. - | - | - |
|  | | |

|  |  |  |
| --- | --- | --- |
| **XYZ Inc. Cost of Goods Sold Schedule For the year ended December 31, Y1** | | |
|  |  | X 100 |
| Beginning finished goods inventory |  | 1,200 |
| Cost of goods manufactured |  | 7.313 |
| Ending finished goods inventory |  | (800) |
| Cost of goods sold |  | 7,713 |
|  |  |  |

|  |  |  |
| --- | --- | --- |
| **XYZ Inc. Cost of Goods Manufactured schedule For the year ended December 31, Y1** | | |
|  |  | X 100 |
| Beginning WIP inventory |  | 600 |
| Beginning raw materials | 200 |  |
| Purchases | 1,000 |  |
| Vender credits | (10) |  |
| Ending raw materials inventory | (353) |  |
| Direct materials |  | 838 |
| Direct wages |  | 2,475 |
| Supervisors' salaries | 350 |  |
| Production supplies | 263 |  |
| Repairs and maintenance | 44 |  |
| Utilities | 131 |  |
| Quality control | 88 |  |
| Rent | 1,050 |  |
| Depreciation | 1,575 |  |
| Total manufacturing overhead |  | 3,500 |
| Ending WIP inventory |  | (100) |
| Cost of goods (products) sold |  | 7,313 |
|  |  |  |

### Alternatively

|  |  |  |
| --- | --- | --- |
| **XYZ Inc. Cost of Goods Sold Schedule For the year ended December 31, Y1** | | |
|  |  | X 100 |
| Cost of goods manufactured |  | 7.313 |
| Change in finished goods inventory |  | 400 |
| Cost of goods sold |  | 7,713 |
|  |  |  |

|  |  |  |
| --- | --- | --- |
| **XYZ Inc. Cost of Goods Manufactured schedule For the year ended December 31, Y1** | | |
|  |  | X 100 |
| Purchases | 1,000 |  |
| Vender credits | (10) |  |
| Ending raw materials inventory | (153) |  |
| Direct materials |  | 838 |
| Direct wages |  | 2,475 |
| Supervisors' salaries | 350 |  |
| Production supplies | 263 |  |
| Repairs and maintenance | 44 |  |
| Utilities | 131 |  |
| Quality control | 88 |  |
| Rent | 1,050 |  |
| Depreciation | 1,575 |  |
| Total manufacturing overhead |  | 3,500 |
| Change WIP inventory |  | 500 |
| Cost of goods (products) sold |  | 7,313 |
|  |  |  |

## Costing system

Since IFRS does not prescribe procedures, the entity decided to account for production as part of its costing system, it calculated individual expense items on the basis of that system. Various possible procedures for tracking production exist. In the following examples, it used job cards**[[25]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote25sym)**.

### Examples

On 3/28/Y1 a production manager at plant # 03 assigned tracking # 03.123 to order 123. Next supervisor 025 requisitioned material 10.5 from warehouse employee 65 who moved it to work station 47 where employee 456 spent 1.75 hours performing task 1. Next employee 478 requisitioned three units of material 32.1 and spent 0.5 hours at station 14 doing task 4. The next day employee 318 spent 0.25 hours on task 48.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Job card, plant 3** | | | | |
| **Job # 03.123** | | | | |
| **Material** | **Date** | **Item** | **WHE** | **ID #** |
| Base | 28.3 | 1 x 10.5 | 65 | 125 |
| Attachment 114 | 28.3 | 3 x 32.1 | 65 | 478 |
| Etc. | - | - | - | - |
|  |  |  |  |  |
| **Work performed** | **Date** | **Code** | **Time** | **ID #** |
| Machining | 28.3 | 1 | 1.75 | 456.1 |
| Installation | 28.3 | 4 | 0.50 | 478.2 |
| Quality control | 29.3 | 48 | 0.25 | 318.1 |
| Etc. | - | - | - | - |
|  |  |  |  |  |
| **Work station** | **Date** | **Station** | **Time** | **ID #** |
| Mach. station | 28.3 | 47 | 1.75 | 456 |
| Polishing station | 28.3 | 14 | 0.50 | 478 |
| Etc. | - | - | - | - |
|  |  |  |  |  |

On completing the job, the entity performed the following calculations.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Job cost sheet, plant 3** | | | | |
| **Job # 03.123** | | | | |
| **Direct material** | **Ref # /** | **Amnt.** | **Cost** | **Σ cost** |
| Base | DM-10.5 | 1 | 325 | 325 |
| Attachment 114 | DM-32.1 | 3 | 412 | 1,236 |
| Etc. | - | - | - | - |
|  |  |  |  | 5,000 |
|  |  |  |  |  |
| **Direct wages** |  |  |  |  |
| Machining | PW-456.1 | 1.75 | 186 | 325 |
| Installation | PW-478.2 | 0.5 | 300 | 150 |
| Etc. | - | - | - | - |
|  |  |  |  | 15,000 |
|  |  |  |  |  |
| **Indirect costs** |  |  |  |  |
| Machining | P-47 | 1.75 | 150 | 263 |
| Installation | P-14 | 0.5 | 250 | 13 |
| Quality control | PW-318.1 | 0.25 | 600 | 150 |
| Etc. | - | - | - | - |
|  |  |  |  | 20,000 |
|  |  |  |  |  |

Keeping track of individual cost items requires various supplemental schedules. Since IFRS does not deal with this issue, their number, form and content will vary considerably between entities. Also, to keep the example as simple as possible, the most detailed supplemental tables, are omitted.

### Examples of supplemental worksheets

|  |  |  |  |
| --- | --- | --- | --- |
| **Schedule DM-10** | | | |
| **Direct material item 10 cost sheet** | | | |
|  | | Ref # / č. |  |
| Purchase 1 (1/1/Y1) 1 (1.1.R1) | |  | 525,000 |
|  | Units |  | 1,500 |
|  | Unit cost | M-10.1 | 350 |
|  |  |  |  |
| Purchase 5 (3/20/Y1) 5 (30.3.R1) | |  | 325,000 |
|  | Units |  | 1000 |
|  | Unit cost | M-10.5 | 325 |
| Etc. | | - | - |
|  | |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **Schedule PW-456** | | | |
| **Employee 456 cost worksheet** | | | |
|  | | Ref # / č. |  |
| Standard time | |  |  |
|  | Hourly wage |  | 120 |
|  | Fringe benefits | FB-1 | 10 |
|  | Compensated absences | CA-1 | 9 |
|  | Bonuses | Bon-1 | 9 |
|  | Withholdings | WTH-1 | 38 |
|  | Unit cost per hour | DW-456.1 | 186 |
|  |  |  |  |
| Overtime | |  |  |
|  | Hourly wage |  | 180 |
|  | Fringe benefits | FB-1 | 12 |
|  | Compensated absences | CA-1 | 10 |
|  | Bonuses | Bon-1 | 9 |
|  | Withholdings | WTH-1 | 54 |
|  | Unit cost per hour | DW-456.2 | 265 |
|  |  |  |  |

Labor costs**[[26]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote26sym)**can be tracked on the basis of time, units produced or a combination.

|  |  |  |  |
| --- | --- | --- | --- |
| **Schedule P-47** | | | |
| **Production station 47 cost sheet** | | | |
|  | | Ref # / č. |  |
| Variable costs | |  |  |
|  | Production material | IM-47 | 15 |
|  | Repairs and maintenance | MRE-47 | 10 |
|  | Electricity | MU-47 | 25 |
| Hourly variable cost | |  | 50 |
|  |  |  |  |
| Fixed costs (at normal capacity) | |  |  |
|  | Depreciation | DS 47 | 95 |
|  | Regular inspections | ISO-47 | 5 |
| Hourly fixed cost | |  | 100 |
| Operating cost per hour | |  | 150 |
|  | |  |  |

The difference between fixed and variable costs is not firmly defined. For example, if inspections were performed periodically (for example annually), they would be considered a fixed cost. On the other hand, if they were performed on the basis of hourly or actual usage, they would be variable. Similarly, straight-line depreciation would be a fixed cost while usage-based depreciation would be variable.

## Normal capacity

Companies are obligated (IAS 2.13) to allocate fixed costs on the basis of normal capacity if the difference between normal and actual is material.

|  |  |  |  |
| --- | --- | --- | --- |
| **Schedule DS-47** | | | |
| **Depreciation schedule 47** | | | |
|  | | Ref # |  |
| 3/15/04 / 15.3.04 | |  |  |
| Machine tool 47 | | Doc. 12-4 |  |
|  | Acquisition cost | A/P 04.369 | 2,310,000 |
|  | Useful life | Doc. 12-4 | 8 |
|  | Salvage value | SV 1 | 340,000 |
| Annual depreciation | |  | 246,250 |
|  |  |  |  |
|  | Annual hourly usage | MC 1 | 2,600 |
| Depreciation per hour | |  | 95 |
|  | |  |  |

On 3/31/Y1, XYZ determined that instead of a normal capacity of 130 type A products, it manufactured only 118.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Normal capacity schedule: Type A** | | | | |
|  | |  |  |  |
| Normal capacity Q1 | |  | 130 |  |
| Actual capacity Q1 | |  | 118 |  |
| Deviation | |  | 12 |  |
|  | |  |  |  |
|  | Machine tool 47 | 95 | 12 | 1140 |
|  | Machine tool 48 | 105 | 12 | 1260 |
|  | Machine tool 49 | 80 | 12 | 960 |
|  | Machine tool 50 | 60 | 12 | 720 |
|  | |  |  | 4,080 |
|  | |  |  |  |

To keep this item from being “lost” in work in process, at the end of the quarter it made this entry.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | |  | Dr. | Cr. |
| WIP normal capacity adj. | | 1.1.4.3.3.3.47 | 4,080 |  |
|  | Work in process | 1.1.4.3.3 |  | 4.080 |

As part of its annual review (IAS 16.51 a 61), the entity tests whether the balance on this account exceeds 5% of the asset’s carving amount. If it does, it re-estimates the asset’s deprecation period, method and salvage value.

## Complicated approach

If it chooses, instead of using a system of supplemental tables, the entity can choose to account for its manufacturing process in its general ledger (sub-ledgers). The disadvantage to this approach is that it makes the financial reporting system more complicated, which can increase the cost of the process and potentially lead to a higher error rate.

In contrast to the previous, this example omits all simplifying assumptions, and records all events into the IFRS general (subsidiary) ledger (ledgers).

### Examples

On 3/13/Y1, XYZ purchased raw material for 100,000 from supplier 80, invoice 45. It also determined that it was entitled to a cash discount of 1,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/13/Y1 / 13.3.R1 | | Post. ref. | Dr. | Cr. |
| Raw materials | | 1.1.4.1.10.5 | 100,000 |  |
|  | Trade payable | 2.1.1.1.12.157 |  | 100,000 |
| Trade payable | | 2.1.1.1.12.157 | 1,000 |  |
|  | Raw materials | 1.1.4.1.10.5 |  | 1,000 |

On 3/28/Y1, a production manager at plant # 03**[[27]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote27sym)**assigned tracking # 03.123 to order 123. Next supervisor 025 requisitioned material 10.5 from warehouse employee 65 who moved it to work station 47 where employee 456 spent 1.75 hours performing task 1. …

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| On 3/28/Y1 / 28.3.R1 | | Post. ref. | Dr. | Cr. |
| WIP, dir. material | | 1.1.4.3.123.1 | 325 |  |
|  | Raw materials | 1.1.4.1.10.5 |  | 325 |
| WIP, dir. material | | 1.1.4.3.123.1 | 325 |  |
|  | Wages payable | 2.1.2.2.1.1.456.1 |  | 210 |
|  | Fringe benefits | 2.1.2.2.1.2.456.1 |  | 17 |
|  | Compensated absences | 2.1.4.1.456.1 |  | 15 |
|  | Bonuses | 2.1.4.2.456.1 |  | 16 |
|  | Withholdings social | 2.1.5.1.1.456.1 |  | 43 |
|  | Withholdings health | 2.1.5.1.2.456.1 |  | 17 |
|  | Withholdings safety | 2.1.5.1.3.456.1 |  | 7 |
|  |  |  |  |  |

Etc.

XYZ manufactures products P1, P2 and P3 for which it uses material M1, M2 and M3. The following schedule presents its period 1 production.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Material X prod** | | | **Total mat** | | |
|  | **V1** | **V2** | **V3** | **M1** | **M2** | **M3** |
| **Quarter 1** | 200 | 300 | 100 |  |  |  |
| Usage M1 | 2 | 1 | 0 | 400 | 300 |  |
| Usage M2 | 1 | 0 | 2 | 200 |  | 400 |
| Usage M3 | 0 | 3 | 1 |  | 600 | 100 |
| **Quarter 2** | 3**00** | **200** | 3**00** |  |  |  |
| Usage M1 | 2 | 1 | 0 | 600 | 200 |  |
| Usage M2 | 1 | 0 | 2 | 300 |  | 1,200 |
| Usage M3 | 0 | 3 | 1 |  | 400 | 300 |
| **Quarter 3** | **600** | **800** | **1,200** |  |  |  |
| Usage M1 | 2 | 1 | 0 | 1,200 | 800 |  |
| Usage M2 | 1 | 0 | 2 | 600 |  | 4,800 |
| Usage M3 | 0 | 3 | 1 |  | 1,600 | 1,200 |
| **Quarter 4** | 3**00** | **500** | **400** |  |  |  |
| Usage M1 | 2 | 1 | 0 | 600 | 500 |  |
| Usage M2 | 1 | 0 | 2 | 300 |  | 1,600 |
| Usage M3 | 0 | 3 | 1 |  | 1,000 | 400 |
| Total mat. / Mat. |  | | | 4,200 | 5,400 | 10,000 |
|  |  | | |  | | |

During period 1, XYZ purchased material.

|  |  |  |  |
| --- | --- | --- | --- |
| **Direct material** | **M1** | **M2** | **M3** |
| Date | 1/15 / 15.1 | 1/14 / 14.1 | 2/1 / 1.2 |
| Purchase | 1,000 | 1,000 | 2,000 |
| Unit cost | 3.00 | 3.00 | 3.00 |
| Total cost | 3,000 | 3,000 | 6,000 |
|  |  |  |  |
| Date | 7/2 /.2.7 | 6/22 / 22.6 | 5/30 / 30.5 |
| Purchase | 3,250 | 2,400 | 8,500 |
| Unit cost | 2.00 | 3.25 | 3.50 |
| Total cost | 6,500 | 7,800 | 29,750 |
|  |  |  |  |
| Date |  | 9/30 / 30.9 |  |
| Purchase |  | *2,000* |  |
| Unit cost |  | 3.50 |  |
| Total cost |  | 7,000 |  |
|  |  |  |  |
| Total purchases | *4,250* | *5,400* | *10,500* |
|  |  |  |  |
| Total cost | 9,500 | 17,800 | 35,750 |
|  |  |  |  |

At period end the entity calculated its cost of materials.

|  |  |  |  |
| --- | --- | --- | --- |
| **Direct material** | **M1** | **M2** | **M3** |
| Beginning physical inv.. | 50 | 100 | 200 |
| Unit cost | 2.25 | 3.00 | 3.25 |
| Beginning inventory | 113 | 300 | 650 |
|  |  |  |  |
| Purchases | 9,500 | 17,800 | 35,750 |
|  |  |  |  |
| Ending physical inv. | (100) | (100) | (700) |
| Weighted average cost | 2.24 | 3.30 | 3.40 |
| Cost of material used | (224) | (330) | (2,383) |
|  |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
| Ending physical inv. | (100) | (100) | (700) |
| FIFO cost | 2.00 | 3.25 | 3.50 |
| Cost of material used | (200) | (325) | (2,450) |
|  |  |  |  |

The manufacture of one P1 requires two units of labor L1 (which includes basic hourly wages, overtime, social security, health and other costs directly related to labor). P2 requires one unit of L2 and P3 requires three units of L3.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Direct labor** | **L1 / P1** | **L2 / P2** | **L3 / P3** | **Σ** |
| **Quarter 1** |  |  |  |  |
| Direct labor units | *400* | *300* | *400* |  |
| Cost per labor unit | 7.08 | 6.68 | 7.95 |  |
|  | 2,832 | 2,004 | 3,180 | 8,016 |
| **Quarter 2** |  |  |  |  |
| Direct labor units | 600 | 200 | 1,200 |  |
| Cost per labor unit | 7.22 | 6.81 | 8.11 |  |
|  | 4,333 | 1,363 | 9,731 | 15,426 |
| **Quarter 3** |  |  |  |  |
| Direct labor units | *1,200* | *800* | *4,800* |  |
| Cost per labor unit | 9.68 | 9.13 | 10.87 |  |
|  | 11,612 | 7,304 | 52,157 | 71,074 |
| **Quarter 4** |  |  |  |  |
| Direct labor units | *600* | *500* | *1,600* |  |
| Cost per labor unit | 7.37 | 6.95 | 8.27 |  |
|  | 4,420 | 3,475 | 13,234 | 21,128 |
| Total |  |  |  | 115,645 |
|  |  |  |  |  |
| Per unit of production |  |  |  |  |
| Weighted average wage | 8.28 | 7.86 | 9.79 |  |
| FIFO wage | 7.37 | 6.95 | 8.27 |  |
|  |  |  |  |  |

During the period, the entity allocates variable indirect costs to products.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Indirect manufacturing costs: variable** | **P1** | **P2** | **P3** | **Σ** |
| **Quarter 1** |  |  |  |  |
| Supervisor salaries | 1,200 | 2,700 | 720 | 4,620 |
| Utilities | 250 | 450 | 200 | 900 |
| Repairs and maint. | 100 | 225 | 100 | 425 |
| Quality control | 600 | 600 | 500 | 1,700 |
|  | 2,150 | 3,975 | 1,520 | 7,645 |
| **Quarter 2** |  |  |  |  |
| Supervisor salaries | 1,800 | 1,800 | 2,160 | 5,760 |
| Utilities | 375 | 300 | 600 | 1,275 |
| Repairs and maint. | 150 | 150 | 300 | 600 |
| Quality control | 900 | 400 | 1,500 | 2,800 |
|  | 3,225 | 2,650 | 4,560 | 10,435 |
| **Quarter 3** |  |  |  |  |
| Supervisor salaries | 3,600 | 7,200 | 8,640 | 19,440 |
| Utilities | 750 | 1,200 | 2,400 | 4,350 |
| Repairs and maint. | 300 | 600 | 1,200 | 2,100 |
| Quality control | 1,800 | 1,600 | 6,000 | 9,400 |
|  | 6,450 | 10,600 | 18,240 | 35,290 |
| **Quarter 4** |  |  |  |  |
| Supervisor salaries | 1,800 | 4,500 | 2,880 | 9,180 |
| Utilities | 375 | 750 | 800 | 1,925 |
| Repairs and maint. | 150 | 375 | 400 | 925 |
| Quality control | 900 | 1,000 | 2,000 | 3,900 |
|  | 3,225 | 6,625 | 6,080 | 15,930 |
|  | 15,050 | 23,850 | 30,400 | 69,300 |
|  |  |  |  |  |
| Per unit of prod. |  |  |  |  |
| Weighted ave. wage**[[28]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote28sym)** | 10.75 | 13.25 | 15.20 |  |
| FIFO wage | 10.75 | 13.25 | 15.20 |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Indirect manufacturing costs: fixed** |  |  |  |  |
| Rent | 25,000 |  |  |  |
| Depreciation | 50,000 |  |  |  |
| Total fixed costs | 75,000 |  |  |  |
|  |  |  |  |  |
| **Quarter** | **Q1** | **Q2** | **Q3** | **Q4** |
| Units produced | 600 | 800 | 2,600 | 1,200 |
| Percentage of total | 12% | 15% | 50% | 23% |
| Normal cost | 8,654 | 11,538 | 37,500 | 17,308 |
|  |  |  |  |  |
| Normal cost |  |  |  |  |
| Per unit | 14.42 | 14.42 | 14.42 | 14.42 |
|  |  |  |  |  |
| Per unit P1 | 4.81 | 5.41 | 3.33 | 3.61 |
| Per unit P2 | 7.21 | 3.61 | 4.44 | 6.01 |
| Per unit P3 | 2.40 | 5.41 | 6.66 | 4.81 |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 - 3/31/Y1 / 1.1. - 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Trade receivable | | 1.1.3.1.42 | 3,493,500 |  |
|  | Revenue | 4 |  | 3,493,500 |

## FIFO

Same facts as example 2 except that the entity makes a FIFO assumption. The only difference is that the average cost is not 155.27 for the year, but 160.42 for the first quarter 156.67 for the second, 152.92 for the third and 155.17 for the forth.

## Subsequent measurement (lower of cost or market)

At the end of each annual period (unless it does so periodically throughout the period), the entity is obligated (IAS 2.34) to perform a physical inventory (count / measure material, work in process and finished goods / merchandise take a stock count) and re-measured that inventory if its fair value less cost to sell is lower than its initial, acquisition cost.

### LCM examples

On 12/1/Y1, XYZ (a wholesaler) purchased 200 units of product number #456 from ABC (supplier # 125) for 100 per unit.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/1/Y1**/**1.12.R1 | | Post. ref. | Dr. | Cr. |
| Inventory write-down | | 2.1.1.1.125 | 20,000 |  |
|  | Merchandise inventory | 1.1.4.5.456 |  | 20,000 |

On 12/31/Y1, XYZ determined it had 100 units of this merchandise in stock. Just prior to year-end, ABC reduced the price of the product to 90 per unit. XYZ estimated that it could sell the product for an average 120 per unit after deducting a discount and additional promotional costs required to clear out this inventory.

Fair value less cost to sell > historical cost. No entry is needed.

Same facts except XYZ estimated that it would sell the product for an average 80 per unit.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Inventory write-down | | 6.4.1 | 2,000 |  |
|  | Merchandise inventory | 1.1.4.5.456 |  | 2,000 |

On 1/15/Y2 XYZ actually sold the goods to its customers for 9,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/15/Y2**/**15.1.R2 | | Post. ref. | Dr. | Cr. |
| Merchandise inventory | | 1.1.4.5.456 | 1,000 |  |
|  | Inventory write-down | 6.4.1 |  | 1,000 |
| Cash | | 1.1.1.1 | 9,000 |  |
|  | Revenue | 4.3.2 |  | 9,000 |
| Cost of sales | | 5.1.4 | 9,000 |  |
|  | Merchandise inventory | 1.1.4.5.456 |  | 9,000 |

Same facts except the entity did not sell the goods to its customers, but to an outlet**[[29]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote29sym)**.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/15/Y2**/**15.1.R2 | | Post. ref. | Dr. | Cr. |
| Merchandise inventory | | 1.1.4.5.456 | 1,000 |  |
|  | Inventory write-down | 6.4.1 |  | 1,000 |
| Cash | | 1.1.1.1 | 9,000 |  |
|  | Merchandise inventory | 1.1.4.5.456 |  | 9,000 |

Same facts except, instead of a reversal, on a voiding entry**[[30]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote30sym)**.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/15/Y2**/**15.1.R2 | | Post. ref. | Dr. | Cr. |
| Inventory write-down | | 6.4.1 | (1,000) |  |
|  | Merchandise inventory | 1.1.4.5.456 |  | (1,000) |
| Cash | | 1.1.1.1 | 9,000 |  |
|  | Merchandise inventory | 1.1.4.5.456 |  | 9,000 |

Same facts except, on the basis of a physical inventory, the entity determined it had only 95 units because its anti theft policy was inadequate**[[31]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote31sym)**.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1**/**31.12.R1 | | Post. ref. | Dr. | Cr. |
| Excessive shrinkage | | 5.3.3 | 500 |  |
|  | Merchandise inventory | 1.1.4.5 |  | 500 |

Same facts except the loss was a loss in mass (not units) and this loss could not be prevented (a fact confirmable by a law of physics).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1**/**31.12.R1 | | Post. ref. | Dr. | Cr. |
| Normal spoilage | | 5.2.8 | 500 |  |
|  | Merchandise inventory | 1.1.4.5 |  | 500 |

Same facts except losses are caused by shoplifting, which cannot be, using reasonably available means, completely eliminated**[[32]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote32sym)**.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1**/**31.12.R1 | | Post. ref. | Dr. | Cr. |
| Normal spoilage / | | 5.2.8 | 500 |  |
|  | Merchandise inventory | 1.1.4.5 |  | 500 |

Same facts, except XYZ is a manufacturer using outdated production technology, which produces an excess of defective goods.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1**/**31.12.R1 | | Post. ref. | Dr. | Cr. |
| Excessive spoilage | | 5.3.3 | 500 |  |
|  | Work in process | 1.1.4.3.1 |  | 500 |

Same facts except XYZ determined an investment in new technology would not provide a positive return**[[33]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote33sym)**.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1**/**31.12.R1 | | Post. ref. | Dr. | Cr. |
| WIP, normal spoilage | | 1.1.4.3.1.x | 500 |  |
|  | Work in process | 1.1.4.3.1 |  | 500 |

Same facts except XYZ is a carbonated beverage manufacturer. Due to low manufacturing and high out-of-stock costs, it commonly overproduces. To properly match expenses, it does not charge inventory directly, but creates an allowance for obsolete inventory (**caveat**).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Inventory aging schedule, product 52** | | | | |
| **Age** | **Batch** | **Cost** | **Factor** | **Total** |
| 1 | 27 | 9,000 | 17% | 1,530 |
| 2 | 24 | 250 | 33% | 83 |
| 3 | - | 0 | 50% | 0 |
| 4 | - | 0 | 67% | 0 |
| 5 | 20 | 425 | 83% | 353 |
| 6 | 18 | 350 | 100% | 350 |
| Allowance | | | | 2,315 |
|  | | | |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Normal spoilage | | 5.2.8 | 2,315 |  |
|  | Obsolete inv. allowance | 1.1.4.4.(10) |  | 2,315 |

1/31/Y2, it disposed of goods from batch 18 worth 325.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| 1/31/Y2 / 31.1.R2 | | Post. ref. | Dr. | | Cr. |
| Obsolete inv. allowance | | 1.1.4.4.(10) | | 325 |  |
|  | Finished goods | 1.1.4.4.52.18 | |  | 325 |

6/30/Y2, it disposed of goods from batch 46 worth 525.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| 6/30/Y2 / 30.6.R2 | | Post. ref. | Dr. | | Cr. |
| Obsolete inv. allowance | | 1.1.4.4.(10) | | 525 |  |
|  | Finished goods | 1.1.4.4.52.46 | |  | 525 |

[**1**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote1anc): Although they should (from a conceptual perspective) by recognized as inventory, costs related to services (because they generally lack physical substance) are often disclosed as accruals.

[**2**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote2anc): The Czech language does have an exact semantic equivalent for „cost“ (the consumption, or using up of, economic benefits) which it translates as “expense” (a cost incurred as a result of delivering goods and/or rendering services). Care must therefore be taken, so that this ambiguity, does not negatively impact practice.

[**3**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote3anc): See: Income statement / Recognition / Cost of sales

[**4**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote4anc): Although IFRS (IAS 1.99) allows an entity to present a function of expense income statement only, IAS 2.16 explicitly disallows recognizing (among other) selling or administrative expenses as inventory. This prohibition implies that IFRS requires recognizing expenses on the basis of their function.

[**5**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote5anc): Managerial accounting theory explores production in great detail. Consequently, common practice bases IFRS reporting on cost accounting. As long as none of its requirements are violated, such an approach would not be inconsistent with IFRS.

[**6**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote6anc): Just-in-time and other Lean manufacturing techniques are widespread and lead to relatively insignificant (balance sheet) inventory (especially at year end). Similarly, since it requires a functional classification of expenses (at minimum: production, distribution and administration) IAS 2 obligates companies use a function of expense classification (at minimum at the general ledger level) even if they choose to publish a nature of expense income statement.

[**7**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote7anc) As discussed in the introduction to this publication, the entire concept of a firmly defined chart of accounts, with firmly assigned account numbers, is reminiscent of the days where accounts were kept by hand. Today, when even basic financial information systems reside atop robust databases, forcing users to record and access date using such a ridged and inflexible format is an anachronism. Nevertheless, since many national accounting systems are procedural in nature, this is the approach that seems “natural” to many accountants.

If such an approach were to be used, rather than attempting this level of disaggregation in the financial accounting system, it would be more practical to initially record and store individual data items in the managerial (costing) system. Information necessary for an IFRS report, would then be drawn from this system.

In any event, since IFRS does not prescribe any specific accounting procedures, the final selection of a workable model should be based on the judgment of each individual entity and its management.

[**8**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote8anc): In practice the UPC (Universal Product Code) is generally used. A shorter number is used here to save space.

[**9**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote9anc): Since IFRS (IAS 1.82.a) does not require revenue to be disaggregated on the basis of what was sold, the company uses a single account to record all its revenue (product, merchandise and service) for IFRS purposes.

[**10**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote10anc): Obviously, most companies would not use their financial reporting system in this manner. Instead, this level of disaggregation would be evident only in a managerial (costing) system. Nevertheless, since many national accounting systems are, in effect, a managerial-financial hybrid (and many a managerial-financial-tax hybrid), accountants accustomed to national systems would often try to approach IFRS in a similar manner. Readers, who would not, are advised to skip ahead to the next section (Shrinkage).

[**11**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote11anc): Simple does merely mean the company has no manufacturing or financial operations. It also means that it has no significant fixed assets, leases, or any of the hundreds of issues treated differently under IFRS, tax law and local accounting statute.

[**12**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote12anc): Up to this point, journal entries had simple (one sided) posting references. Since this entry is not directly supported by a source document, a two sided (“from / to”) reference is used.

[**13**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote13anc): IFRS does not discuss procedures. Consequently, the acronyms (and schedule itself) used herein should not taken as generally accepted. Quite the opposite. In applying IFRS, each company is obligated to create its supporting documentation so as to (in its own judgment) best capture the character and nature of its own, particular operations. In drafting this documentation the company should keep in mind two goals. First, provide sufficient evidence to support the correctness of each entry. Second, make the auditor’s job as easy as possible (not necessarily for the auditor’s sake but to minimize hours spent, hours billed).

[**14**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote14anc): Since supplemental schedule have not been used up to this point, journal entries had simple (one sided) posting references. Here, since the entry is not directly supported by a source document, a “from / to” posting reference is necessary.

[**15**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote15anc): For simplicity, this entry assumes the banks debit credit sales the same day.

[**16**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote16anc): IFRS (IAS 2.16.a) disallows recognizing abnormal wastage in cost of inventories. It does not, however, explicitly define the term „abnormal“. In practice, it is common to define as abnormal, wastage that could have been reasonably prevented. Therefore, shrinkage that occurs at the retail level (which cannot be fully prevented by camera systems, security or electronic countermeasures) is generally considered to be normal. If the loss occurs at the warehouse level (where it is reasonable to expect it to be preventable), it would be classified as abnormal.

[**17**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote17anc): In this example, the entity uses a hybrid approach whereby it capitalizes merchandise but expenses indirect costs. Since indirect costs (compared to merchandise costs) are immaterial, any potential misstatement so insignificant that the costs associated with a more rigorous approach would outweigh any potential benefits.

[**18**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote18anc): In this simplified example (where the purchase is made as a single transaction), an allowance for vender discounts would not be necessary (the entity would know precisely the discount to which it was entitled). In practice (where goods are purchased over an extended period), an allowance is used, if the entity assumes it will eventually purchase a sufficient amount to entitle it to the discount.

[**19**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote19anc): For clarity, a single, period-end entity is presented.

[**20**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote20anc): To simplify the process, it assumes cash flow precedes production and (to eliminate unnecessary entries) tracks individual expense items in the costing system only.

[**21**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote21anc): Unfortunately, companies often prefer the complex solution even when a simply approach is available. This bias is especially prevalent at large, multi-national companies where accounting policy is either set by committees or ad hoc by people with varying degrees of IFRS knowledge.

[**22**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote22anc): If a schedule was prepared to this single product.

[**23**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote23anc): In contrast to IFRS, most national accounting systems, do not require anywhere near the level of detail. This is also the primary reason why most cannot be reconciled to IFRS without an extensive amount of additional effort.

[**24**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33#sdfootnote24anc): Work in process is measured at cost of fair value less cost to sell, expected gross and cost to complete.

**[25](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote25anc)**: In practice, rather than hand-written job tags, most companies automate the process by using bar code, RFID or similar technology, making the following procedures applicable to most types of serial manufacturing.

**[26](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote26anc)**: IAS 19.4: employee benefits include wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing, bonuses, etc. Because this topic is relatively complex, this example only indicates how such costs could be included in cost of inventory.

**[27](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote27anc)**: This example assumes that the company keeps its IFRS book on a world-wide basis. If the company had decided to keep its book by manufacturing facility (for example if that facility was a separate segment) account 3.1.1.4.123.1.rather than 1.1.4.3.123.1 would be used.

**[28](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote28anc)**: To simplify this example, it is assumed that prices of variable costs remained constant thought the period (which leads to weighted average FIFO being equal).

**[29](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote29anc)**: Since the goods were sold below cost so someone other than a traditional customer, the essence of this transaction is disposal, not sale. Unfortunately, a strict reading of IFRS (AS 2.34) may lead the careless accountant to the opposite conclusion. In any event, if revenue is recognized, this issue must be brought to the auditor’s attention. Because if not, if it were revealed in testing, it would almost certainly be considered an error.

**[30](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote30anc)**: While IFRS (IAS 39.65) explicitly requires reversal (disallowing voiding entries), since it does not explicitly outline exact procedures, the question of whether voiding entries are or are not consistent with IFRS is academic, rather than substantive.

**[31](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote31anc)**: Since IAS 2 explicitly discusses excessive spoilage, if this item was larger than insignificant, a footnote disclosure describing how it arose and why it was not prevented, would be necessary.

**[32](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote32anc)**: The entity used all commonly available means (closed circuit camera, security, electronic tags, etc.) to eliminate 95% (an estimate sported by independent, expert study) of these thefts. Eliminating the final 5% would require (on the basis of the same study) procedures whose cost would significantly outweigh the merchandise lost.

**[33](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=33" \l "sdfootnote33anc)**: The entity compared the cost of new technology with the cost of the material and production lost to the spoilage, and determined that the losses were not high enough to make an investment in the new technology yield a positive return.

# Accruals

Accruals come into existence when revenues / expenses[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote1sym)are recognized at a different point in time than the related cash inflows / outflows.

## Pre-paid items

Pre-paid items are recorded when cash flows occur before revenue or expenses.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Time 1** |  | **Time 2** |  |  |
| Cash inflow (receipt) |  | Revenue | = | Unearned revenue |
| Cash outflow (expenditure) |  | Expense | = | Pre-paid expense |

## Accrued items

Accrued items are recorded when cash flows occur after revenue or expenses.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Time 1** |  | **Time 2** |  |  |
| Revenue |  | Cash inflow | = | Accrued revenue |
| Expense |  | Cash outflow | = | Accrued expense |

On the balance sheet accruals are either disclosed ass assets or liabilities:

|  |  |
| --- | --- |
| **Accrued assets** | **Accrued liabilities** |
| Pre-paid expenses | Unearned revenue |
| Accrued revenue | Accrued expenses |

## Deferred items

Although not technically accruals, deferred items are often disclosed together with accruals on the balance sheet.

|  |  |
| --- | --- |
| **Assets** | **Liabilities** |
| Deferred assets | Deferred liabilities |
| (Deferred revenue) |  |

Deferred revenue (for example deferred interest) is disclosed as a contra asset and deducted from the related asset item (for example receivables). Deferred assets and liabilities (for example deferred taxes) are disclosed as separate line items.

## Uncertain accrued items

IFRS (unlike some national accounting systems) does not have an exact equivalent for “uncertain accrued items”, which is unfortunate as they exactly conform to this IAS 37.11.b description “…. Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.”

## Unbilled revenue

Although not explicitly mentioned[**[2]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote2sym), if one were to analogize[**[3]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote3sym)from accrued expenses (IAS 37.11.b), one would logically conclude that unbilled revenue should be disclosed as an accrual, rather than a trade receivable[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote4sym).

### Examples

### Pre-paid expenses

On 1/1/Y1, XYZ paid 4,000 (one-year subscription to a magazine), 500,000 (one-year insurance for a manufacturing facility) and 400,000 (two-year MIS service contract).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Subscriptions | | 1.1.5.1.1 | 4,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 4,000 |
| Unexpired insurance | | 1.1.5.1.1 | 500,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 500,000 |
| Pre-paid service | | 1.1.5.1.2 | 200,000 |  |
| Pre-paid service | | 1.5.3.2.1 | 200,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 400,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Subscriptions | | 5.1.3.2.5 | 1,000 |  |
|  | Subscriptions | 1.1.5.1.1 |  | 1,000 |
| Insurance[**[2]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote5sym) | | 5.1.3.2.4 | 125,000 |  |
|  | Unexpired insurance | 1.1.5.1.1 |  | 125,000 |
| Service | | 1.1.5.1.1 | 50,000 |  |
|  | Pre-paid service | 1.1.5.1.2 |  | 50,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Pre-paid service | | 1.1.5.1.2 | 200,000 |  |
|  | Pre-paid service | 1.5.3.2.1 |  | 200,000 |

### Accrued revenue

On 12/31/Y1, XYZ (a natural gas distributor) determined that it was due 200,000 (rent for a portion of its building that it did not use itself), 250,000 (interest on its bank deposits) and 40,000 (payment from customer # 456 for gas used but not yet paid for).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Rent receivable | | 1.1.5.2.3.13 | 200,000 |  |
|  | Rent revenue | 6.1.3 |  | 200,000 |
| Interest receivable | | 1.1.5.2.1 | 250,000 |  |
|  | Interest revenue | 6.1.1 |  | 250,000 |
| Trade receivable | | 1.1.3.456 | 40,000 |  |
|  | Revenue | 4 |  | 40,000 |

On Monday 1/3/R2, bookkeeper number 345 examined XYZ’s bank statement and determined that the bank debited the company’s account for 243,872 for interest earned to midnight, 12/31/R1. On 5.1.Y2, a 200,000 rent payment was received and recorded by bookkeeper 456. On 1/7/Y2, technician 789 read customer 456’s meter. On 1/8/Y2, the customer’s liability was calculated to be 43,785 and on 2/1/Y2 an invoice was issued and recorded by bookkeeper 987 (the customer paid on 3/2/Y2).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Interest revenue | | 6.1.1 | 250,000 |  |
|  | Interest receivable | 1.1.5.2.1 |  | 250,000 |
| Interest receivable | | 1.1.5.2.1 | 243,872 |  |
|  | Interest revenue | 6.1.1 |  | 243,872 |
| Cash in bank | | 1.1.1.2 | 243,872 |  |
|  | Interest receivable | 1.1.5.2.1 |  | 243,872 |
| Reversal of estimate and receipt of interest | | Recorded by 345 on 1/3/R2 | | |

Alternatively, the bookkeeper decides to void the entry[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote6sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Interest receivable | | 1.1.5.2.1 | (250,000) |  |
|  | Interest revenue | 6.1.1 |  | (250,000) |
| Interest receivable | | 1.1.5.2.1 | 243,872 |  |
|  | Interest revenue | 6.1.1 |  | 243,872 |
| Cash in bank | | 1.1.1.2 | 243,872 |  |
|  | Interest receivable | 1.1.5.2.1 |  | 243,872 |
| Reversal of estimate and receipt of interest | | Recorded by 345 on 1/3/R2 | | |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/5/Y2 / 5.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 200,000 |  |
|  | Rent receivable | 1.1.5.2.3.13 |  | 200,000 |
| Receipt of rental from renter # 13 | | Recorded by 456 on 1/5/Y2 | | |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Revenue | | 4 | 40,000 |  |
|  | Trade receivable | 1.1.3.456 |  | 40,000 |
| Trade receivable | | 1.1.3.456 | 43,785 |  |
|  | Revenue | 4 |  | 43,785 |
| Reversal of estimate, re-recognition of revenue | | Recorded by 987 on 1/8/R2 | | |

Same facts, except XYZ is a subsidiary, and its international parent requires a closed financial report by the end of the third working day after year end. After receiving auditor approval, the entity established that day, as its authorization date[**[2]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote7sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Rent receivable | | 1.1.5.2.3.13 | 200,000 |  |
|  | Rent revenue | 6.1.3 |  | 200,000 |
| Interest receivable | | 1.1.5.2.1 | 250,000 |  |
|  | Interest revenue | 6.1.1 |  | 250,000 |
| Accrued revenue | | 1.1.5.2.6.456 | 40,000 |  |
|  | Revenue | 4 |  | 40,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Revenue | | 4 | 40,000 |  |
|  | Accrued revenue | 1.1.5.2.6.456 |  | 40,000 |
| Accrued revenue | | 1.1.5.2.6.456 | 43,785 |  |
|  | Revenue | 4 |  | 43,785 |

Since the subsidiary could not amend its financial report, it reported the effect of the adjusting event as a prior period adjustment[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote8sym)(in its statement of changes in equity).

|  |  |
| --- | --- |
| **XYZ Inc.  Statement of changes in equity As of December**3**1, 2YY2** | |
| Beginning retained earnings | 5,000,000 |
| Prior period adjustment | 3,785 |
| Adjusted Beginning R/E | 5,003,785 |
| Net income for period | - |
| - | - |

### Insurance claim

On 1/1/Y1, XYZ acquired a automobile for 60,000. It determined its useful life to be 4 years, salvage value 20,000 and selected straight-line depreciation. On 12/31/Y2, the automobile was involuntarily liquidated leading to an insurance claim of 55,000. During the investigation of the event, it was, however, determined that the sales representative driving the vehicle left it unattended (motor running) to buy cigarettes. XYZ and the insurance carrier settled on a payout of 45,000 (paid on 2/15/Y3).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Vehicle, Sales rep. | | 1.3.3.2.1.1.35 | 60,000 |  |
|  | Unearned revenue | 2.1.1.1 |  | 60,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y2 / 31.12.R2 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.3.(2.1.1.35) | 20,000 |  |
| Insurance claim | | 1.1.6.1 | 55,000 |  |
|  | Gain | 6.3.8 |  | 15,000 |
|  | Vehicle, Sales rep. | 1.3.3.2.1.1.35 |  | 60,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y3 / 31.12.R3 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 40,000 |  |
| Gain | | 6.3.8 | 10,000 |  |
|  | Insurance claim | 1.1.6.1 |  | 55,000 |

### Unearned revenue

#### Non-returnable deposits

On 9/15/R1, XYZ received a deposit of 50,000 from customer number 123 on order 456. On 12/28/Y1, it delivered a machine and, on 1/2/Y2, issued an invoice for 100,000 (the country of XYZ’s tax domicile “accrues” revenue, thus a tax obligation arose on the day the delivery is formally invoiced; the tax rate was 20%). The customer paid on 1/29/Y2.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 9/15/Y1 / 15.9.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 50,000 |  |
|  | Unearned revenue | 2.1.2.1.456 |  | 50,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/28/Y1 / 28.12.R1 | | Post. ref. | Dr. | Cr. |
| Trade receivable | | 1.1.1.2.123 | 50,000 |  |
| Unearned revenue | | 2.1.2.1.456 | 50,000 |  |
|  | Revenue | 4 |  | 100,000 |
| Income tax expense | | 7 | 20,000 |  |
|  | Deferred tax liability | 2.1.2.3.1 |  | 20,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/2/Y2 / 2.1.R2 | | Post. ref. | Dr. | Cr. |
| Deferred tax liability | | 2.1.2.3.1 | 20,000 |  |
|  | Accrued tax payable[**[2]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote9sym) | 2.1.2.2.4 |  | 20,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/29/Y2 / 29.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 50,000 |  |
|  | Trade receivable | 1.1.1.2.123 |  | 50,000 |

Same facts, except the entity decided to record the issuance of the invoice[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote10sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 9/15/Y1 / 15.9.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 50,000 |  |
|  | Unearned revenue | 2.1.2.1.456 |  | 50,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/28/Y1 / 28.12.R1 | | Post. ref. | Dr. | Cr. |
| Unbilled revenue | | 1.1.5.2.7.1 | 50,000 |  |
| Unearned revenue | | 2.1.2.1.456 | 50,000 |  |
|  | Revenue | 4 |  | 100,000 |
| Income tax expense | | 7 | 20,000 |  |
|  | Deferred tax liability | 2.1.2.3.1 |  | 20,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/2/Y2 / 2.1.R2 | | Post. ref. | Dr. | Cr. |
| Trade receivable | | 1.1.1.2.123 | 50,000 |  |
|  | Unbilled revenue | 1.1.5.2.7.1 |  | 50,000 |
| Deferred tax liability | | 2.1.2.3.1 | 20,000 |  |
|  | Accrued tax payable[**[2]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote11sym) | 2.1.2.2.4 |  | 20,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/29/Y2 / 29.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 50,000 |  |
|  | Trade receivable | 1.1.1.2.123 |  | 50,000 |

Same situation except that taxable income accrued on the delivery date.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/28/Y1 / 28.12.R1 | | Post. ref. | Dr. | Cr. |
| Trade receivable | | 1.1.1.2.123 | 50,000 |  |
| Unearned revenue | | 2.1.2.1.456 | 50,000 |  |
|  | Revenue | 4 |  | 100,000 |
| Income tax expense | | 7 | 20,000 |  |
|  | Accrued tax payable | 2.1.2.2.4 |  | 20,000 |

Same facts, except the tax domicile is a country that taxes receipts rather than revenue[**[3]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote12sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 9/15/Y1 / 15.9.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 50,000 |  |
|  | Unearned revenue | 2.1.2.1.456 |  | 50,000 |
| Income tax expense | | 7 | 10,000 |  |
|  | Accrued tax payable | 2.1.2.2.4 |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/28/Y1 / 28.12.R1 | | Post. ref. | Dr. | Cr. |
| Trade receivable | | 1.1.1.2.123 | 50,000 |  |
| Unearned revenue | | 2.1.2.1.456 | 50,000 |  |
|  | Revenue | 4 |  | 100,000 |
| Income tax expense | | 7 | 10,000 |  |
|  | Deferred tax liability | 2.1.2.3.1 |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/28/Y1 / 28.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 50,000 |  |
|  | Trade receivable | 1.1.1.2.123 |  | 50,000 |
| Deferred tax liability | | 2.1.2.3.1 | 10,000 |  |
|  | Accrued tax payable | 2.1.2.2.4 |  | 10,000 |

#### Pre-payments

On 12/27/R1, XYZ entered into a two-year service agreement with customer 123 and received payment of 90,000 for the quarter ending 3/31/R2.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/27/Y1 / 27.12.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 90,000 |  |
|  | Unearned revenue | 2.1.2.1.123 |  | 90,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/31/Y2 / 31.1.R2 | | Post. ref. | Dr. | Cr. |
| Unearned revenue | | 2.1.2.1.123 | 30,000 |  |
|  | Revenue | 4 |  | 30,000 |

On 12/28/R1, ABC sold a two-year license on its web site for 24,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/28/Y1 / 28.12.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 24,000 |  |
|  | Unearned revenue | 2.1.2.1 |  | 24,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/31/Y2 / 31.1.R2 | | Post. ref. | Dr. | Cr. |
| Unearned revenue | | 2.1.2.1 | 1,000 |  |
|  | Revenue | 4 |  | 1,000 |

On 12/29/Y1, it sold an unlimited-term license for 30,000[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote13sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/29/Y1 / 29.12.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 30,000 |  |
|  | Revenue | 4 |  | 30,000 |

Same facts, except the entity was obligated (by law) to provide regular security updates for two years. It was able to estimate both the approximate number and cost of these updates. On 1/13/Y2, it released an update.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/29/Y1 / 29.12.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 30,000 |  |
|  | Revenue | 4 |  | 18,000 |
|  | Unearned revenue | 2.1.2.1.234 |  | 12,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/13/Y1 / 13.1.R1 | | Post. ref. | Dr. | Cr. |
| Unearned revenue | | 2.1.2.1.234 | 150 |  |
|  | Revenue | 4 |  | 150 |
| Cost of sales | | 5.1.7 | 75 |  |
|  | Cash in bank[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote14sym) | 1.1.1.2 |  | 70 |

Same facts, except the obligation was constructive rather than legal.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/29/Y1 / 29.12.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 30,000 |  |
|  | Revenue | 4 |  | 18,000 |
|  | Unearned revenue | 2.1.2.1.234 |  | 12,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/13/Y1 / 13.1.R1 | | Post. ref. | Dr. | Cr. |
| Unearned revenue | | 2.1.2.1.234 | 150 |  |
|  | Revenue | 4 |  | 150 |
| Cost of sales | | 5.1.7 | 75 |  |
|  | Cash in bank | 1.1.1.2 |  | 75 |

Same facts, except the entity was not able to determine the number of updates.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/29/Y1 / 29.12.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 30,000 |  |
|  | Revenue | 4 |  | 18,000 |
|  | Unearned revenue | 2.1.2.1.234 |  | 12,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y2 / 31.1.R2 | | Post. ref. | Dr. | Cr. |
| Unearned revenue | | 2.1.2.1.234 | 500 |  |
|  | Revenue | 4 |  | 500 |

12/30/Y1, XYZ sold customer # 456 a license for 60,000. The license had an unlimited term, but the entity regularly upgraded its product. In its experience 94% of its customers purchase the upgrade.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/30/Y1 / 30.12.R1 | | Post. ref. | Dr. | Cr. |
| Trade receivable | | 1.1.1.2.456 | 60,000 |  |
|  | Unearned revenue | 2.1.2.1.456 |  | 60,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y2 / 31.3.R2 | | Post. ref. | Dr. | Cr. |
| Unearned revenue | | 2.1.2.1.456 | 5,000 |  |
|  | Revenue | 4 |  | 5,000 |

Same facts, except only 45% of its customers upgraded[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote15sym)(the remainder either purchased a competing product, or one of XYZ’s other products).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/30/Y1 / 30.12.R1 | | Post. ref. | Dr. | Cr. |
| Trade receivable | | 1.1.1.2.456 | 60,000 |  |
|  | Revenue | 4 |  | 60,000 |

### Returnable deposits

On 1/1/Y1, XYZ rented commercial space and paid a security deposit of 100,000. After 5 years, it vacated the premises.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Trade receivable | | 1.5.5.1 | 100,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 100,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y4 / 31.12.R4 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 100,000 |  |
|  | Trade receivable | 1.5.5.1 |  | 100,000 |

#### Accrued expenses (estimated items)

On 12/31/Y1, XYZ determined that it consumed natural gas valued at 42,500[**[2]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote16sym)in its retail outlets. On 2/2/R2, it received an invoice of 43,785 for gas used to 7/7/R2. The entry was made by accountant number 78.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
|  | | 5.2.11.1 | 42,500 |  |
|  | Trade payable | 2.1.1.1 |  | 42,500 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Trade payable | | 2.1.1.1 | 42,500 |  |
|  | Utilities | 5.2.11.1 |  | 42,500 |
| Utilities | | 5.2.11.1 | 43,785 |  |
|  | Trade payable | 2.1.1.1 |  | 43,785 |
| Reversal of estimate, re-recognition of revenue | | Recorded by 78 on 1/15/R2 | | |

Same facts, except the entity’s chief accountant realized there was plenty of time to the end of the first quarter (the authorization date as defined by IAS 10.17), and decided to save himself (and his team) some effort[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote17sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Utilities | | 5.2.11.1 | 43,785 |  |
|  | Trade payable | 2.1.1.1 |  | 43,785 |
| Reversal of estimate, re-recognition of revenue | | Recorded by 78 on 1/15/R2 | | |

Same facts, except XYZ was a subsidiary whose parent required a closed book by the end of the third working day after the year end. After receiving auditor approval, the entity established this day, as its authorization date[**[2]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote18sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Utilities | | 5.2.11.1 | 40,000 |  |
|  | Accrued gas expense | 2.1.2.2.2.2 |  | 40,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Accrued gas expense | | 2.1.2.2.2.2 | 42,500 |  |
|  | Utilities | 5.2.11.1 |  | 42,500 |
| Utilities | | 5.2.11.1 | 43,785 |  |
|  | Accrued gas expense | 2.1.2.2.2.2 |  | 43,785 |

|  |  |
| --- | --- |
| **XYZ Inc.  Statement of changes in equity As of December**3**1, 2YY2** | |
| Beginning retained earnings | 5,000,000 |
| Prior period adjustment | 1,285 |
| Adjusted Beginning R/E | 4,998,715 |
| Net income for period | - |
| - | - |

### Events after the Reporting Period

#### Adjusting event

On 12/15/Y1, XYZ purchased merchandise for 100,000 and sold 10,000 worth by 12/31/Y1. At year-end, it estimated that it would be able to sell the remaining merchandise for 140,000 in total. On 1/1/Y2, a manufacture of competing goods (which XYZ did not carry) announced a newer, better and cheaper completing product. After month’s futile effort, XYZ sold the goods to an outlet for 60,000. Since this event confirmed the value of an asset disclosed at year-end, the entity was obligated (IAS 10) to adjust its year one report for this event.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Inventory write-down | | 6.4.1.1 | 43,785 |  |
|  | Merchandise inventory | 1.1.4.5 |  | 43,785 |
| Reversal of estimate, re-recognition of revenue | | Recorded by 78 on 1/31/R2 | | |

#### Non-adjusting event

On 3/15/Y2, ABC learned that it was the defendant in a product liability suit filed by a customer that purchased the defective product on 1/15/Y2. The legal department estimated that the company would pay damages of 246,663.

Since the condition did not exist on the balance sheet date, the company merely added a discussion to its footnotes. Its financial statements were not adjusted.

Same facts, except the customer purchased the goods on 1/15/Y2[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote19sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/15/Y2 / 15.3.R2 | | Post. ref. | Dr. | Cr. |
| Litigation | | 6.4.11 | 246,663 |  |
|  | Litigation provision | 2.1.4.5 |  | 246,663 |

[**1**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote1anc): Goods and services are generally „accrued“ in the context of full absorption costing. When incurred, related costs are capitalized (to inventory) and expensed (as cost of sales) at the moment of sale. As a reset, only selling, administrative (general) and other expenses are commonly classified as “accruals”.

[**2**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote2anc): Unbilled revenue is mentioned only once (IAS 11), and then only in an example dealing with construction contracts.

[**3**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote3anc): Which (since accounting ought to be symmetrical) should be permissible, although some professionals are of a different opinion.

[**4**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote4anc): Properly, these items should be disclosed as receivables because revenue is not recognized on the basis of invoicing, but rather delivery (IAS 18.14.a). Nevertheless, in some jurisdictions, the actual act of issuing an invoice leads to taxable revenue (regardless of when delivery occurs). Consequently, under IFRS a deferred tax item must be recorded. Recording this item in conjunction with “unbilled revenue” simply leads to clearer accounting.

**Important:**Invoicing prior to delivery/rendering (especially if payment is collected) is a „bill and hold sale“, which has its own, specific accounting procedure.

[**5**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote5anc): In practice, insurance is occasionally classified as an “other expense” regardless of what is being insured. Although IFRS does not explicitly address this issue, insurance of production machinery has the same economic character as depreciation or rent, thus should be included in cost of sales (inventory), regardless of whether the asset is owned, leased or rented.

[**6**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote6anc): Many European national accounting systems do not favor voiding (rather than reversing entries). Since IFRS does not (technically) prescribe procedures, a company can choose whether to void or reverse on the basis of its own judgment.

[**7**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote7anc): Since IFRS applies to the consolidated entity, the authorization date of that entity is also the authorization date of each of its subsidiaries. It is, however, common practice (especially at large, multinational corporations) for a parent to require its subsidiaries to prepare and submit finalized reports considerably sooner (a week is common, although several days, even hours, are possible). The authorization date for the subsidiary would thus be the date set by the parent.

**Caution:**Since this procedure is a technical violation of IAS 10, (at minimum) auditor approval is required.

[**8**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote8anc): The Czech practice of recording the effect of the chase in a subsequent period’s profit and loss is not acceptable from an IFRS perspective.

[**9**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote9anc): Taxes payable and receivable with the same taxing authority can be recorded in separate accounts (which are offset) or in a single account (which is disclosed as either an asset or liability depending on its balance.

[**10**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote10anc): Since both approaches result in comparable financial reports, either would be acceptable under IFRS.

[**11**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote11anc): This account would also be used for tax-deductible expenses until a tax return is prepared and tax paid. The account would be disclosed as either an asset or liability (provided both taxable revenue and tax deductible expenses are with the same taxis authority) depending on whether its balance is debit or credit.

[**12**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote12anc): In many European tax jurisdictions, accrual accounting is also used for tax purposes. The implication is that taxes are often owed on receivables that are uncollectible. Aside from being unfair, this system also motivates business people to use various mitigating procedures. Care must, however, be taken to ensure that no tax driven policy influences the IFRS report.

[**13**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote13anc): The entity had no obligation to provide upgrades or service, nevertheless it did so (periodically) as part of its generally customer service policy.

[**14**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote14anc): For illustration purposes, this entry assumes the cash cost is incurred immediately.

[**15**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote15anc): Since IAS 18 does not provide instructions in this much detail, judgment is required when applying the standard to specific situations.

[**16**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote16anc): Although it could have determined (on the basis of daily gas reading, for example) that gas valued at 42,373 was actually consumed in December, it decided that the cost of making such a precise estimate would exceed the benefits of the exactitude.

[**17**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote17anc): If most estimated amounts will be clarified relatively soon after year-end, it is reasonable to present the auditor with a “hard close” (books closed to the end of the 11[th] month, for example). By the time he finishes, many items that would have had to be estimated have occurred and can be recorded normally. Similarly, it is reasonable (from an accounting / auditing perspective) to select the end of the slowest month (rather than the end of busiest or the calendar year) as the end of the fiscal year.

[**18**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote18anc): Since the subsidiary could not amend its financial report, it reported the effect of the adjusting event as a prior period adjustment (in its statement of changes in equity). The including this amount in a subsequent period’s net income (common in some national accounting systems) is not acceptable IFRS practice.

**Important:** Since IFRS applies to the consolidated entity, the authorization date of that entity is the authorization date of each of subsidiary. It is, however, common practice (especially at large, multinational corporations) for a parent to require its subsidiaries to prepare and submit finalized reports considerably sooner (a week is common, although several days, even hours, are possible). **Since this practice is a technical violation of IAS 10, (at minimum) auditor approval is required.**

[**19**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=31#sdfootnote19anc): The entity recorded the amount but did not disclose it as a separate line item (nor provide specific commentary in the footnotes). Instead, it aggregated it with similar items and disclosed it as a “general litigation provision” (and provided similarly aggregated footnote disclosure). If a company was to provide more (than the legally required minimum) information about individual cases, it could disadvantage itself. Consequently, IFRS (IAS 37.84-86) requires disclosures for the entire class, not individual items.

# Long-lived assets

Long-lived (fixed, non-current) assets are assets that are not (IAS 1.61) recoverable (to be sold, consumed or otherwise liquidated) within 12 months[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote1sym) of the balance sheet date (end of the reporting period).

## Basic classifications

1. Financial instruments

2 Property, plant and equipment (PP&E)

3. Intangible assets

4. Resources[**[2]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote2sym)

## Investments (financial instruments)

Although they make up a significant part of IFRS[**[3]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote3sym), financial instruments are not (for the average industrial company) a key accounting topic. Consequently, this publication does not provide a discussion of this topic[**[4]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote4sym).

## Property plant and equipment

Property plant and equipment (PP&E) comprises assets that have physical substance and are used in the entity’s operations (rather than being held or sale). As PP&E is generally held for longer than one year (operating cycle), it is commonly disclosed as a sub-classification of fixed assets.

### Recognition

IFRS (IAS 16.9) explicitly states it “does not prescribe the unit of measure for recognition, ie what constitutes an item of property, plant and equipment.” The reason being, that every company is unique and prescribing standard asset groups, classes or units would mask this uniqueness[**[5]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote5sym).

Generally, companies should base their classification decision on these two criteria (in order of priority):

1. Intended use.

2. Expected useful life given that use.

Also, since it is quite common for an entity to change the manner in which it utilizes its assets as they age, it is normal to transfer an asset from one class to another[**[6]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote6sym).

#### Example

XYZ manufactures turbines and generators (which it sells directly to electric generating plants) and consumer durables (which it sells both to retailers and the general public, on its electronic storefront). Each year it purchases computers that it classifies:

1.3.3.1.5.1.1.321 Assets / PP&E / Machinery & equipment / Manufacturing / MIS / Turbine division / Hubs and routers / Router 321[**[7]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote7sym)

1.3.3.1.5.1.2.3.345 … turbine division / control systems / type A / machine # 345

1.3.3.2.4.1.1.456 Assets / PP&E / Machinery and equipment / Sales / MIS / Personal computers / notebooks / machine # 456[**[8]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote8sym)

1.3.3.2.4.2.141 … MIS / online storefront / Server 141

1.3.3.3.4.4.1.45 Assets / PP&E / Machinery and equipment / Administrative / general / Accounting MIS / Work stations / Work station 45

1.3.3.3.5.4.1 Assets / PP&E / Machinery and equipment / Administrative / R&D/ MIS / Super computer

1.3.3.3.5.1.4.2.79 … R&D / MIS / work stations / machine number 79

Etc.

#### Disclosure

The classification scheme outlined in the previous section could be used in the context of the financial reporting system. In practice (since PP&E and inventory accounting are interrelated) it is much more common to account for these assets as part of the managerial system, then base the financial (IFRS) report on information taken from this system.

#### Example

IFRS (IAS 1.54) sets out minimum reporting requirements. If an entity were to follow these instructions to the letter, it would publish a balance sheet with approximately this level of aggregation.

|  |  |  |
| --- | --- | --- |
| **XYZ Group Statement of financial position As at 31 December 20X1** | | |
|  | |  |
| **Non-current assets** | |  |
|  | Property, plant and equipment | 171,000 |
|  | Goodwill / Goodwill | 4,000 |
|  | Other intangible assets | 55,000 |
|  | Investments in associates | 12,750 |
|  | Available-for-sale financial assets | 21,250 |
| **Total non-current assets** | | 901,620 |
|  | |  |

In addition to this minimum, it is also necessary (IAS 1.55) for the entity to ”present additional line items, headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity’s financial position.“ If the same entity were to follow these instructions to the letter, it would publish a balance sheet with approximately this level of disaggregation[**[9]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote9sym).

|  |  |  |
| --- | --- | --- |
| **XYZ Group Statement of financial position As at 31 December 20X1** | | |
| … | |  |
| Property plant and equipment | |  |
|  | Loading docks and buildings (net of 15,000 accumulated depreciation) | 26,000 |
|  | Barns and repair yards (net of 14,000 accumulated depreciation) | 21,000 |
|  | Rolling stock, cargo (net of 10,000 accumulated depreciation) | 55,000 |
|  | Rolling stock, passenger (net of 60,000 accumulated depreciation) | 15,000 |
|  | Rails, gantry towers and infrastructure (net of 15,000 acc. depreciation) | 45,000 |
|  | Station buildings (net of 22,000 accumulated depreciation) | 6,000 |
|  | Office buildings (net of 2,000 accumulated depreciation) | 1,000 |
|  | Other administrative assets (net of 1,000 accumulated depreciation) | 2,000 |
| Total property plant and equipment | | 171,000 |
| … | |  |

#### Cost versus benefit

Drafting a financial report always requires a careful balancing of the costs and benefits associated with detailed information. On the one hand, investors (potential investors) are entitled to adequate financial information that, if provided, lowers their risk and, as a consequence, accounting entity’s risk premium. On the other, published financial reports are not just read by investors. They are also carefully studied by competitors, and other parties, who may use the information to the detriment of the entity (and its investors).

In any event, regardless of the content of the published report, any publicly traded entity should be able (and prepared) to provide information with (at minimum) the level of disaggregation as example two to the professional investing community[**[10]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote10sym).

### Measurement

#### Initial Measurement

IFRS (IAS 16.16[**[11]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote11sym)) provides general guidance on the costs that may be capitalized as property, plant or equipment. They comprise purchase price (including all non-refundable taxes an fees), delivery (including freight, customs fees, duties, insurance and similar costs), installation, break-in and an estimate of disposal costs (if they are expected[**[12]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote12sym)).

#### Subsequent measurement

### Useful life and depreciation period

Depreciation period is determined on the basis of useful life (the term during which the asset will be useful to the entity) not economic life (the term during which the asset is useful generally). In determining useful life, the entity should use its experience and weigh the following factors:

1. Expected usage of the asset,

2. Expected physical wear and tear of the asset,

3. Technical or commercial obsolescence (both internal and external[**[13]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote13sym)),

4. Legal or similar limits on the use of the asset.

### Depreciation method

Under IFRS (IAS 16.60), the depreciation method “shall reflect the pattern in which the asset’s future economic benefits are expected to be consumed by the entity”. Nevertheless, according to Framework 53 “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.” Translated into practice, these two, not fully consistent, sets of instructions mean that the depreciation method may be determined using either a “consumption of benefits” (which usually leads to straight-line depreciation) or a “contribution to earnings” (which often leads to non-linear depreciation) approach. Being that the former is contained in a standard (while he latter in the framework), straight line is, by far, the most common deprecation method.

### Salvage value[[14]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote14sym)

IAS 16.6: The residual value of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

### Capitalized subsequent costs

The 2003 revision to IAS 16 considerably simplified the accounting for costs subsequent to acquisition. Instead of pondering abstract questions such as improved quality, the current approach is straightforward. The entity simply determines whether it replaced a component (IAS 16.43[**[15]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote15sym)). If it did, the cost is capitalized. If it did not, it is expensed.

### Annual review

Under IFRS (IAS 16.51 / 61), each entity is obligated to review depreciation periods, salvage values and depreciation methods (for individual assets, groups or classes) at the end of each financial year-end. If any of these estimates change, the entity shall apply change in estimate accounting (IAS 8.36). If the entity neglects to review these estimates, it would be an error (mistake in applying accounting policies), and it would restate (IAS 8.42) the effected period when the error became material.

### Impairment

At minimum, as part of its annual review, each entity shall evaluate the impairment indicators (IAS 36.12) to determine whether an impairment test should be performed.

### Revaluation model

Although a high quality standard, IAS 16 (as currently in force) contains one serious flaw, in that it allows company’s to choose between two, diametrically opposed models (historical cost and revaluation) putting it in direct conflict with the concept of comparability (between and among entities). Fortunately, the existence of a revaluation model causes few practical complications[**[16]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote16sym) (though it does serve as impetus for vigorous debate at academic conferences and similar get-togethers).

#### Examples

#### Acquisition a disposal

On 1/1/Y1, XYZ purchased a machine for 12,000. It assigned it item number 123, estimated its useful life to be 5 years, salvage value of 2,000 and selected straight-line depreciation. On 12/31/Y5, it sold the machine for 2,500.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Manufacturing machine | | 1.3.3.1\_123 | 12,000 |  |
|  | Trade payable | 2.1.1.1 |  | 12,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 - 5 / 31.12.R1 - 5 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.2.1 | 2,000 |  |
|  | Accumulated depreciation | 1.3.3.1\_ (123) |  | 2,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y5 / 31.12.R5 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.3.1\_ (123) | 10,000 |  |
| Cash in bank | | 1.1.1.2 | 2.500 |  |
|  | Manufacturing machine | 1.3.3.1\_123 |  | 12,000 |
|  | Disposal gain | 6.3.4 |  | 500 |

Same facts, except the entity sold the asset for 1,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y5 / 31.12.R5 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.3.1\_ | 10,000 |  |
| Cash in bank | | 1.1.1.2 | 1,000 |  |
| Disposal loss | | 6.4.8 | 1,000 |  |
|  | Manufacturing machine | 1.3.3.1\_ |  | 12,000 |

Same facts, except the entity paid 2,280 VAT, 500 agent’s fees, 150 shipping, 50 insurance, 75 customs fees and 2,000 to a contractor who installed and broke-in the asset.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Manufacturing machine | | 1.3.3.1\_ | 14,775 |  |
| VAT | | 2.1.2.2.4.1 | 2,280 |  |
|  | Trade payable | 2.1.1.1 |  | 14,280 |
|  | Trade payable | 1.1.1.2 |  | 500 |
|  | Cash in bank | 1.1.1.2 |  | 150 |
|  | Cash in bank | 1.1.1.2 |  | 50 |
|  | Trade payable | 2.1.1.1 |  | 75 |
|  | Trade payable | 2.1.1.1 |  | 2,000 |

Same facts, except it acquired an asset for which VAT was not deductible and the 2,000 was not paid to install the asset, but rather to train company employees in its proper use.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Manufacturing machine | | 1.3.3.1\_ | 15,055 |  |
|  | Trade payable | 2.1.1.1 |  | 14,280 |
|  | Trade payable | 1.1.1.2 |  | 500 |
|  | Cash in bank | 1.1.1.2 |  | 150 |
|  | Cash in bank | 1.1.1.2 |  | 50 |
|  | Trade payable | 2.1.1.1 |  | 75 |
| Training | | 5.3.2.6.2 | 2,000 |  |
|  | Trade payable | 2.1.1.1 |  | 2,000 |

#### Immaterial error

Same facts, except the entity determined, at the end of year 5, the asset to be still useful and decided to not dispose of it. It actually disposed of it a year later for 1,000.

As this error misstated both expenses and income, the entity’s auditor required it to disclose (in its footnotes) that net income reported in year 6 was 1,833 higher than it would have been if no error was corrected, while net income for years 1 through 5 was 167 lower. Since the auditor determined that the error was not material (IAS 8.42), no restatement was required.

#### Material error

Same facts, except the entity sold the asset for 500 on 12/31/Y7. Since useful life was significantly misstated and since the entity committed the same error with several items over several periods, the auditor determined that the error was material and required its correction.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 - 5 / 31.12.R1 - 5 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.3.1\_ | 2,000 |  |
|  | Depreciation | 5.1.3.2.1 |  | 2,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 - 7 / 31.12.R1 - 7 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.2.1 | 1,643 |  |
|  | Accumulated depreciation | 1.3.3.1\_ |  | 1,643 |

Since the error was, from the perspective of the financial report, material, the entity also had to restate the comparative periods contained in its annual report for the year in which the error was discovered.

#### Change in estimate

Same facts, except the entity determined that the asset would be useful 7 years at the end of the second period. Since it presented persuasive evidence that it could not have reasonable foreseen this change earlier, the auditor agreed treat the adjustment as a change in estimate.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y3 - 7 / 1.1.R3 - 7 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.2.1 | 1,500 |  |
|  | Accumulated depreciation | 1.3.3.1\_ |  | 1,500 |

#### Depreciation methods

##### Units of production method[[17]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote17sym)

On 1/1/Y1, XYZ acquired an industrial die for 120,000 and assigned it ID # 36. It determined that it would be able to manufacture 1,200,000 units of product X before die wore out and that it would be sold for scrap for 1,000[**[18]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote18sym). During the first quarter, it manufactured 186,943 products X. On 12/31/R5, it manufactured the 1,200,000**[th]**: product and scraped the die for 725[**[19]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote19sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Die | | 1.3.3.1.4.36 | 120,000 |  |
|  | Trade payable | 2.1.1.1 |  | 120,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.7 | 18,694 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(36) |  | 18,694 |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| 12/31/Y5 / 31.12.R5 | | Post. ref. | Dr. | | Cr. |
| Accumulated depreciation | | 1.3.3.1.4.(36) | | 120,000 |  |
|  | Die | 1.3.3.1.4.36 | |  | 120,000 |
| Petty cash | | 1.1.1.1 | | 725 |  |
|  | Disposal gain | 6.3.4 | |  | 725 |

##### Straight line method

Same facts, except the asset was a hydraulic press. On the basis of expected wear and tear, XYZ estimated its useful life and salvage value to be 15 to 17 years and 20,000. To keep it simple[**[20]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote20sym), it selected straight-line depreciation. It actually sold the asset during year 17 for 18,750.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Acquisition price** | **Salvage value** | **Depreciable value** | **Number of periods** | **Depreciation** |
| **A** | **B** | **C = A - B** | **D** | **E = C / D** |
| 120,000 | 20,000 | 100,000 | 16 | 6,250 |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Press | | 1.3.3.1.4.42 | 120,000 |  |
|  | Trade payable | 2.1.1.1 |  | 120,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.7 | 1,563 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(42) |  | 1,563 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/24/Y17 / 24.6.R17 | | Post. ref. | Dr. | Cr. |
| Cash | | 1.1.1.1 | 18,750 |  |
| Accumulated depreciation | | 1.3.3.1.4.(42) | 100,000 |  |
| Disposal loss | | 6.4.8 | 2,250 |  |
|  | Press | 1.3.3.1.4.42 |  | 120,000 |

Same facts, except at the end of period two, the company determined wear and tear to be significantly less than expected and that the asset would be useful for another 18 years.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y3 / 31.3.R3 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.7 | 1,215 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(42) |  | 1,215 |

Same facts, except at the end of year eight, the company determined that a newly introduced model significantly increased wear and tear on the press and that it would last only another three years. After three years, it was sold it for scrap for 550.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y9 / 31.3.R9 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.7 | 6,528 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(42) |  | 6,528 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y12 / 31.12.R12 | | Post. ref. | Dr. | Cr. |
| Cash | | 1.1.1.1 | 550 |  |
| Accumulated depreciation | | 1.3.3.1.4.(42) | 120,000 |  |
|  | Press | 1.3.3.1.4.42 |  | 120,000 |
|  | Disposal gain | 6.3.4 |  | 550 |

##### Sum-of-the-years' digits method

Same facts, except asset was an integrated circuit fabrication machine. Based on historical experience, XYX estimated that, when new, the circuits would generate direct gross profit (revenue less direct manufacturing overhead) of 100 per unit and that this would decline by 20 per annum. Since it consumed the economic benefits in a non-linear fashion, XYZ elected to use the SYD method. Since, it expected to abandon the asset, it set no salvage. On 12/31/R5, a scraper removed the machine at its own expense.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Year** | **Depreciable value** | **Sum of years’ digest** | **Coefficient** | **Depreciation** |
|  | **A** | **B** | **C** | **D = A (C / B)** |
| 1 | 120,000 | 15[**[22]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote21sym) | 5 | 40,000 |
| 2 | 120,000 | 15 | 5 | 32,000 |
| 3 | 120,000 | 15 | 3 | 24,000 |
| 4 | 120,000 | 15 | 2 | 16,000 |
| 5 | 120,000 | 15 | 1 | 8,000 |
|  |  |  |  | 120,000 |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Fabrication machine | | 1.3.3.1.4.18 | 120,000 |  |
|  | Trade payable | 2.1.1.1 |  | 120,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.7 | 10,000 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(18) |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y5 / 31.12.R5 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.7 | 2,000 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(18) |  | 2,000 |
| Accumulated depreciation | | 1.3.3.1.4.(18) | 120,000 |  |
|  | Fabrication machine | 1.3.3.1.4.18 |  | 120,000 |

Same facts, except direct gross profit declined by 5 per quarter and the company estimated that it would have to pay 50,000[**[23]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote22sym) to have the machine disposed of (it actually paid 48,950).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Quarter** | **Depreciable value** | **Sum of years’ digest** | **Coefficient** | **Depreciation** |
|  | **A** | **B** | **C** | **D = A (C / B)** |
| 1 | 152,497 | 210 | 20 | 14,523 |
| - | - | - | - | - |
| 20 | 152,497 | 210 | 1 | 726 |
|  |  |  |  | 152,497 |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Fabrication machine | | 1.3.3.1.4.18 | 152,497 |  |
|  | Trade payable | 2.1.1.1 |  | 120,000 |
|  | Disposal provision | 2.2.6.1 |  | 32,497[**[24]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote23sym) |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.7 | 14,523 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(18) |  | 14,523 |
| Interest expense | | 6.2.1.2 | 731 |  |
|  | Disposal provision | 2.2.6.1 |  | 731 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y5 / 31.12.R5 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.7 | 726 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(18) |  | 726 |
| Interest expense | | 6.2.1.2 | 1,032 |  |
|  | Disposal provision | 2.2.6.1 |  | 1,032 |
| Accumulated depreciation | | 1.3.3.1.4.(18) | 152,497 |  |
|  | Fabrication machine | 1.3.3.1.4.36 |  | 152,497 |
| Disposal provision | | 2.2.6.1 | 50,000 |  |
|  | Cash | 1.1.1.2 |  | 48,950 |
|  | Disposal gain | 6.3.4 |  | 1,050 |

Same facts, except the company decided to use the machine for 4 years and expected to sell it for 20,000 (it actually sold it for 19,500).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Quarter** | **Depreciable value** | **Sum of years digest** | **Coefficient** | **Depreciation** |
|  | **A** | **B** | **C** | **D = A (C / B)** |
| 1 | 100,000 | 136 | 20 | 11,765 |
| - | - | - | - | - |
| 16 | 100,000 | 136 | 1 | 735 |
|  |  |  |  | 100,000 |
|  |  |  |  |  |

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| --- | --- | --- | --- | --- |
| 12/31/Y4 / 31.12.R4 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.7 | 735 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(18) |  | 735 |
| Accumulated depreciation | | 1.3.3.1.4.(18) | 100.000 |  |
|  | Fabrication machine | 1.3.3.1.4.36 |  | 120,000 |
| Cash | | 1.1.1.2 | 19,500 |  |
| Disposal loss | | 6.4.3 | 500 |  |

##### Declining balance method

Same facts as the first SYD example, except that XYZ decided to use the diminishing balance method (with a coefficient of 2) because it is explicitly mentioned by IFRS[**[25]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote24sym) (IAS 16.62),

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Year** | **Depreciable value** | **Straight-line in percent** | **Coefficient**  **2** | **Declining balance** | **Depreciation** |
|  | **A = A(A-D)** | **B** | **C** | **D = B x C** | **E = A - D** |
| 1 | 120,000 | 20% | 2 | 40% | 48,000 |
| 2 | 72,000 | 20% | 2 | 40% | 28,800 |
| 3 | 43,200 | 20% | 2 | 40% | 17,280 |
| 4 | 25,920 | 20% | 2 | 40% | 10,368 |
| 5 | 15,552 | 20% | 2 | 40% | 6,221 |
|  |  |  |  |  | 110,669 |
|  |  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Fabrication machine | | 1.3.3.1.4.18 | 120,000 |  |
|  | Trade payable | 2.1.1.1 |  | 120,000 |

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| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.7 | 12,000 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(18) |  | 12,000 |

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| --- | --- | --- | --- | --- |
| 12/31/Y5 / 31.12.R5 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.7 | 1,555 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(18) |  | 1,555 |
| Fabrication machine | | 1.3.3.1.4.18 | 110,669 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(18) |  | 120,000 |
|  | Loss on disposal | 6.4.8 |  | 9,331 |

Same facts, except the company set salvage value to 20,000.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Year** | **Depreciable value** | **Straight-line in percent** | **Coefficient**  **2** | **Declining balance** | **Depreciation** |
|  | **A = A(A-D)** | **B** | **C** | **D = B x C** | **E = A - D** |
| 1 | 120,000 | 20% | 2 | 40% | 48,000 |
| 2 | 72,000 | 20% | 2 | 40% | 28,800 |
| 3 | 43,200 | 20% | 2 | 40% | 17,280 |
| 4 | - | - | - | - | 5,920 |
| - | - | - | - | - | - |
|  |  |  |  |  | 100,000 |
|  |  |  |  |  |  |

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| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Fabrication machine | | 1.3.3.1.4.18 | 120,000 |  |
|  | Trade payable | 2.1.1.1 |  | 120,000 |

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| --- | --- | --- | --- | --- |
| 9/30/Y4 / 30.9.R4 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.7 | 1,555 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(18) |  | 1,555 |

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| --- | --- | --- | --- | --- |
| 12/31/Y4 / 31.12.R4 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.7 | 1,254 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(18) |  | 1,254 |

No depreciation recognized during year 5.

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| --- | --- | --- | --- | --- |
| 12/31/Y5 / 31.12.R6 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.3.1.4.(18) | 100,000 |  |
|  | Fabrication machine | 1.3.3.1.4.18 |  | 120,000 |

##### Decelerated depreciation methods

While IFRS does not explicitly disallow their use, auditor skepticism makes decelerated depreciation methods a rarity in practice.

##### Statutory (tax) deprecation

Same facts as the first straight-line example, except the asset fell into category X (as outlined in the legislation of the country where the asset was used) and this statute prescribed a 4-year depreciation period[**[26]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote25sym) (the company’s tax rate was 20%).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Asset | | 1.3.3.1.4.18 | 120,000 |  |
|  | Trade payable | 2.1.1.1 |  | 120,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.7 | 15,625 |  |
|  | Accumulated depreciation | 1.3.3.1.4.(18) |  | 15,625 |
| Deferred tax asset | | 1.5.4.1 | 11,875 |  |
|  | Income tax expense | 7 |  | 11,875 |

#### Capitalized subsequent costs

##### Component

On 1/1/Y1, XYZ acquired machine # 34 for 60,000 (including 10,000 installation). Machine 34 had one component. The entity determined that if it had purchased the component separately (as a spare part), it would have paid 18,000. It also determined that the component’s useful life was 5 years, while that of the asset was 10. Finally, it estimated that it would be able to sell the component and the asset for 3,000 and 8,000 respectively. XYZ used straight-line depreciation for both the component and the asset.

On 1/1/Y6, it replaced the component with an improved unit costing 24,000 (including 4,000 installation). It sold the old component for 2,500. On 12/31/Y9, it disposed of the asset, which it sold for 9,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Manufacturing machine | | 1.3.3.1\_34 | 60,000 |  |
|  | Trade payable | 2.1.1.1 |  | 50,000 |
|  | Installation costs | X |  | 10,000 |

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| --- | --- | --- | --- | --- |
| 12/31/Y1 - 5 / 31.12.R1 - 5 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.2.1 | 6,900 |  |
|  | Accumulated depreciation | 1.3.3.1\_ (34A) |  | 3,400 |
|  | Accumulated depreciation | 1.3.3.1\_ (34) |  | 3,500 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y6 / 1.1.R6 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.3.1\_ (34A) | 17,000 |  |
| Cash in bank | | 1.1.1.2 | 2,500 |  |
| Disposal loss | | 6.4.8 | 500 |  |
|  | Manufacturing machine | 1.3.3.1\_34A |  | 20,000 |
| Manufacturing machine | | 1.3.3.1\_34A | 24,000 |  |
|  | Trade payable | 2.1.1.1 |  | 20,000 |
|  | Installation costs | X |  | 4,000 |

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| --- | --- | --- | --- | --- |
| 12/31/Y6 - 9 / 31.12.R6 - 9 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.2.1 | 7,700 |  |
|  | Accumulated depreciation | 1.3.3.1\_ (34A) |  | 4,200 |
|  | Accumulated depreciation | 1.3.3.1\_ (34) |  | 3,500 |

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| --- | --- | --- | --- | --- |
| 12/31/Y9 / 31.12.R9 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.3.1\_ (34) | 56,000 |  |
| Cash in bank | | 1.1.1.2 | 9,000 |  |
|  | Manufacturing machine | 1.3.3.1\_34 |  | 64,000 |
|  | Disposal gain | 6.3.4 |  | 1,000 |

##### Components

On 1/1/Y1, XYZ acquired a single asset (ID # 123) with two identifiable components for 12,000. Components A, B had useful lives of 2 and 4 years, cost of 3,000 and 4,000 and had salvage values of 200 and 800 respectively. The entire asset (including its components) had a useful life of 8 years and salvage value of 2,000. On 1/1/Y3, XYZ expended 3,500 to replace component A, which it sold for 150. It determined the new component to have a useful life of 2 years and salvage value of 250. On 1/1/Y5, it expended 3,250 to replace component A, which it sold for 300 and 4,750 for component B, which it sold for 1,000. Etc.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Asset / Component** | **Acquisition price** | **Salvage value** | **Depreciable value** | **Useful life** | **Annual depreciation** |
|  | **A** | **B** | **C = A - B** | **D** | **E = C / D** |
| 1/1/Y1 – 12/31/Y2 / 1.1.R1 - 31.12.R2 | | | | | |
| 123A | 3,000 | 200 | 2,800 | 2 | 1,400 |
| 123B | 4,000 | 800 | 3,200 | 4 | 800 |
| 123 | 5,000 | 1,000 | 4,000 | 8 | 500 |
|  | 12,000 | 2,000 | 10,000 |  | 2,700 |
|  |  |  |  |  |  |
| 1/1/Y3 – 12/31/Y4 / 1.1.R3 - 31.12.R4 | | | | | |
| 123A | 3,500 | 250 | 3,250 | 2 | 1,625 |
| 123B | 4,000 | 800 | 3,200 | 4 | 800 |
| 123 | 5,000 | 1,000 | 4,000 | 8 | 500 |
|  | 12,500 | 2,050 | 10,450 |  | 2,925 |
|  |  |  |  |  |  |

##### Repairs and maintenance

Same facts, except the entity (during year one) spent 600 for regular maintenance and the replacement of spare parts that it did not depreciate separately. It performed these operations regularly, every month.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/31/Y1 / 31.1.R1 | | Post. ref. | Dr. | Cr. |
| Maintenance and repairs exp. | | 5.1.3.1.2 | 50 |  |
|  | Spare parts inventory | 1.3.3.1.9 |  | 10 |
|  | Petty cash | 1.1.1.1 |  | 7 |
|  | Cash in bank | 1.1.1.2 |  | 8 |
|  | Trade payables | 2.1.1.1 |  | 10 |
|  | Wages and salaries | 2.1.2.2.1 |  | 15 |

Same facts, except the company performed all its maintenance once per period (the last week of the year[**[26]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote26sym)) and estimated that it would cost 600.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/31 – 11/30/Y1 / 31.1 – 30.11.R1 | | Post. ref. | Dr. | Cr. |
| Maintenance and repairs exp. | | 5.1.3.1.2 | 50 |  |
|  | MRE allowance | 1.3.3.1.(1) |  | 50 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Maintenance and repairs exp. | | 5.1.3.1.2 | 50 |  |
| MRE allowance | | 1.3.3.1.(1) | 550 |  |
|  | Spare parts inventory | 1.3.3.1.9 |  | 120 |
|  | Trade payables | 2.1.1.1 |  | 360 |
|  | Wages and salaries | 2.1.2.2.1 |  | 180 |

Same facts, except the entity actually spent 638.41.

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| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Maintenance and repairs exp. | | 5.1.3.1.2 | 88.41 |  |
| MRE allowance | | 1.3.3.1.(1) | 550.00 |  |
|  | Spare parts inventory | 1.3.3.1.9 |  | 127.68 |
|  | Trade payables | 2.1.1.1 |  | 319.21 |
|  | Wages and salaries | 2.1.2.2.1 |  | 191.52 |

##### Spare parts inventory

On 1/1/Y1, XYZ purchased a machine and spare parts for that machine worth 5,000. The parts were purchased to replace worn-out parts and technological change had no impact on their future utility. On 6/30/R3, it used them to replace parts it did not depreciate separately.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Spare parts inventory | | 1.3.3.1.9 | 5,000 |  |
|  | Trade payables | 2.1.1.1 |  | 5,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/30/Y3 / 30.6.R3 | | Post. ref. | Dr. | Cr. |
| Maintenance and repairs exp. | | 5.1.3.1.2 | 5,000 |  |
|  | Spare parts inventory | 1.3.3.1.9 |  | 5,000 |

Same facts, except the parts were influenced by technological change, which limited their usefulness to 5 years.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Spare parts inventory | | 1.3.3.1.9 | 5,000 |  |
|  | Trade payables | 2.1.1.1 |  | 5,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.2.1 | 1,000 |  |
|  | Spare parts inv.[**[27]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote27sym) | 1.3.3.1.9 |  | 1,000 |

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| --- | --- | --- | --- | --- |
| 6/30/Y3 / 30.6.R3 | | Post. ref. | Dr. | Cr. |
| Maintenance and repairs exp. | | 5.1.3.1.2 | 2,500 |  |
|  | Spare parts inventory | 1.3.3.1.9 |  | 2,500 |

Same facts as the first example, except the parts replaced components.

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| --- | --- | --- | --- | --- |
| 6/30/Y3 / 30.6.R3 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.3.1\_A | 4,000 |  |
| Cash in bank | | 1.1.1.2 | 1,000 |  |
|  | Manufacturing machine | 1.3.3.1\_ |  | 5,000 |
| Manufacturing machine | | 1.3.3.1\_ | 5,000 |  |
|  | Spare parts inventory | 1.3.3.1.9 |  | 5,000 |

##### Enhancements

On 1/1/Y1, XYZ acquired an asset for 500,000, determined it had no components, a useful life of 40 years, salvage value of 50,000 and selected straight-line depreciation. On 12/31/Y5, it spent a total of 100,000 (including 10,000 for installation) to replace a part in order to enhance the performance of the asset. It sold the old part for 20,000.

Since the replacement fulfilled IAS 16.7[**[28]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote28sym) it qualified for capitalization even though it was not carried as a component. Since the entity could not reasonable foresee this replacement[**[29]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote29sym), it was not classified an error (incorrect application of IAS 16.43) but accounted for under IAS 16.70[**[30]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote30sym).

The entity was able to determine that, when new, the part’s value had been 50,000.

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| --- | --- | --- | --- | --- |
| 12/31/Y5 / 31.12.R5 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation[**[31]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote31sym) | | 1.3.3.(1\_) | 5,625 |  |
| Cash in bank | | 1.1.1.2 | 20,000 |  |
| Disposal loss | | 6.4.8 | 24,375 |  |
|  | Manufacturing machine |  |  | 50,000 |
| Component A | | 1.3.3.1\_A | 100,000 |  |
|  | Trade payable | 2.1.1.1 |  | 90,000 |
|  | Wages and salaries | 2.1.2.2.1 |  | 10,000 |

Same facts, except the entity was not able to determine the value of the replaced part had had when new.

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| --- | --- | --- | --- | --- |
| 12/31/Y5 / 31.12.R5 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.3.(1\_) | 5,625 |  |
| Cash in bank | | 1.1.1.2 | 20,000 |  |
| Disposal loss | | 6.4.8 | 64,375 |  |
|  | Manufacturing machine |  |  | 90,000 |
| Component A | | 1.3.3.1\_A | 100,000 |  |
|  | Trade payable | 2.1.1.1 |  | 90,000 |
|  | Wages and salaries | 2.1.2.2.1 |  | 10,000 |

#### Self-manufactured asset[[32]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote32sym)

On 1/1/Y1, XYZ began to construct a self-constructed asset by hiring a systems designer to design a new production line. From 1/1/Y1 to 2/15/Y1, the entity spent 20,000 (paid to a contractor), 10,000 (to rent specialized equipment) and 15,000 (wages and salaries) to clear and prepare space for the new asset[**[33]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote33sym).

On 4/1Y1, the designer finished the design and issued an invoice for 50,000. The same day, XYZ ordered the first three major parts (ID: A, B and C) costing 25,000, 35,000 and 40,000 respectively. The manufacturer of part A’s plant was located in a different country, but since XYZ normally delivered goods to that country, it will-called the part (the round trip cost wages and salaries 500, fuel and consumables 300). The manufacturer of part B delivered the part and XYZ paid a shipper 500 to deliver the third. The parts arrived on 4/4, 4/6 and 4/8.

From 4/4 to 6/30 XYZ’s employees spent time valued at 40,000 (including supervisor’s quality control salaries of 2.500 and 15,000) consuming material valued at 10,000 to install and test the first three parts. During construction, the entity also rented specialized machinery (50,000) and utilize a production machine (whose direct and indirect costs were 30,000**[[34]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote34sym)**). Borrowing costs were capitalized at a rate of 10% (and interest actually paid far exceeded interest capitalized). Etc.

|  |  |  |  |  |
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| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Production line**[[35]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote35sym)** | | 1.3.3.1\_3 | 20,000 |  |
| Production line | | 1.3.3.1\_3 | 10,000 |  |
| Production line | | 1.3.3.1\_3 | 15,000 |  |
| Production line | | 1.3.3.1\_3 | 11,250 |  |
|  | Cash in bank | 1.1.1.1 |  | 20.000 |
|  | Trade payable | 2.1.1.1 |  | 10,000 |
|  | Wages and salaries | 2.1.2.2.1 |  | 15,000 |
|  | Interest expenses | 6.2.1 |  | 10,250 |
|  | Other borrowing costs | 6.2.2 |  | 1,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/1/Y1 / 1.4.R1 | | Post. ref. | Dr. | Cr. |
| Production line | | 1.3.3.1\_3 | 50,000 |  |
|  | Trade payable | 2.1.1.1 |  | 50,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/1/Y1 / 1.4.R1 | | Post. ref. | Dr. | Cr. |
| Production line | | 1.3.3.1\_3 | 50,000 |  |
|  | Trade payable | 2.1.1.1 |  | 50,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/4/Y1 / 4.4.R1 | | Post. ref. | Dr. | Cr. |
| Production line | | 1.3.3.1\_3A | 25,400 |  |
|  | Trade payable | 2.1.1.1 |  | 25,000 |
|  | Cash in bank | 1.1.1.1 |  | 150 |
|  | Wages and salaries | 2.1.2.2.1 |  | 250 |

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| --- | --- | --- | --- | --- |
| 4/6/Y1 / 6.4.R1 | | Post. ref. | Dr. | Cr. |
| Production line | | 1.3.3.1\_3B | 35,000 |  |
|  | Trade payable | 2.1.1.1 |  | 35,000 |

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| --- | --- | --- | --- | --- |
| 4/8/Y1 / 8.4.R1 | | Post. ref. | Dr. | Cr. |
| Production line | | 1.3.3.1\_3C | 40,500 |  |
|  | Trade payable | 2.1.1.1 |  | 35,000 |
|  | Cash in bank | 1.1.1.1 |  | 500 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/30/Y1 / 30.6.R1 | | Post. ref. | Dr. | Cr. |
| Production line | | 1.3.3.1\_3A | 32,500 |  |
| Production line | | 1.3.3.1\_3B | 45,500 |  |
| Production line | | 1.3.3.1\_3C | 52,000 |  |
| Production line | | 1.3.3.1\_3 | 57,500 |  |
|  | Wages and salaries**[[36]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote36sym)** | 2.1.2.2.1 |  | 40,000 |
|  | Raw materials | 1.1.4.1 |  | 10,000 |
|  | Cash in bank | 1.1.1.1 |  | 50,000 |
|  | Cost of sales**[[37]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote37sym)** | 5.1.3.1.5 |  | 7,000 |
|  | Cost of sales | 5.1.3.1.6 |  | 3,000 |
|  | Cost of sales | 5.1.3.2.1 |  | 20,000 |
|  | Interest expenses | 6.2.1 |  | 5,111 |
|  | Other borrowing costs | 6.2.2 |  | 52,389 |

#### Leasehold improvements

On 12/31/Y1, XYZ rented office space for 10 years. During December it spent 100,000 on improvements to the leasehold (new flooring, lighting, IT infrastructure, etc.). It expected to abandon the improvements at the end of the lease term.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Office building | | 1.3.2.3.1 | 100,000 |  |
|  | Trade payable | 2.1.1.1 |  | 100,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.3.8 | 10,000 |  |
|  | Accumulated depreciation | 1.3.2.3.(1) |  | 10,000 |

Same facts, except it agreed to abandon the improvements at the end of the term and the landlord agreed to forgive rent of 5,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Office building | | 1.3.2.3.1 | 100,000 |  |
|  | Trade payable | 2.1.1.1 |  | 100,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.3.8 | 9,500 |  |
|  | Accumulated depreciation | 1.3.2.3.(1) |  | 9,500 |

Same facts, except the agreement was for five years but, at its signing, the company expected it would extend it for another 5.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Office building | | 1.3.2.3.1 | 100,000 |  |
|  | Trade payable | 2.1.1.1 |  | 100,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.3.8 | 10,000 |  |
|  | Accumulated depreciation | 1.3.2.3.(1) |  | 10,000 |

Same facts, except the company could not estimate how may extensions it may make**[[38]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote38sym)**. The improvement, on the other hand, had an useful life of 10 years.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Office building | | 1.3.2.3.1 | 100,000 |  |
|  | Trade payable | 2.1.1.1 |  | 100,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.3.8 | 10,000 |  |
|  | Accumulated depreciation | 1.3.2.3.(1) |  | 10,000 |

#### Lump-sum purchases

On 1/1/Y1, XYZ acquired three delivery vehicles for 1,350,000. If it had acquired them separately, it would have paid 500,000 for vehicle #23, 525,000 for #24 and 475,000 for #25.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Delivery equipment | | 1.3.3.2.1.23 | 450,000 |  |
| Delivery equipment | | 1.3.3.2.1.24 | 472,500 |  |
| Delivery equipment | | 1.3.3.2.1.25 | 427,500 |  |
|  | Trade payable | 2.1.1.1 |  | 135,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.2.3.2.3 | 139,125 |  |
|  | Accumulated depreciation | 1.3.3.2.1.(23) |  | 56,250 |
|  | Accumulated depreciation | 1.3.3.2.1.(24) |  | 47,250 |
|  | Accumulated depreciation | 1.3.3.2.1.(25) |  | 35,625 |

Same facts, except it paid full price for the delivery vehicles, but received a 150,000 discount on a personal automobile that normally sold for 200,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Delivery equipment | | 1.3.3.2.1.23 | 441,176 |  |
| Delivery equipment | | 1.3.3.2.1.24 | 463,235 |  |
| Delivery equipment | | 1.3.3.2.1.25 | 419,118 |  |
| Delivery equipment | | 1.3.3.3.1.12 | 176,471 |  |
|  | Trade payable | 2.1.1.1 |  | 150,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 1.3.3.2.1.23 | 136,397 |  |
| Depreciation | | 5.3.9 | 68,397 |  |
| Depreciation**[[39]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote39sym)** | | 5.3.1.3.001 | 68,397 |  |
|  | Accumulated depreciation | 1.3.3.2.1.(23) |  | 55,147 |
|  | Accumulated depreciation | 1.3.3.2.1.(24) |  | 46,324 |
|  | Accumulated depreciation | 1.3.3.2.1.(25) |  | 34,926 |
|  | Accumulated depreciation | 1.3.3.3.1.(12) |  | 58,824 |

Same facts, except the personal automobile was purchased on 6/15/Y2 and the manager forgot to inform accounting about the oral amendment that served as the basis for determining the automobile’s sales price.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Delivery equipment | | 1.3.3.2.1.23 | 441,176 |  |
| Delivery equipment | | 1.3.3.2.1.24 | 463,235 |  |
| Delivery equipment | | 1.3.3.2.1.25 | 419,118 |  |
| Deferred credit | | 1.1.5.6.24 | 26,471 |  |
|  | Delivery equipment | 1.3.3.2.1.23 |  | 450,000 |
|  | Delivery equipment | 1.3.3.2.1.24 |  | 472,500 |
|  | Delivery equipment | 1.3.3.2.1.25 |  | 427,500 |
| Reversal of prior period error | | Recorded by RM on 6/15/R2 | | |

Since the entity committed error (depending on the circumstances, an oversight, misinterpretation of facts, or fraud) it corrected it retrospectively (IAS 8.43). Since the error did not, however, have a material impact on its consolidated balance sheet, it was not obligated to restate its comparative financial statements**[[40]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote40sym)** (IAS 8.42).

#### Reinstallation, reorganization a relocation

From 1/1/Y1 to 31/1/Y1, XYZ relocated and reinstalled a manufacturing line from country A to country B, incurring costs of 10,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/31/Y1 / 31.1.R1 | | Post. ref. | Dr. | Cr. |
| Relocation, reinstallation | | 5.3.9 | 10,000 |  |
|  | Trade payable | 1.1.1.2 |  | 10,000 |

#### Low value (small) assets

##### Group method

During the average year, XYZ buys a significant number of “small” tools and other individual immaterial items. During Y1, it purchased 1,000 such items for a total of 15,000. Since these tools, in the aggregate, represented a significant sum, XYZ decided not to apply the exception to capitalization (IAS 16.12). Since the tools all had approximately equal useful lives, it applied the group method**[[41]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote41sym)** over 5 years.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Hand tools Y 1 | | 1.3.3.1.3.1 | 14.75 |  |
|  | Cash in bank | 1.1.1.1 |  | 14.75 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/2/Y1 / 2.1.R1 | | Post. ref. | Dr. | Cr. |
| Hand tools Y 1 | | 1.3.3.1.3.1 | 17.50 |  |
|  | Cash in bank | 1.1.1.1 |  | 17.50 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y2 - Y6 / 31.12.R2 – R6 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.1.6 | 3,000 |  |
|  | Accumulated depreciation | 1.3.3.1.3.(1) |  | 3,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y6 / 31.12.R6 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.3.1.3.(1) | 15,000 |  |
|  | Hand tools Y 1 | 1.3.3.1.3.1 |  | 15,000 |

##### Composite method

Same facts, except hammers had a life of 5 years while crescent wrenches only 3.

The entity used the same general procedures except that instead of a simple average life, it determined a weighted average life.

##### Expense an incurred

Same facts, except the entity decided to apply the IAS 16.12 exception.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Hand tools Y 1 | | 5.1.3.1.6 | 14.75 |  |
|  | Cash in bank | 1.1.1.1 |  | 14.75 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/2/Y1 / 2.1.R1 | | Post. ref. | Dr. | Cr. |
| Hand tools Y 1 | | 5.1.3.1.6 | 17.50 |  |
|  | Cash in bank | 1.1.1.1 |  | 17.50 |

##### Removal costs (retirement obligations)

On 1/1/Y1, XYZ leased a plot of land on which it erected an asset number 4 costing 1,000,000. The lease was for 15 years (a term that was not expected to be extended) at the end of which XYZ was obligated to remove the asset and re-cultivate the land at an estimated net cost of 500,000. It determined that the average rate paid on its obligations with a comparable term**[[42]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote42sym)** was 8%.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Provision** | **Rate** | **Interest** |
| **A** | **B = BB+1+ D** | **C** | **D = B \* C** |
| 1 | 157,621**[[43]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote43sym)** | 8% | 12,610 |
| 2 | 170,231 | 8% | 13,618 |
| - | - | - | - |
| 14 | 428,670 | 8% | 34,294 |
| 15 | 462,963 | 8% | 37,037 |
|  | 500,000 |  |  |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Tower | | 1.3.3.1\_4 | 1,157,621 |  |
|  | Trade payable | 2.1.1.1 |  | 1,000,000 |
|  | Disposal provision | 2.2.6.1\_4 |  | 157,621 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.2.1 | 77,175 |  |
| Interest expense**[[44]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote44sym)** | | 6.2.1.2 | 12,610 |  |
|  | Accumulated depreciation | 1.3.3.1\_(4) |  | 77,175 |
|  | Disposal provision | 2.2.6.1\_46 |  | 12,610 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/15 / 31.12.15 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.2.1 | 77,175 |  |
| Interest expense | | 6.2.1.2 | 37,037 |  |
|  | Accumulated depreciation | 1.3.3.1\_(4) |  | 77,175 |
|  | Disposal provision | 2.2.6.1\_4 |  | 37,037 |
| Accumulated depreciation | | 1.3.3.1\_(4) | 1,157,621 |  |
| Disposal provision | | 2.2.6.1\_46 | 500,000 |  |
|  | Tower | 1.3.3.1\_46 |  | 1,157,621 |
|  | Cash in bank | 1.1.1.1 |  | 500,000 |

Same facts, except the asset was land that was not depreciated.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Land | | 1.3.3.1\_4 | 1,000,000 |  |
| Land | | 1.3.3.1\_4A | 157,621 |  |
|  | Trade payable | 2.1.1.1 |  | 1,000,000 |
|  | Disposal provision | 2.2.6.1\_4 |  | 157,621 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.2.1 | 10,508 |  |
| Interest expense | | 6.2.1.2 | 12,610 |  |
|  | Accumulated depreciation | 1.3.3.1\_(4A) |  | 10,508 |
|  | Disposal provision | 2.2.6.1\_46 |  | 12,610 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/15 / 31.12.15 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.2.1 | 10,508 |  |
| Interest expense | | 6.2.1.2 | 37,037 |  |
|  | Accumulated depreciation | 1.3.3.1\_(4) |  | 10,508 |
|  | Disposal provision | 2.2.6.1\_4 |  | 37,037 |
| Accumulated depreciation | | 1.3.3.1\_(4A) | 157,621 |  |
| Disposal provision | | 2.2.6.1\_46 | 500,000 |  |
|  | Tower | 1.3.3.1\_46A |  | 157,621 |
|  | Cash in bank | 1.1.1.1 |  | 500,000 |

Same facts as the first example, except that, at the end it the fifth year, XYZ determined that the applicable discount rate increased to 9% and applied IFRIC 1 (which obligated the entity to review both the obligation and discount rate each period).

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Provision** | **Rate** | **Interest** |
| **A** | **B = BB+1+ D** | **C** | **D = B \* C** |
| 6 | 211,206**[[45]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote45sym)** | 9% | 19,009 |
| 7 | 230,214 | 9% | 20,719 |
| - | - | - | - |
| 14 | 420,840 | 9% | 37,876 |
| 15 | 458,716 | 9% | 41,284 |
| 16 | 500,000 |  |  |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y5 / 31.12.R5 | | Post. ref. | Dr. | Cr. |
| Disposal provision | | 2.2.6.1\_4 | 20,391**[[46]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote46sym)** |  |
|  | Tower | 1.3.3.1\_4 |  | 20,391 |

Same facts, except (due to a change in environmental law) the originally estimate was too low. The revised estimate was 250,000 higher.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Provision** | **Rate** | **Interest** |
| **A** | **B = BB+1+ D** | **C** | **D = B \* C** |
| 6 | 316,808**[[47]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote47sym)** | 9% | 28,513 |
| 7 | 345,321 | 9% | 31,079 |
| - | - | - | - |
| 14 | 631,260 | 9% | 56,813 |
| 15 | 688,073 | 9% | 61,927 |
| 16 | 750,000 |  |  |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y5 / 31.12.R5 | | Post. ref. | Dr. | Cr. |
| Tower | | 1.3.3.1\_4 | 85,211 |  |
|  | Disposal provision | 2.2.6.1\_4 |  | 85,211 |

### Capitalized interest (borrowing costs)

**As of 1/1/2009, IAS 2**3**requires interest capitalization from all entities. The previous option of expensing interest as incurred has been disallowed.**

This requirement applies to all qualifying assets (“asset[s] that necessarily [take] a substantial period of time to get ready for [their] intended use or sale”). In other words, it applies to self-manufactured assets and projects for sale or lease (rent).

Interest may not be capitalized (IAS 23.7) to inventory (unless the substantial period of time criteria is met) or assets that are ready for their intended use (even if that use has not yet begun).

#### Borrowing costs

IAS 23.5: Borrowing costs may include:

(a) interest on bank overdrafts and short-term and long-term borrowings;

(b) amortisation of discounts or premiums relating to borrowings;

(c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;

(d) finance charges in respect of finance leases recognised in accordance with IAS 17 Leases; and

(e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

#### Capitalizable borrowing costs

##### Specific borrowings

If an entity arranges specific financing for a specific qualifying asset, it capitalizes the interest paid during the period(s) when costs to complete (the asset) are being accrued.

##### General borrowings

If an entity does not arrange specific financing for a specific qualifying asset, it is still obligated (IAS 23.14) to capitalize interest. The only difference is that rather than capitalizing the interest actually paid (as with specific borrowings), it calculates capitalized interest by applying the weighted average rate on (qualifying) borrowings to the costs being incurred during the acquisition period(s).

##### Capitalization ceases

Capitalization ceases (IAS 23.23) when the asset is ready for its intended use. IAS 22 explicitly states that the entity should not extend the capitalization period because “routine administrative work” (such as final building inspection and approval) has yet to be completed. Similarly, the capitalization period may not including finishing (for example painting the façade, hanging banners, installing mastheads, landscaping and other tasks not directly effecting the functionality of the asset) and must be suspended (IAS 23.22) if work is suspended (costs to complete cease to accrue) such as when construction is stopped during winter.

##### Specific borrowings

On 1/1/Y1, XYZ began constructing production facility 6. It borrowed 2,000,000 (the total estimated cost of the building) at 6%. It agreed to make monthly, interest-only payments and to pay off the loan on 12/31/Y4. It decided to reinvest the portion of the loan that was not needed (at a 6.5% annual rate).

By 1/15/R3, construction progressed to the point where it was possible to move in and begin to utilize the facility. The building was given final approval on 1/31/R3, the façade completed on 2/28/Y3 and, on the same day, XYZ finally moved in.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 2,000,000 |  |
|  | Loan | 2.2.3\_6 |  | 2,000,000 |
| Investment | | 1.1.2.2 | 1,900,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 1,900,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/31/Y1 / 31.1.R1 | | Post. ref. | Dr. | Cr. |
| Production facility | | 1.3.2.1\_6 | 100,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 100,000 |
| Production facility**[[48]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote48sym)** | | 1.3.2.1\_6 | 10,000 |  |
|  | Cash in bank | 2.2.3\_6 |  | 10,000 |
| Cash in bank | | 2.2.3\_8 | 10,292 |  |
|  | Interest revenue | 6.1.1 |  | 292 |
|  | Production facility | 1.3.2.1\_6 |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/28/Y1 / 28.2.R1 | | Post. ref. | Dr. | Cr. |
| Production facility | | 1.3.2.1\_6 | 110,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 110,000 |
| Production facility | | 1.3.2.1\_6 | 10,000 |  |
|  | Cash in bank | 2.2.3\_6 |  | 10,000 |
| Cash in bank | | 2.2.3\_8 | 9,696 |  |
|  | Production facility | 1.3.2.1\_6 |  | 9,696 |

Etc.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y2 / 31.12.R2 | | Post. ref. | Dr. | Cr. |
| Production facility | | 1.3.2.1\_6 | 80,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 80,000 |
| Production facility | | 1.3.2.1\_6 | 10,000 |  |
|  | Cash in bank | 2.2.3\_6 |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/31/Y3 / 31.1.R3 | |  | Dr. | Cr. |
| Production facility | | 1.3.2.1\_6 | 20,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 20,000 |
| Production facility | | 1.3.2.1\_6 | 5,000 |  |
| Interest expense | | 6.2.1 | 5,000 |  |
|  | Cash in bank | 2.2.3\_6 |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/28/Y1 / 28.2.R1 | | Post. ref. | Dr. | Cr. |
| Interest expense | | 6.2.1 | 10,000 |  |
|  | Cash in bank | 2.2.3\_6 |  | 10,000 |

##### General borrowings

Same facts, except the capitalizing entity is a subsidiary of a multinational company. This subsidiary (X) is 100% held by its parent (XYZ Holding). During the construction period XYZ (the consolidated entity) had the following loan structure:

Loan 1: from 1/1/Y1 to 6/30Y1, subsidiary X paid 8% interest on a 2.000.000 loan. This loan was secured by its assets (assets owned by it as a legal entity) and was used to finance working capital.

Loan 2: from 1/1/Y1 to 12/31/Y1, subsidiary X paid 7% interest on a 1.000.000 loan. This loan was guaranteed by the holding only. It was used to finance the construction of a warehouse.

Loan 3: from 1/1/Y1 to 12/31/Y1, subsidiary X paid 6% interest on a 3.000.000. This loan was guaranteed by the holding, which also pledged the assets of several consolidated entities as collateral. Subsidiary X used this loan for general business purposes.

Loan 4: from 1/1/Y1 to 12/31/Y1, XYZ Holding paid 5% interest on a 30.000.000 loan, which was backed by the full faith and credit of the entire holding and had the highest priority at liquidation.

Loan 5: from 1/1/Y1 to 12/31/Y1, XYZ paid 6% on a 15.000.000 loan for which it pledged a production facility owned by (on a legal entity basis) subsidiary Y.

Loan 6: from 1/1/Y1 to 12/31/Y2, subsidiary Y paid 7% on a 5.000.000 loan, which was secured by the same production facility on a subordinated basis. The loan was used to finance working capital.

Loan 7: from 1/1/Y2 to 12/31/Y2, subsidiary Y paid 6% on a 2.000.000 loan guaranteed by XYZ Holding. The loan was also used to finance working capital.

Loan 8: from 1/1/Y2 to 12/31/Y2, subsidiary Z paid 8% on a 4.000.000 loan, secured by a retail outlet chain, which it fully owned (as a legal entity). The loan was used for general business purposes.

From 1.1.R1 to 30.6.R1, the cost of construction to subsidiary X was 5.000.000, from 1.7.R1 do 31.12.R1 it was 3.000.000 and from 1.1.R2 to 31.12.R2 it was 10,000,000.

**From 1/1/Y1 to**3**/**3**0/Y1** subsidiary X capitalized 274,000 = 5.000.000 x 5.48%**[[49]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote49sym)**.

**From 7/1/Y1 to 12/**3**1/Y1** subsidiary X capitalized 161,250 = 3.000.000 x 5.38%**[[50]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote50sym)**.

**From 1/1/Y2 to 12/**3**1/Y2** subsidiary X capitalized 240,000 = 2.000.000 x 6%**[[51]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote51sym)**.

### Asset impairment

If an asset’s (group’s**[[52]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote52sym)**) value declines by an amount to large to capture with a change in depreciation policy**[[53]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote53sym)**, the entity applies IAS 36.

#### Impairment test

At the end of each reporting period**[[54]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote54sym)**, the entity assesses whether is any indication that the asset (group) is impaired. If so, it performs an impairment test. If the test is positive, it writes the asset (group) down. The indications (IAS 36.12) are:

1. A significant (unexpected) decline in asset’s (group’s) market value has occurred.

2. A significant adverse external change (technological, market, economic, legal, regulatory environment, etc.) has occurred or is expected**[[55]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote55sym)**.

3. A significant adverse internal change to asset (obsolescence**[[56]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote56sym)**, physical damage, theft, etc.) has occurred or is expected.

4. A significant adverse change in company’s operations (asset idling, asset disposal, business restructuring or reorganization, etc.) has occurred or is expected.

5. The return on the asset (group) was below budget or a decline in its economic performance is expected.

6. The cost of acquiring the asset significantly above budget**[[57]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote57sym)**.

7. The useful life is reassessed to finite**[[58]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote58sym)**.

8. Entity’s market capitalization declined below the carrying amount (book value) of the net assets.

9. A change in market interests relates caused a material decline in the asset’s (group’s) recoverable amount.**[[59]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote59sym)**

#### Recoverable amount

Recoverable amount is the **higher** of an asset’s (group’s) fair value less cost to less **or** value-in-use**[[60]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote60sym)**.

##### Examples

XYZ provides intercity bus transport. On 1/1/Y1, it purchased bus # 123 for 1,400,000 for the City A : City B line. The asset had a useful life of 10 years, salvage value of 200,000 and the company selected (to simplify this example) straight-line depreciation.

Prior to the end of year 2, the company learned that a high speed rail link between A and B was being put into service on 1/1/Y3 and decided to reassign the bus to line A : C (which was approximately as long as A : B). Since bus 123 generated its own identifiable cash flow, and because A : C was less frequently traveled, a significant adverse external change to the asset occurred, and the company was obligated to test for impairment.

As a first step, it confirmed that the remaining useful life (based on distance traveled) was still valid. Next management estimated**[[61]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote61sym)** that if the asset were fully utilized, it would bring in 600,000 annually, if partially, 350,000 and if under, 230,000. Finally it assigned probabilities of 20%, 40% and 40% to each outcome. Next, the accounting department**[[62]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote62sym)** calculated expenditures (250,000, 230,000 and 220,000) determined that 8-year government obligations were trading at 4%. Finally, the company adjusted the cash flow for risk and discounted this risk adjusted cash flow using the risk free rate:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **A** | **B** | **C = A - B** | **D** | **E = C x D** |
| 600,000 | 250,000 | 350,000 | 0.20 | 70,000 |
| 350,000 | 230,000 | 120,000 | 0.40 | 48,000 |
| 230,000 | 220,000 | 10,000 | 0.40 | 4,000 |

|  |  |  |  |
| --- | --- | --- | --- |
| **Present value discounts with risk free rate** | | | |
| **A** | **B** | **C** | **D = B / (1 + C%)[A]:** |
| 1 | 122,000 | 0.04 | 117,308 |
| 2 | 122,000 | 0.04 | 112,796 |
| - | - | - | - |
| 8 | 122,000 | 0.04 | 89,144 |
| 8 | 200,000 | 0.04 | 146,138 |
|  |  |  | 967,533 |
|  |  |  |  |

Since value-in-use was lower than the carrying amount, the company also determined that similarly outfitted, two-year-old buses from the same manufacturer commonly sell for 990,000**[[63]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote63sym)** and that if it were to sell this asset, transactions costs would be 10,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Bus | | 1.3.3\_123 | 1,400,000 |  |
|  | Trade payable | 2.1.1.1 |  | 1,400,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.2.1 | 120,000 |  |
|  | Accumulated depreciation | 1.3.3\_(123) |  | 120,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y2 / 31.12.R2 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.2.1 | 120,000 |  |
|  | Accumulated depreciation | 1.3.3\_(123) |  | 120,000 |
| Impairment loss | | 6.4.3 | 180,000 |  |
|  | Bus | 1.3.3\_123 |  | 180,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y3 / 31.12.R3 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.2.1 | 97,500 |  |
|  | Accumulated depreciation | 1.3.3\_(123) |  | 97,500 |

Same facts, except during year three the bus was relatively often fully occupied, always at partially occupied and it was probable that this usage pattern would continue for the remainder of its useful life. Value-in-use was thus re-estimated and determined to be 1,596,809.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y3 / 31.12.R3 | | Post. ref. | Dr. | Cr. |
| Depreciation**[[64]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote64sym)** | | 5.1.3.2.1 | 120,000 |  |
|  | Accumulated depreciation | 1.3.3\_(123) |  | 120,000 |
| Bus | | 1.3.3\_123 | 180,000 |  |
|  | Impairment loss | 6.4.3 |  | 180,000 |

Same facts, except management put in the effort to create a somewhat more realistic budget (as understood by IAS 36.30**[[65]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote65sym)**).

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Per** | **Receipts** | **Expend.** | **Net CF** | **Probability** | **Adjusted CF** | **Pres. value** |
| **A** | **B** | **C** | **D = B - C** | **E** | **F = D x E** | **G = D / (1+RF)[A]:** |
|  | 625,000 | 250,000 | 375,000 | 0.35 | 131,250 |  |
|  | 585,000 | 230,000 | 355,000 | 0.30 | 106,500 |  |
|  | 315,000 | 220,000 | 95,000 | 0.20 | 19,000 |  |
|  | 265,000 | 215,000 | 50,000 | 0.10 | 5,000 |  |
|  | 225,000 | 215,000 | 10,000 | 0.05 | 500 |  |
| 1 |  |  |  | 3.00%\* | 262,250 | 254,612 |
|  | 570,000 | 245,000 | 325,000 | 0.30 | 97,500 |  |
|  | 380,000 | 225,000 | 155,000 | 0.25 | 38,750 |  |
|  | 275,000 | 220,000 | 55,000 | 0.25 | 13,750 |  |
|  | 260,000 | 215,000 | 45,000 | 0.15 | 6,750 |  |
|  | 220,000 | 215,000 | 5,000 | 0.05 | 250 |  |
| 2 |  |  |  | 3.25%\* | 157,000 | 147,272 |
|  | 545,000 | 240,000 | 305,000 | 0.25 | 76,250 |  |
|  | 360,000 | 220,000 | 140,000 | 0.20 | 28,000 |  |
|  | 260,000 | 220,000 | 40,000 | 0.30 | 12,000 |  |
|  | 260,000 | 215,000 | 45,000 | 0.20 | 9,000 |  |
|  | 190,000 | 215,000 | (25,000) | 0.05 | (1,250) |  |
| 3 |  |  |  | 3.75%\* | 124,000 | 111,034 |
|  | 510,000 | 230,000 | 280,000 | 0.20 | 56,000 |  |
|  | 340,000 | 220,000 | 120,000 | 0.15 | 18,000 |  |
|  | 250,000 | 215,000 | 35,000 | 0.35 | 12,250 |  |
|  | 230,000 | 215,000 | 15,000 | 0.20 | 3,000 |  |
|  | 190,000 | 215,000 | (25,000) | 0.10 | (2,500) |  |
| 4 |  |  |  | 4.50%\* | 86,750 | 72,745 |
|  | 480,000 | 230,000 | 250,000 | 0.15 | 37,500 |  |
|  | 235,000 | 220,000 | 15,000 | 0.10 | 1,500 |  |
|  | 230,000 | 215,000 | 15,000 | 0.40 | 6,000 |  |
|  | 230,000 | 215,000 | 15,000 | 0.25 | 3,750 |  |
|  | 190,000 | 215,000 | (25,000) | 0.10 | (2,500) |  |
| 5 |  |  |  | 5.50%\* | 46,250 | 35,387 |
|  |  |  |  |  |  |  |
| 6 |  |  |  | 6.00%\* | 33,000**[[1]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote66sym)** | 23,264 |
| 7 |  |  |  | 6.25%\* | 23,546 | 15,404 |
| 8 |  |  |  | 6.75%\* | 16,801 | 9,963 |
|  |  |  |  |  |  | 669,681 |
|  | \* Risk free rate | | | | |  |

Same facts, except the bus was used in a city’s public transportation system.

Since the bus did not have its own, identifiable cash flows (the city uses coupons instead of direct payment to the driver) and since the reallocation of a single bus to a different line is not a significant event, no impairment test was performed.

#### Aggregating and disaggregating

Same facts, except XYZ provided public transport services to three cities. At year-end, it determined that the return on cities A and B was 20% and city C 30% below budget.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Test results** | **A** | **B** | **C** | Σ |
|  | **X 1,000,000** | | | |
| Carrying amount | 100 | 110 | 90 | 3**00** |
| Recoverable amount | 110 | 130 | 80 | 3**20** |
|  | 10 | 20 | (10) | **20** |
|  |  |  |  |  |

It recorded an impairment charge of 10,000,000 for cash generating unit C**[[66]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote67sym)**.

Same facts, except, instead of entering into individual agreements with each city, the company entered into a single agreement with the county. The agreement had explicit terms that required a minimum level of service in each city.

Since the agreement stipulated that city C cannot be terminated without voiding the entire contract, the company was able (IAS 36.68.example) to aggregate the three groups.

**Assets to be disposed of**

Same facts, except the company decided to sell the assets.

After management with sufficient authority decided to sell, the assets were written down to fair value less cost to sell (value-in-use is, at this point, zero). From the day potential buyers were informed about this pending sale, the assets were disclosed under the balance sheet heading „assets to be disposed of**[[67]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote68sym)**“.

[**1**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote1anc): If an entity’s operating cycle clearly differs, it can (IAS 1.66.a and 68) select a different than 12-month “annual” period. It must (IAS 1.36), however, disclose this fact, explain its reasons and provide a disclaimer clearly explaining that this choice makes it incomparable with entities using a 12-month year. Consequently, it is seldom done in practice.

[**2**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote2anc): Resourcess should be recognized separately from the related land. If the land and resource cannot be separated, they should be recognized as **depreciable land** (IAS 16.59).

[**3**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote3anc): Approximately 18% of IFRS’s text (a number that more than double if implementation and other related guidance was included) is devoted to the accounting for financial instruments. In comparison, production and fixed assets together do not even occupy 3%, while revenue (the most important topic of all, for the average company) 1.2%.

[**4**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote4anc): This chapter is currently under review.

[**5**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote5anc): Even though entities are free to use judgment in classifying their assets, **overly aggregated classification**is one of the commonest mistakes in applying IFRS.

[**6**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote6anc): The transfer would be treated as a change in estimate.

[**7**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote7anc): This example assumes that the company keeps its IFRS book on a world-wide basis. If the company had decided to keep it by **manufacturing facility** (for example if that facility was a separate segment), account**1**.1.3.3.1.5.1.123 not 1.3.3.1.5.**1**.1.123 would be used.

As discussed in the introduction to this publication, the entire concept of a firmly defined chart of accounts, with firmly assigned account numbers, is reminiscent of the days where accounts were kept by hand. Today, when even basic financial information systems reside atop robust databases, forcing users to record and access date using such a ridged and inflexible format is an anachronism. Nevertheless, since many national accounting systems are procedural in nature, this is the approach that seems “natural” to many accountants.

If such an approach were to be used, rather than attempting this level of disaggregation in the financial accounting system, it would be more practical to initially record and store individual data items in the managerial (costing) system. Information necessary for an IFRS report, would then be drawn from this system.

In any event, since IFRS does not prescribe any specific accounting procedures, the final selection of a workable model should be based on the judgment of each individual entity and its management.

[**8**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote8anc): While it is possible to account for items such as personal computers using a group or composite method, these assets are often material on the basis of the information they contain. Since it is necessary to keep careful track of them throughout their useful lives (regardless of their monetary value), it is common to account for them as separate asset items, even if their actual acquisition cost is quite low.

[**9**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote9anc): For brevity’s sake, only the PP&E section is presented.

[**10**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote10anc): Every publicly traded company wanting to attract and keep analyst coverage will provide that community (which is ethically and, occasionally, legally bound to confidentiality) significantly more detailed information than the general investing public.

**IMPORTANT:** The above should, in no case, be interpreted to mean that a company is entitled to selectively disseminate market-moving information. Such an act would, in most countries, be a violation of law. However, since insider-trading legislation is not the topic of this publication, a discussion of the nature of information that may and may not be selectively provided is beyond its scope.

[**11**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote11anc): IAS 16.17 also provides several additional examples of capitalizable costs.

[**12**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote12anc): IAS 16.18 (somewhat cryptically) states “An entity applies IAS 2 Inventories to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period”. This requirement simply means that unless disposal costs are capitalized as PP&E at the moment of acquisition, they are to included in cost of sales (what inventory becomes as it is sold) in each period that the asset is used (in production).

[**13**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote13anc): Technological changes can be external (in that the entity reacts to innovation on the part of competitors) or internal (in that the entity’s own research and development can be the drivers of innovation).

[**14**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote14anc): To avoid confusion with the term “residual value” (guaranteed residual value) as used in IAS 17, the term salvage value is used in this publication.

[**15**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote15anc): IAS 16.43: Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

[**16**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote16anc): According to studies ([**HEastmanFVMEducationAmsJune2008.ppt**](http://www.gaap.cz/main_page/link-to-IASB-ppt.htm)), less than 3% of IFRS companies choose to revalue their PP&E.

[**17**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote17anc): Because it most accurately represents economic reality, the units of production (a.k.a. sum-of-the-units) method is preferred. Unfortunately, since the performance of most assets cannot be measured sufficiently accurately, its use is fairly rare in practice.

[**18**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote18anc): Since the salvage value was insignificant, the company elected (IAS 16.53) to set it at zero.

[**19**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote19anc): Since this selling price was not material, it was not necessary to correct the erroneous salvage value.

[**20**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote20anc): Aside from mathematical simplicity, straight-line also has the advantage that it is seldom questioned (by management, auditors or regulators) and, as long as it is regularly reviewed, is as accurate as other methods (excepting units of production).

[**21**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote21anc): Sum of the years’ digest: 5+4+3+2+1=15

[**22**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote22anc): The company decided to amortize the interest on an annual basis and simply accrue it to individual quarters. Since this did not represent a significant misstatement, its auditor did not object.

[**23**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote23anc): 50,000/(1+9%)**[5]**: = 32,497; 9% x 32,497 = 2,925; 2,925 / 4 = 731

[**24**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote24anc): Although mentioned by IFRS, this method has its disadvantages. Primarily, since (even if used with the most common coefficient of 2) it significantly accelerates depreciation, it is a popular choice if the intent it to create hidden reserves. This implies that gaining an auditor’s unqualified agreement is often a complicated and time-consuming endeavor. Also (as seen in the example), it is not appropriate to situations where no salvage value is set. Finally, if a salvage value is set, it not only accelerates depreciation, but also shortens useful life. For these reasons, it is relatively rare in practice.

[**25**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote25anc): Which, coincidentally, was the same as tax deprecation for this class of assets.

[**36**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote26anc): Under IAS 37, company cannot recognize provisions for repairs and maintenance, allowances are not, however, disallowed.

[**27**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote27anc): This entity can also be made against an accumulated depreciation account.

[**28**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote28anc): “(a) it is probable that future economic benefits associated with the item will flow to the entity; and (b) the cost of the item can be measured reliably.”

[**29**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote29anc): This example is based on an actual case in which a change in legislation lead to a change in the way a building was used, rendering its existing elevator unfit (to slow, insufficient lifting capacity).

[**30**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote30anc): IAS 16.70 If, under the recognition principle in paragraph 7, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of a replacement for part of the item, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.

[**31**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote31anc): Since it did not depreciate this part as a component, only 5,625 (of a total of 56,250) of the entire assets accumulated depreciation is attributable to this part. If it had depreciated it separately, at minimum 30,000 would have been attributable. The difference makes the disposal loss abnormally large, and this fact should be disclosed in the footnotes.

[**32**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote32anc): For clarity’s sake, all the journal entries are simplified as much as possible.

[**33**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30#sdfootnote33anc): The entity also estimated that depreciation, utilities and other related indirect costs were approximately 1,000. Management, however, decided that the cost of exactly calculating these costs (the salaries of the people doing the calculations) would exceed the benefits (a precisely measured acquisition cost) and decided to expense them as incurred. Since the amounts involved were not material, the auditor agreed to this approach.

**[34](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote34anc)**: In this case, since a material amount was involved, after receiving auditor approval, the entity decided to calculate and capitalize this amount.

**[35](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote35anc)**: Since it considered it to be a single integrated unit, the company decided to record the entire line as a single asset. It carried the individual robots, conveyer belts and other machines as components.

Similarly, the line was classified Assets / PP&E / Equipment / Manufacturing / Division 6 (measuring equipment) / Product type 8 (laboratory equipment) / Production facility 4 (City B) / Line 3 implying account number 1.3.3.1.6.8.4.3. Alternatively, the company could have used a financial system built on a robust database, in which case the IT would have assigned the asset a number autonomously.

**[36](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote36anc)**: Although the entity periodically paid these wages and salaries, for simplicity, they are presented here as a single liability. Other amounts are treated similarly.

**[37](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote37anc)**: Since the entity accounted for its serial manufacturing as part of its (managerial) costing system, it did not track costs by function on its balance sheet. As a result, it had to back them out of Cost of Sales.

**[38](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote38anc)**: It was, however, able to determine that the term was not „major“ (IAS 17.10).

**[39](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote39anc)**: Since employee number 001 used the vehicle for business and personal, a portion of the related expenses were classified as part of his compensation (fringe benefits).

**[40](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote40anc)**: Whether it had to correct and re-file its (and the employee’s) tax return, depends on the tax legislation of the country where it (the employee) had tax residency. If so, under IFRS it would also have had to correct its tax expenses, income after taxes and deferred taxes.

**[41](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote41anc)**: Some national accounting systems (primarily in continental Europe) require a formal „inventory“ of all assets, including low-value items. Consequently, companies operating in these economies often expense overly aggressively (a distortion exacerbated by the interrelation of tax and financial accounting in many countries).

If small assets, as a group, represent a material amount, expensing them would be a misinterpretations of facts (IAS 8.5) and an error (IAS 8.41-48). Similarly, intentionally aggregating / disaggregating assets to avoid capitalization (for example, to conform to local law or custom) would also a violation of IFRS (IAS 8.7-12). Unfortunately, even though it should be self evident, this fact must occasionally often be (vigorously) explained to auditors (even those employed in national members firms in a “big 4” network) whose expertise primarily involves interpreting and applying national standards, rather than IFRS.

**[42](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote42anc)**: Instead of the incremental borrowing rate (as required, for example, by IAS 17), the present value of a disposal reserve is calculated using the current borrowing rate (IAS 37.47), which is generally much easier to determine.

**[43](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote43anc)**: 500,000 / (1+8%)**[15]**: = 157,621

**[44](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote44anc)**: This “interest” may not (IFRIC 1.8) be capitalized (IAS 23).

**[45](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote45anc)**: 500,000 / (1+9%)**[10]**: = 211,206

**[46](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote46anc)**: 231,597 - 211,206 = 20,391

**[47](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote47anc)**: 750,000 / (1+9%)**[10]**: = 316,808

**[48](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote48anc)**: In the case of specific borrowings, if the entity invests the funds prior to using them to finance the project it is obligated (IAS 23.13) deduct interest earned from interest paid.

**[49](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote49anc)**: The weighted average of loans 1, 3, 4 and 5 is 5.48%.

**[50](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote50anc)**: The weighted average of loans 3, 4 and 5 is 5.38%.

**[51](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote51anc)**: While the entity would (mathematically) capitalize 600,000 (10.000.000 x 6%), since interest of 240,000 only was actually paid, it only capitalizes that amount.

**[52](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote52anc)**: IAS 36.66 discusses “cash generating units” (the lowest possible level, where net cash flow is determinable). If an individual asset has its own identifiable cash inflows and outflows, that asset is a cash-generating unit. If not, the cash-generating unit is the next smallest grouping of assets, with identifiable receipts and expenditures. Since the term “cash-generating unit” and “group of cash-generating unit” (IAS 36.67 example) is somewhat cumbersome, they are simply referred to as “assets” or “asset groups”.

**[53](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote53anc)**: Relatively small declines can be captured by accelerating depreciation, shortening the period and/or decreasing salvage value.

**[54](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote54anc)**: Semiannually, quarterly or monthly, depending on the entity’s reporting periodicity.

**[55](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote55anc)**: Generally, a probability approaching 50% is sufficient to trigger a test.

**[56](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote56anc)**: While similar to a technological change in the previous indicator, obsolescence is, however, the result of the entity’s own activities. For example, if the entity acquires new software that makes half of its administrative staff redundant, it will test all of the assets used by that staff (computers, furniture even office space) since it is likely it will be disposed of (idled) once that staff is dismissed.

**[57](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote57anc)**: While not explicitly addressed by IAS 36 (it is addressed by US GAAP, FAS 144), this is an issue at many companies and should, nevertheless, be considered.

**[58](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote58anc)**: Since only they can have indefinite lives, this item only applies to intangible assets.

**[59](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote59anc)**: Applicable to assets where recoverable amount was determined as value-in-use only.

**[60](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote60anc)**: Since value-in-use can be determined using internal information (which is generally more readily available), an impairment test is generally performed by first comparing the asset’s (group’s) carrying amount (net book value) to its value-in-use. Only if NBV < value-in-use, is it compared with fair value less cost to sell. This approach should not, however, be confused with US GAAP’s “two-step test” (which was considered and explicitly rejected by the IASB).

Also, since value-in-use is generally based on best use by a particular entity, it tends to be lower than fair value less cost to sell, which generally reflects best use by the entity that can use the asset in the best way.

**[61](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote61anc)**: Since accountants have insufficient information (and often insufficient qualifications), to estimate future cash flows, IAS 36.33 explicitly states that this is **management’s** best estimate. “Management” is understood to the person (group) that was responsible for acquiring the asset and/or is responsible for assigning it to its current use. If this estimate was made by an accounting employee lacking such authority, the entity committed an error (a mistake in applying accounting policies, IAS 8.5.definitions) that will likely result in a qualified auditor’s opinion.

**[62](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote62anc)**: In contrast to cash inflows (which cannot be estimated by extrapolating historical data), cash outflows and can be determined on the basis of historical data for any given level of receipts (as long as reasonable adjustments – the cost of relocating the asset, increased/decreased MRE, etc. – are made). Thus, while it would be procedurally invalid, for the accounting department to estimate receipts, determining expenditures is common accounting practice.

**[63](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote63anc)**: IFRS (IAS 36.27) requires fair value to “reflect the amount that an entity could obtain, at the end of the reporting period, from the disposal of the asset in an arm’s length transaction between knowledgeable, willing parties, after deducting the costs of disposal.” Nevertheless, the entity’s auditor was satisfied that the average of three offers to sell (made by three independent used bus dealers) a comparable bus (after an estimate of the dealers’ gross profit was deducted) provided sufficient evidence of what willing parties would pay in an arm’s length transaction.

**[64](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote64anc)**: Since the change in recoverable amount was made prior to the end of the subsequent period, the entity simply reinstated its original depreciation period. Had it occurred after, it would have treated this change in depreciation as a change in estimate.

**[65](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote65anc)**: The following elements shall be reflected in the calculation of an asset’s value-in-use:

(a) an estimate of the future cash flows the entity expects to derive from the asset;

(b) expectations about possible variations in the amount or timing of those future cash flows;

(c) the time value of money, represented by the current market risk-free rate of interest;

(d) the price for bearing the uncertainty inherent in the asset; and

(e) other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

**[66](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote66anc)**: A detailed budget should be created for five years (IAS 36.35-36). If it is supported by the facts, it can be extended beyond this period, but it should be assumed that it will decline over time.

**[67](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote67anc)**: This charge is applied to all the group’s assets, using their carrying amounts as a weighting.

**[68](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=30" \l "sdfootnote68anc)**: Since it is zero, assets to be abandoned cannot be disclosed at fair value less cost to sell. Although IFRS 5.13 states that they should be measured at a value based on their use until liquidated, this is also often zero. As a result, assets to be abandoned are commonly not disclosed on the balance sheet, but merely in the footnotes.

# Intangible assets

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

## Recognition and disclosure

An intangible asset is recognized by applying (in order) the following criteria:

1 It arises from law, contract or some other (legally enforceable) claim(s) or obligation(s).

2. It does not arise from law or contract but is separable (can be sold, transferred, licensed, rented or exchanged) either individually or together with another asset(s) or liability(ies).

3. It does not arise from law or contract, is not separable but is the difference between the amount paid for a business and the fair value of that business’s net assets.

Once they are identified, intangible assets are recognized and disclosed[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote1sym) using reasonably descriptive titles.

### Legal intangible assets

Patents: scientific discoveries, technology, manufacturing processes, business methods, software, etc.

Copyrights: literary works (books, magazines, newspapers, etc.), musical and theatrical works (plays, operas, ballets, compositions, song lyrics, etc.), audiovisual material (motion pictures, music videos, television programs, etc.), pictures, photographs, software developed for sale, etc.

Trademarks, trade names, brands and brand names: logos, advertising jingles, tag lines, endorsements, service marks, collective marks, certification marks, trade dress, package design, mastheads, Internet domain names, etc.

### Contractual intangible assets

Contracts and agreements: employment, customer, manufacturing, construction, development, distribution, shelf-space, listing (slotting) agreements, supply, service agreements (consulting, management, advertising), franchising, standstill, non-compete, capital (financial) leases, etc.

Licenses: broadcast (radio, television, mobile phone, etc.), operating, royalty, purchased software, etc.

Rights and permits: construction or development, landing (i.e. airport slots), mining, drilling, exploration, logging, water use, air use, pollution, CO2 emissions, route authority, toll taking, etc.

Commitments: servicing agreements (mortgage, debt, insurance, maintenance, service, etc.), order backlogs, production backlogs, bank accounts, lines of credit, guarantees, insurance agreements, etc.

### Separable intangible assets

Relationships: distribution channels, freight forwarding, non-contractual customer relationships, lender relationships, advertising relationships, supplier relationships, etc.

Lists: customer, advertising, mailing, dealer, supplier, subscription, etc.

Systems and services: a delivery system (market presence), customer service network, product service system, etc.

Records: legal, medical, credit, service, client history, etc. /

Documentation: databases, blueprints, drawings, training manuals, procedural manuals, repair manuals, etc.

Unpatented technology: manufacturing processes, production lines, custom made machines, trade secrets, secret formulas and recipes, software developed for own use, etc.

### Goodwill

|  |
| --- |
| Purchase price of business |
| (Fair value of business’s net assets) |
| Goodwill |

## Initial Measurement

An intangible asset is initially measured at cost (IAS 38.24), regardless of whether it was acquired separately or (together with other assets) in business combination.

### Acquired separately

As with property, plant and equipment the cost of intangible assets comprises purchase price plus related costs. In contrast to PP&E, transportation[**[3]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote2sym), installation, break-in[**[2]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote3sym), or estimated costs to dismantle and remove are not among them (not because their inclusion is proscribed, but simply because they are not, as a rule, incurred).

Consequently, the only significant (practical) difference between IAS 16 and IAS 38 measurement is that the cost of intangible assets may (IAS 38.57) include certain, limited[**[4]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote4sym) development costs[**[5]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote5sym).

### Acquired in business combination

IFRS 3.15: At the acquisition date, the acquirer shall classify or designate the identifiable assets acquired and liabilities assumed as necessary to apply other IFRSs subsequently. The acquirer shall make those classifications or designations on the basis of the contractual terms, economic conditions, its operating or accounting policies and other pertinent conditions as they exist at the acquisition date.

IFRS 3.18 The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.

## Subsequent measurement

### Useful life and depreciation period

In contrast to plant and equipment (property can have an unlimited life), which always have a finite useful life, intangible assets can have a useful life that cannot be determined[**[6]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote6sym). Thus, while it cannot be determined, intangible assets are not depreciated. Instead (IAS 38.108), they are (at minimum[**[7]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote7sym)) tested for impairment annually (see: Asset impairment).

### Depreciation method

IFRS provides comparable instructions for both amortization and depreciation methods. A careful reading of IAS 38.98[[8]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote8sym), however, explains why methods other than straight line are practically never used.

### Salvage value

Unlike IAS 16, IAS 38 (paragraphs 100 to 103) makes an effort to discourage entities setting salvage value. As a result, it almost never occurs in practice.

### Capitalized subsequent costs

Unlike IAS 16, IAS 38.20 discourages entity’s capitalizing components. As a result, almost all subsequent costs are expensed[[9]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote9sym) (as repairs and maintenance) as incurred.

### In process R&D

Under certain conditions (IAS 38.34), in-process research and development (R&D that hasn’t yet to yield in a separately recognizable asset, such as a patent) is recognized. This applies to both stand-along purchases as well as in-process R&D acquired in business combinations.

Once it has been capitalized, related subsequent costs should be recognized, provided they meet the criteria for development capitalization (IAS 38.54-62).

### Annual review

As with IAS 16, the entity is obligated to review its estimates (amortization period, amortization method and salvage value) annually. In contrast to IAS 16, it must also perform an (at minimum) annual impairment test on assets that are not being amortized.

### Revaluation model

Like IAS 16, IAS 38 allows entity’s to elect a revaluation model. Also like IAS 16, entities rarely elect this model in practice.

#### Examples

On 1/1/Y1, XYZ purchased a patent for 12,000, assigned it item number 123, and estimated its useful life to be 5 years[**[10]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote10sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Patent | | 1.4.3.2\_123 | 12,000 |  |
|  | Trade payable | 2.1.1.1 |  | 12,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 - 5 / 31.12.R1 - 5 | | Post. ref. | Dr. | Cr. |
| Amortization | | 5.1.3.2.5 | 2,400 |  |
|  | Accumulated amortization | 1.4.3.2\_ (123) |  | 2,400 |

Same situation, except that it purchased a trademark which can be extended indefinitely and could not determine how long it would market products with this mark.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Brand | | 1.4.3.2\_456 | 12,000 |  |
|  | Trade payable | 2.1.1.1 |  | 12,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 - / 31.12.R1 - | | Post. ref. | Dr. | Cr. |
| Amortization[**[11]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote11sym) | | 5.1.3.2.5 | 0 |  |
|  | Accumulated amortization | 1.4.3.2\_ (456) |  | 0 |

Same facts, except XYZ did not purchase the brand separately, but together with all of the other assets of ABC company, in a business combination. Since ABC created this brand, it did not rec**o**gnize it in its own accounting[**[12]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote12sym).

#### Important

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Brand | | 1.4.3.2\_456 | 12,000 |  |
|  | Trade payable | 2.1.1.1 |  | 12,000 |

# Mergers, acquisitions and consolidation[[13]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote13sym)

Identifying and measuring all of the assets (liabilities) acquired in a business combination is the most demanding task the average practicing accountant is ever likely to face[**[14]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote14sym). Fortunately, once accomplished, the accounting procedures themselves (as demonstrated in the preceding examples) are simple.

## Consolidation

IFRS is applicable to the economic (consolidated), not legal, entity[**[15]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote15sym). In a nutshell, consolidation involves summing all the asset, liabilities, income and expense of the parent and its subsidiaries, eliminating inter-company profits and creating a financial report as if no individual entities existed.

In general, IFRS only requires a consolidated financial report from publicly traded companies[**[16]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote16sym). The consolidated financial report should comprise all entities under common management[**[17]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote17sym) control.

### Examples

On 1/1/Y1, XYZ acquired a 100% interest in ABC for 15,000, which was equal to the fair value of its net assets.

|  |  |
| --- | --- |
| **ABC**  **Unconsolidated balance sheet**  **As at 1/1/R1** | |
| Cash | 250 |
| Receivables | 250 |
| Inventory | 500 |
| Current assets | 1,000 |
| Property plant and equipment | 14,000 |
| Total assets | 15,000 |
|  |  |
| Payables | 0 |
| Loans | 0 |
| Total liabilities | 0 |
| Common stock | 2,000 |
| Additional paid in capital | 8,000 |
| Retained earnings | 5,000 |
| Total equity | 15,000 |
| Liabilities and equity | 15,000 |
|  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **XYZ**  **Unconsolidated balance sheet**  **As at 1/1/R2** | | | |
|  | Pre-acq. | Dr. / (Cr.) | Post-acq. |
| Cash | 17,000 | (15,000) | 2,000 |
| Receivables | 1,000 |  | 1,000 |
| Inventory | 2,000 |  | 2,000 |
| Accruals | 1,000 |  | 1,000 |
| Current assets | 21,000 |  | 6,000 |
| Investment in sub | 0 | 15,000 | 15,000 |
| PP&E | 74,000 |  | 74,000 |
| Total assets | 95,000 |  | 95,000 |
|  |  |  |  |
| Payables | 2,000 |  | 2,000 |
| Loans | 20,000 |  | 20,000 |
| Total liabilities | 22,000 |  | 22,000 |
| Common stock | 10,000 |  | 10,000 |
| Additional paid in capital | 33,000 |  | 33,000 |
| Retained earnings | 30,000 |  | 30,000 |
| Total equity | 73,000 |  | 73,000 |
| Liabilities and equity | 95,000 |  | 95,000 |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Consolidation schedule** |  |  |  |  |
| **As at 1/1/R2** | **XYZ** | **ABC** | **Dr.** | **Cr.** |
| Cash | 2,000 | 250 |  |  |
| Receivables | 1,000 | 250 |  |  |
| Inventory | 2,000 | 500 |  |  |
| Accruals | 1,000 | 0 |  |  |
| Current assets | 6,000 | 1,000 |  |  |
| Investment in sub | 15,000 | 0 |  | 15,000 |
| PP&E | 74,000 | 14,000 |  |  |
| Total assets | 95,000 | 15,000 |  |  |
|  |  |  |  |  |
| Payables | 2,000 | 0 |  |  |
| Loans | 20,000 | 0 |  |  |
| Total liabilities | 22,000 | 0 |  |  |
| Common stock | 10,000 | 2,000 | 2,000 |  |
| Additional paid in capital | 33,000 | 8,000 | 8,000 |  |
| Retained earnings | 30,000 | 5,000 | 5,000 |  |
| Total equity | 73,000 | 15,000 |  |  |
| Liabilities and equity | 95,000 | 15,000 |  |  |
|  |  |  |  |  |

|  |  |
| --- | --- |
| **ABC–XYZ**  **Consolidated balance sheet**  **As at 1/1/R2** | |
| Cash | 2,250 |
| Receivables | 1,250 |
| Inventory | 2,500 |
| Accruals | 1,000 |
| Current assets | 7,000 |
| Investment in sub[**[18]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote18sym) | 0 |
| PP&E | 88,000 |
| Total assets | 110,000 |
|  |  |
| Payables | 2,000 |
| Loans | 20,000 |
| Total liabilities | 22,000 |
| Common stock | 10,000 |
| Additional paid in capital | 33,000 |
| Retained earnings | 30,000 |
| Total equity | 88,000 |
| Liabilities and equity | 110,000 |
|  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Consolidation schedule** |  |  |  |  |
| **As at 12/31/R2** | **XYZ** | **ABC** | **Dr.** | **Cr.** |
| Cash | 1,750 | 500 |  |  |
| Receivables | 1,250 | 700 |  |  |
| Inventory | 2,250 | 800 |  |  |
| Accruals | 750 | 0 |  |  |
| Current assets | 6,000 | 2,000 |  |  |
| Investment in sub | 15,000 | 0 |  | 15,000 |
| PP&E | 80,000 | 16,000 |  |  |
| Total assets | 101,000 | 18,000 |  |  |
|  |  |  |  |  |
| Payables | 500 | 0 |  |  |
| Loans | 13,500 | 0 |  |  |
| Total liabilities | 14,000 | 0 |  |  |
| Common stock | 10,000 | 2,000 | 2,000 |  |
| Additional paid in capital | 33,000 | 8,000 | 8,000 |  |
| Retained earnings | 44,000 | 8,000 | 5,000 |  |
| Total equity | 87,000 | 18,000 |  |  |
| Liabilities and equity | 101,000 | 18,000 |  |  |
|  |  |  |  |  |

|  |  |  |
| --- | --- | --- |
| **ABC-XYZ**  **Consolidated balance sheet**  **As at 12/31/R2** | | |
|  |  | Prior [**[19]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote19sym) |
| Cash | 2,250 | 2,250 |
| Receivables | 1,950 | 1,250 |
| Inventory | 3,050 | 2,500 |
| Accruals | 750 | 1,000 |
| Current assets | 8,000 | 7,000 |
| PP&E | 96,000 | 88,000 |
| Total assets | 119,000 | 110,000 |
|  |  |  |
| Payables | 500 | 2,000 |
| Loans | 13,500 | 20,000 |
| Total liabilities | 14,000 | 22,000 |
| Common stock | 10,000 | 10,000 |
| Additional paid in capital | 33,000 | 33,000 |
| Retained earnings | 47,000 | 30,000 |
| Total equity | 105,000 | 88,000 |
| Liabilities and equity | 119,000 | 110,000 |
|  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
|  | XYZ | ABC | ABC-XYZ |
| Revenue | 40,000 | 12,000 | 52,000 |
| Expenses | 13,000 | 4,000 | 17,000 |
| Depreciation | 10,000 | 3,000 | 13,000 |
| Taxes | 3,000 | 1,000 | 4,000 |
| Net income | 14,000 | 4,000 | 18,000 |
|  |  |  |  |

|  |  |  |
| --- | --- | --- |
| **XYZ–ABC**  **Consolidated income statement**  **For year ended 12/31/R1** | | |
|  |  | Prior |
| Revenue | 52,000 | 46,800 |
| Expenses | 17,000 | 15,300 |
| Depreciation | 13,000 | 11,700 |
| Taxes | 4,000 | 3,600 |
| Net income | 18,000 | 16,200 |
|  |  |  |

Same facts except that ABC sold XYZ goods (that it had bought for 100) for 200.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Consolidation schedule** |  |  |  |  |
| **As at 12/**3**1/R2** | **XYZ** | **ABC** | **Dr.** | **Cr.** |
| Cash | 1,750 | 500 |  |  |
| Receivables | 1,250 | 900 |  | 200 |
| Inventory | 2,**450** | 700 | 100 | **200** |
| Accruals | 750 | 0 |  |  |
| Current assets | 6,000 | 2,000 |  |  |
| Investment in sub | 15,000 | 0 |  | 15,000 |
| PP&E | 80,000 | 16,000 |  |  |
| Total assets | 101,200 | 18,100 |  |  |
|  |  |  |  |  |
| Payables | **700** | 0 | **200** |  |
| Loans | 13,500 | 0 |  |  |
| Total liabilities | 14,000 | 0 |  |  |
| Common stock | 10,000 | 2,000 | 2,000 |  |
| Additional paid in capital | 33,000 | 8,000 | 8,000 |  |
| Retained earnings | 44,000 | 8,100 | 5,100 |  |
| Total equity | 87,000 | 18,000 |  |  |
| Liabilities and equity | 101,200 | 18,100 |  |  |
|  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **XYZ** | **ABC** |  | **ABC–XYZ** |
| Revenue | 40,000 | 12,000 | (200) | 52,000 |
| Intra-company revenue |  | 200 |  |  |
| Expenses | 13,000 | 4,100 | (100) | 17,000 |
| Depreciation | 10,000 | 3,000 |  | 13,000 |
| Taxes | 3,000 | 1,000 |  | 4,000 |
| Net income | 14,000 | 4,100 | (100) | 18,000 |
|  |  |  |  |  |

Same facts as the first example except that XYZ assumed ABC’s liabilities.

|  |  |
| --- | --- |
| **ABC**  **Unconsolidated balance sheet**  **As at 1/1/R1** | |
| Cash | 250 |
| Receivables | 250 |
| Inventory | 500 |
| Current assets | 1,000 |
| Property plant and equipment | 14,000 |
| Total assets | 15,000 |
|  |  |
| Payables | 250 |
| Loans | 750 |
| Total liabilities | 1,000 |
| Common stock | 2,000 |
| Additional paid in capital | 8,000 |
| Retained earnings | 4,000 |
| Total equity | 14,000 |
| Liabilities and equity | 15,000 |
|  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **Goodwill calculation schedule** | | | |
| Purchase price |  |  | 15,000 |
| Cash | (250) |  |  |
| Receivables | (250) |  |  |
| Inventory | (500) |  |  |
| PP&E | (14,000) |  |  |
| Total assets |  | (15,000) |  |
| Trade Payables | 250 |  |  |
| Loans | 750 |  |  |
| Total liabilities |  | 1,000 |  |
| Net assets |  |  | (14,000) |
| Goodwill / Goodwill |  |  | 1,000 |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Consolidation schedule** | **XYZ** | **ABC** | **Dr.** | **Cr.** |
| Cash | 2,000 | 250 |  |  |
| Receivables | 1,000 | 250 |  |  |
| Inventory | 2,000 | 500 |  |  |
| Accruals | 1,000 | 0 |  |  |
| Current assets | 6,000 | 1,000 |  |  |
| Investment in sub | 15,000 | 0 |  | 15,000 |
| PP&E | 74,000 | 14,000 |  |  |
| Goodwill |  |  | 1,000 |  |
| Total assets | 95,000 | 15,000 |  |  |
|  |  |  |  |  |
| Payables | 2,000 | 250 |  |  |
| Loans | 20,000 | 750 |  |  |
| Total liabilities | 22,000 | 1,000 |  |  |
| Common stock | 10,000 | 2,000 | 2,000 |  |
| Additional paid in capital | 33,000 | 8,000 | 8,000 |  |
| Retained earnings | 30,000 | 4,000 | 4,000 |  |
| Total equity | 73,000 | 14,000 |  |  |
| Liabilities and equity | 95,000 | 15,000 |  |  |
|  |  |  |  |  |

|  |  |
| --- | --- |
| **ABC-XYZ**  **Consolidated balance sheet**  **As at 1/1/R2** | |
| Cash | 2,250 |
| Receivables | 1,250 |
| Inventory | 2,500 |
| Accruals | 1,000 |
| Current assets | 7,000 |
| PP&E | 88,000 |
| Goodwill | 1,000 |
| Total assets | 96,000 |
|  |  |
| Payables | 2,250 |
| Loans | 20,750 |
| Total liabilities | 23,000 |
| Common stock | 11,500 |
| Additional paid in capital | 46,500 |
| Retained earnings | 15,000 |
| Total equity | 73,000 |
| Liabilities and equity | 96,000 |
|  |  |

Same facts except that XYZ did not pay cash, but rather with its own shares.

|  |  |  |  |
| --- | --- | --- | --- |
| **XYZ**  **Unconsolidated balance sheet**  **As at 1/1/R2** | | | |
|  | Pre-acq. | Dr. (Cr.) | Post-acq. |
| Cash | 2,000 |  | 2,000 |
| Receivables | 1,000 |  | 1,000 |
| Inventory | 2,000 |  | 2,000 |
| Accruals | 1,000 |  | 1,000 |
| Current assets | 6,000 |  | 6,000 |
| Investment in sub | 0 | 15,000 | 15,000 |
| PP&E | 74,000 |  | 74,000 |
| Total assets | 80,000 |  | 95,000 |
|  |  |  |  |
| Payables | 2,000 |  | 2,000 |
| Loans | 20,000 |  | 20,000 |
| Total liabilities | 22,000 |  | 22,000 |
| Common stock | 10,000 | 1,500 | 11,500 |
| Additional paid in capital | 33,000 | 13,500 | 46,500 |
| Retained earnings | 15,000 |  | 15,000 |
| Total equity | 58,000 |  | 73,000 |
| Liabilities and equity | 80,000 |  | 95,000 |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Consolidation schedule** | **XYZ** | **ABC** | **Dr.** | **Cr.** |
| Cash | 2,000 | 250 |  |  |
| Receivables | 1,000 | 250 |  |  |
| Inventory | 2,000 | 500 |  |  |
| Accruals | 1,000 | 0 |  |  |
| Current assets | 6,000 | 1,000 |  |  |
| Investment in sub | 15,000 | 0 |  | 15,000 |
| PP&E | 74,000 | 14,000 |  |  |
| Goodwill | 0 | 0 | 1,000 |  |
| Total assets | 95,000 | 15,000 |  |  |
|  |  |  |  |  |
| Payables | 2,000 | 250 |  |  |
| Loans | 20,000 | 750 |  |  |
| Total liabilities | 22,000 | 1.000 |  |  |
| Common stock | 10,000 | 2,000 | 2,000 |  |
| Additional paid in capital | 33,000 | 8,000 | 8,000 |  |
| Retained earnings | 30,000 | 4,000 | 4,000 |  |
| Total equity | 73,000 | 14,000 |  |  |
| Liabilities and equity | 95,000 | 15,000 |  |  |
|  |  |  |  |  |

|  |  |
| --- | --- |
| **ABC-XYZ**  **Consolidated balance sheet**  **As at 1/1/R2** | |
| Cash | 2,250 |
| Receivables | 1,250 |
| Inventory | 2,500 |
| Accruals | 1,000 |
| Current assets | 7,000 |
| PP&E | 88,000 |
| Goodwill | 1,000 |
| Total assets | 96,000 |
|  |  |
| Payables | 2,250 |
| Loans | 20,750 |
| Total liabilities | 23,000 |
| Common stock | 11,500 |
| Additional paid in capital | 46,500 |
| Retained earnings | 15,000 |
| Total equity | 73,000 |
| Liabilities and equity | 96,000 |
|  |  |

### Goodwill valuation

Same facts except that XYZ paid 20,000 and determined that the fair value of ABC’s PP&E was 18,000.

|  |  |  |  |
| --- | --- | --- | --- |
| Purchase price |  |  | 20,000 |
| Cash | (250) |  |  |
| Receivables | (250) |  |  |
| Inventory | (500) |  |  |
| PP&E | (18,000) |  |  |
| Total assets |  | (19,000) |  |
| Trade Payables | 250 |  |  |
| Loans | 750 |  |  |
| Total liabilities |  | 1,000 |  |
| Net assets |  |  | (18,000) |
| Goodwill |  |  | 2,000 |
|  |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **ABC**  **Unconsolidated balance sheet**  **As at 1/1/R2** | | | |
|  | Pre-acq. | Dr. (Cr.) | Post-acq. |
| Cash | 250 |  | 250 |
| Receivables | 250 |  | 250 |
| Inventory | 500 |  | 500 |
| Current assets | 1,000 |  | 1,000 |
| PP&E | 14,000 | 4,000 | 18,000 |
| Total assets | 15,000 |  | 19,000 |
|  |  |  |  |
| Payables | 250 |  | 250 |
| Loans | 750 |  | 750 |
| Total liabilities | 1,000 |  | 1,000 |
| Common stock | 2,000 |  | 2,000 |
| Additional paid in capital | 8,000 | (4,000) | 12,000 |
| Retained earnings | 4,000 |  | 4,000 |
| Total equity | 14,000 |  | 18,000 |
| Liabilities and equity | 15,000 |  | 19,000 |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Consolidation schedule** | **XYZ** | **ABC** | **Dr.** | **Cr.** |
| Cash | 2,000 | 250 |  |  |
| Receivables | 1,000 | 250 |  |  |
| Inventory | 2,000 | 500 |  |  |
| Accruals | 1,000 | 0 |  |  |
| Current assets | 6,000 | 1,000 |  |  |
| Investment in sub | 20,000 | 0 |  | 20,000 |
| PP&E | 74,000 | 18,000 |  |  |
| Goodwill | 0 | 0 | 2,000 |  |
| Total assets | 100,000 | 19,000 |  |  |
|  |  |  |  |  |
| Payables | 2,000 | 250 |  |  |
| Loans | 20,000 | 750 |  |  |
| Total liabilities | 22,000 | 1.000 |  |  |
| Common stock | 12,000 | 2,000 | 2,000 |  |
| Additional paid in capital | 51,000 | 12,000 | 12,000 |  |
| Retained earnings | 15,000 | 4,000 | 4,000 |  |
| Total equity | 78,000 | 18,000 |  |  |
| Liabilities and equity | 100,000 | 19,000 |  |  |
|  |  |  |  |  |

|  |  |
| --- | --- |
| ABC-XYZ  Consolidated balance sheet  As at 1/1/R2 | |
| Cash | 2,250 |
| Receivables | 1,250 |
| Inventory | 2,500 |
| Accruals | 1,000 |
| Current assets | 7,000 |
| PP&E | 92,000 |
| Goodwill | 2,000 |
| Total assets | 101,000 |
|  |  |
| Payables | 2,250 |
| Loans | 20,750 |
| Total liabilities | 23,000 |
| Common stock | 12,000 |
| Additional paid in capital | 51,000 |
| Retained earnings | 15,000 |
| Total equity | 78,000 |
| Liabilities and equity | 101,000 |
|  |  |

Same facts except that XYZ did not acquire 100% equity and determined that the fair value of the minority (non-controlling) interest was 3,000.

Aside from assets (liabilities), goodwill valuation also requires the proper valuation of minority interests.

|  |  |  |  |
| --- | --- | --- | --- |
| Purchase price |  |  | 20,000 |
| Non-controlling interest |  |  | 3,000 |
| Cash | (250) |  |  |
| Receivables | (250) |  |  |
| Inventory | (500) |  |  |
| PP&E | (18,000) |  |  |
| Total assets |  | (19,000) |  |
| Trade Payables | 250 |  |  |
| Loans | 750 |  |  |
| Total liabilities |  | 1,000 |  |
| Net assets |  |  | (18,000) |
| Goodwill / Goodwill |  |  | 5,000 |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Consolidation schedule** | **XYZ** | **ABC** | **Dr.** | **Cr.** |
| Cash | 2,000 | 250 |  |  |
| Receivables | 1,000 | 250 |  |  |
| Inventory | 2,000 | 500 |  |  |
| Accruals | 1,000 | 0 |  |  |
| Current assets | 6,000 | 1,000 |  |  |
| Investment in sub | 23,000 | 0 |  | 23,000 |
| PP&E | 74,000 | 18,000 |  |  |
| Goodwill | 0 | 0 | 5,000 |  |
| Total assets | 103,000 | 19,000 |  |  |
|  |  |  |  |  |
| Payables | 2,000 | 250 |  |  |
| Loans | 20,000 | 750 |  |  |
| Total liabilities | 22,000 | 1.000 |  |  |
| Common stock | 12,000 | 2,000 | 2,000 |  |
| Additional paid in capital | 51,000 | 12,000 | 12,000 |  |
| Retained earnings | 15,000 | 4,000 | 4,000 |  |
| Non-controlling interest | 0 | 0 |  | 3,000 |
| Total equity | 78,000 | 18,000 |  |  |
| Liabilities and equity | 100,000 | 19,000 |  |  |
|  |  |  |  |  |

|  |  |
| --- | --- |
| **ABC–XYZ**  **Consolidated balance sheet**  **As at 1/1/R2** | |
| Cash | 2,250 |
| Receivables | 1,250 |
| Inventory | 2,500 |
| Accruals | 1,000 |
| Current assets | 7,000 |
| PP&E | 92,000 |
| Goodwill | 5,000 |
| Total assets | 104,000 |
|  |  |
| Payables | 2,250 |
| Loans | 20,750 |
| Total liabilities | 23,000 |
| Common stock | 12,000 |
| Additional paid in capital | 51,000 |
| Retained earnings | 15,000 |
| Non-controlling interest | 3,000 |
| Total equity | 78,000 |
| Liabilities and equity | 104,000 |
|  |  |

# Leasing

A lease is an agreement whereby one party (economic entity[[20]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote20sym)) gains the right to use an asset[[21]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote21sym) belonging to a different party. Lease accounting is thus applicable to any situation where a company receives the right to use an asset belonging to another party, regardless of whether the agreement is deemed a “lease” by law or regulation.

## Recognition

A finance lease (IAS 17.4) is an agreement that transfers, to the reporting entity, “substantially all the risks and rewards incidental to ownership of an asset” it does not own. An operating lease is a similar agreement that is not a finance lease.

### Financial lease (situations)

The agreement transfers substantially all the risks and rewards of ownership if:

1. The agreement transfers ownership of the leased asset, and/or

2. The agreement includes a right buy the asset at a sufficiently lower price than the expected fair value, which makes the exercise of the option appears to be reasonably assured, and/or

3. The agreement’s term is for the major part[**[22]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote22sym) of (IFRS) the asset’s estimated economic life, and/or

4. The discounted net minimum payments are equal to substantially all[**[23]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote23sym) of the asset’s fair value, and/or

The lessee’s discount rate is the interest rate implicit in the lease (if this is practicable to determine) or the lessee’s incremental borrowing rate.

5. The leased assets are of a specialised nature such that only the lessee can use them without major modifications being made (the asset was made to order for the lessee).

### Indicators of situations

In addition to the five primary criteria, the following are also evaluated:

1. “If the lessee can cancel the lease, the lessor’s losses associated with the cancellation are borne by the lessee” and/or

2. “Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease)” and/or

3. “The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.”

## Measurement

In general, a finance lease is measured like a debt purchase. An operating lease (since no asset / liability is recognized) is not measured. Instead, lease payments are classified (by purpose) as period expenses (rent) on the income statement.

### Initial Measurement (financial lease)

The asset and liability are recorded at the present value of the (minimum) payments or the fair value of the (leased) asset, which ever is lower.

### Subsequent measurement

If the lease became a finance lease because of criteria 1 or 2, the asset should be amortized in a manner comparable (same period, method and salvage value) to similar assets the company owns. If, on the other hand, criteria 3, 4 or 5 were met, it should be amortized over the lease term (including expected extensions), to a zero salvage, straight-line[**[24]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote24sym).

The liability is amortized over the lease term using either the incremental borrowing rate (if the asset was measured at present value) or the implicit rate (if it was measured at fair value).

## Disclosure

Leasing is (technically) a contractual relationship. Consequently, this publication discusses leasing under the heading of intangible assets. Nevertheless, since the object of a financial lease is (generally) tangible, the finance lease asset is disclosed under property, plant and equipment. Similarly, amortization of a finance lease is not disclosed on the income statement as “amortization” but as “depreciation”.

## Examples

1/1/Y1 XYZ signed a rental agreement for a machine with ABC (its manufacturer). The term of the agreement was 5 years and the machine’s fair value was 12,000. Annual lease payments, due each 31.12, were 3,944 including 500 insurance (an executory / service cost) and 550 VAT. At the end of the lease term, XYZ returned the asset and did not guarantee any residual value. XYZ determined that if it had purchased the asset, it could have served its purpose for 7 to 8 years.

As a first step, the company determined whether the lease transferred substantially all risks and rewards of ownership:

1. Since the asset was returned, indication 1 was negative.

2. Since the agreement mentioned no bargain purchase option, indication 2 was negative.

3. The company was not able to determine the asset’s economic life, but based on its useful life (75% of which was 5¼ to 6 years), it was likely[**[25]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote25sym) that indication 3 was negative.

5. Since the asset was not made to order, indication 5 was negative[**[26]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote26sym).

4. After determining its incremental borrowing rate to be 10%, the company found that the present value of payments 10,971 was higher than 90% of the asset’s fair value (10,800). Indication 4 was positive and the lease was recognized as a finance lease.

|  |  |  |  |
| --- | --- | --- | --- |
| **P** | **Discount rate** | **Payment** | **PV of payments** |
| **A** | **B** | **C** | **D = C / (1 + B)[A]:** |
| 1 | 10% | 2,894 | 2,631 |
| 2 | 10% | 2,894 | 2,392 |
| 3 | 10% | 2,894 | 2,174 |
| 4 | 10% | 2,894 | 1,977 |
| 5 | 10% | 2,894 | 1,797 |
|  |  |  | 10,971 |
|  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **P** | **Discount rate** | **Liability** | **Interest expense** | **Payment** | **Amortization** |
| **A** | **B** | **C (C+1)= C - F** | **D = B x C** | **E** | **F = E - D** |
| 1 | 10% | 10,971 | 1,097 | 2,894 | 1,797 |
| 2 | 10% | 9,174 | 917 | 2,894 | 1,977 |
| 3 | 10% | 7,197 | 720 | 2,894 | 2,174 |
| 4 | 10% | 5,023 | 502 | 2,894 | 2,392 |
| 5 | 10% | 2,631 | 263 | 2,894 | 2,631 |
|  |  |  | 3,500 | 14,470 | 10,971 |
|  |  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Machine | | 1.3.3.1.2.24 | 10,971 |  |
|  | Capital lease obligation | 2.2.2.24 |  | 10,971 |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | | Dr. | | Cr. |
| Depreciation | | 5.1.3.2.1 | 2,194 | |  | |
|  | Accumulated depreciation | 1.3.3.1.2.(24) |  | | 2,194 | |
| Capital lease obligation | | 2.2.2.24 | 1,797 | |  | |
| Insurance expense | | 5.1.3.2.6 | 500 | |  | |
| Interest expense | | 6.2.1 | 1,097 | |  | |
|  | Trade payable | 2.1.1.1 |  | | 3,394 | |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y2 / 1.1.R2 | | Post. ref. | Dr. | Cr. |
| Trade payable | | 2.1.1.1 | 3,394 |  |
| VAT | | 2.1.2.2.4.1 | 550 |  |
|  | Cash in bank | 1.1.1.2 |  | 3,944 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y6 / 1.1.R6 | | Post. ref. | Dr. | Cr. |
| Trade payable | | 2.1.1.1 | 3,394 |  |
| VAT | | 2.1.2.2.4.1 | 550 |  |
|  | Cash in bank | 1.1.1.2 |  | 3,944 |
| Accumulated depreciation | | 1.3.3.1.2.(24) | 10,971 |  |
|  | Machine | 1.3.3.1.2.24 |  | 10,971 |

Same facts, except XYZ retained the asset and the annual payment (net) was 3,204. XYZ depreciated all similar assets using the sum-of-the-years’-digests method over 7 years to a salvage value of 1/8 their acquisition price value (1,500).

Since the first indication was clearly met, the company did not determine its incremental borrowing rate, but applied the rate implicit in the lease (10.075%) instead.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **P** | **Discount rate** | **Liability** | **Interest expense** | **Payment** | **Amortization** |
| **A** | **B** | **C (C+1)= C - F** | **D = B x C** | **E** | **F = E - D** |
| 1 | 10.475% | 12,000 | 1,257 | 3,204 | 1,947 |
| 2 | 10.475% | 10,053 | 1,053 | 3,204 | 2,151 |
| 3 | 10.475% | 7,902 | 828 | 3,204 | 2,376 |
| 4 | 10.475% | 5,526 | 579 | 3,204 | 2,625 |
| 5 | 10.475% | 2,900 | 304 | 3,204 | 2,900 |
|  |  |  | 4,020 | 16,021 | 12,000 |
|  |  |  |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **P** | **Discount rate** | **Liability** | **Interest expense** |
| **A** | **B** | **C (C+1)= C - F** | **D = B x C** |
| 1 | 7/ 28 | 10,500 | 2,625 |
| 2 | 6/28 | 10,500 | 2,250 |
| 3 | 5/28 | 10,500 | 1,875 |
| 4 | 4/28 | 10,500 | 1,500 |
| 5 | 3/28 | 10,500 | 1,125 |
| 6 | 2/28 | 10,500 | 750 |
| 7 | 1/28 | 10,500 | 375 |
|  |  |  | 10,500 |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Machine | | 1.3.3.1.2.24 | 12,000 |  |
|  | Capital lease obligation | 2.2.2.24 |  | 12,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Depreciation | | 5.1.3.2.1 | 2,625 |  |
|  | Accumulated depreciation | 1.3.3.1.2.(24) |  | 2,625 |
| Capital lease obligation | | 2.2.2.24 | 1,947 |  |
| Interest expense | | 6.2.1 | 1,257 |  |
|  | Trade payable | 2.1.1.1 |  | 3,204 |

Same facts, except XYZ agreed to pay 4,000 down, 2,387 annually and received an option to buy the asset after 4 years for 500.

|  |  |  |  |
| --- | --- | --- | --- |
| **P** | **Discount rate** | **Payment** | **PV of payments** |
| **A** | **B** | **C** | **D = C / (1 + B)[A]:** |
| 0 | 10.475% | 4,000 | 4,000 |
| 1 | 10.475% | 2,400 | 2,172 |
| 2 | 10.475% | 2,400 | 1,966 |
| 3 | 10.475% | 2,400 | 1,780 |
| 4 | 10.475% | 2,400 | 1,611 |
| 4 | 10.475% | 500 | 336 |
|  |  |  | 11,866 |
|  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **P** | **Discount rate** | **Liability** | **Interest expense** | **Payment** | **Amortization** |
| **A** | **B** | **C (C+1)= C - F** | **D = B x C** | **E** | **F = E - D** |
| 0 | 10.475% | 11,866 | 0 | 4,000 | 4,000 |
| 1 | 10.475% | 7,866 | 824 | 2,400 | 1,576 |
| 2 | 10.475% | 6,290 | 659 | 2,400 | 1,741 |
| 3 | 10.475% | 4,549 | 476 | 2,400 | 1,924 |
| 4 | 10.475% | 2,625 | 275 | 2,900 | 2,625 |
|  | 10.475% |  | 2,234 | 14,100 | 11,866 |
|  |  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Machine | | 1.3.3.1.2.24 | 11,866 |  |
|  | Capital lease obligation | 2.2.2.24 |  | 7,866 |
|  | Cash in bank | 1.1.1.2 |  | 4,000 |

## Real estate

Real estate rentals are evaluated by using the same indicators as other assets. Since it is uncommon for real estate rentals to fulfil any of the 5 indicators (plus 3), most real estate leases are classified as operating.

## Sale lease-back

In a sale lease-back, the lease back is evaluated in the same manner as other leases. If it is classified as a finance lease, any gain is deferred and amortized over the lease term. If it is classified as an operating, it is recognized immediately. Losses, in both cases, are recognized immediately.

### Lessor

IAS 17.36 36: “Lessors shall recognise assets held under a finance lease in their statements of financial position and present them as a receivable at an amount equal to the net investment in the lease.”

### Other fixed assets

While not a defined asset class, it is fairly common for company’s to control assets that are not PP&E, intangible, investment nor resources. If they are, in aggregate, material[**[27]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote27sym), these assets are disclosed as “other”.

In no particular order, the following items are commonly classified as “other”:

* Restricted assets (funds)
* Assets to be disposed of (held for sale)
* Assets to be abandoned
* Assets not currently used in operations
* Long-term receivables
* Contracts in progress
* Deferred assets (deferred tax assets)
* Long-term, pre-paid assets (non-returnable deposits, progress payments, etc.)
* Returnable deposits (security deposits, guarantees, retainages (retentions), etc.)

### Organization costs

Unlike various national systems, IFRS does not consider organization costs to be assets because they yield no future economic benefits.

[**1**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote1anc)**:**As with property, plant and equipment, drafting a published financial report always requires a careful weighing of the cost and benefits of detailed information. Nevertheless, for inter-company purposes, the entity should sub-classify its intangible assets into (at minimum) the following groups and classes.

[**2**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote2anc)**:**Although they may include customs charges or other non-refundable taxes and fees.

[**3**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote3anc)**:**Often, a stand-alone intangible asset (for example a television broadcast license) requires no installation or break in. On the other hand, installing and implementing accounting software may cost significantly more than the license. In this situation, license and implementation installation would be likely treated as a single, self-constructed asset.

[**4**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote4anc)**:**Since the criteria for capitalization are fairly rigorous, most costs related to development are, in practice, expensed.

[**5**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote5anc)**:**Thus, if research and development costs are incurred during the acquisition of property, plant and equipment, these costs are evaluated using IAS 38 (not IAS 16) guidance.

[**6**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote6anc)**:**IFRS (IAS 38.91) explicitly states that intangible assets cannot have an infinite life. Only land can have this characteristic.

[**7**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote7anc)**:**Immediately, if an indication of impairment arises.

[**8**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote8anc)**:**The last sentence of the paragraph: “There is rarely, if ever, persuasive evidence to support an amortisation method for intangible assets with finite useful lives that results in a lower amount of accumulated amortisation than under the straight-line method.”

[**9**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote9anc)**:**While it is theoretically possible to justify splitting an intangible assets into component parts (which would justify subsequent cost capitalization), the fact that IAS 38 discourages this means that convincing an auditor to accept such a policy, requires a very rigorous explanation of its appropriateness.

[**10**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote10anc)**:**The patent’s legal life was 10 years, its historical experience showed, technological change would make the patent worthless in five.

[**11**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote11anc)**:**This entry is presented here for illustration purposes only. In practice, entries with a zero value are simply not made.

[**12**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote12anc)**:**The most egregious (and, unfortunately, common) errors is applying the recognition and measurement policies outlined by a national "GAAP" (the statutory accounting standards prescribed by law in most countries) during the period, and then bridging, mapping or converting this "GAAP" into a report that resembles IFRS. While often done in practice, this procedure not only violates IFRS (IAS 8.7) and EU regulation (EC 1606/2002) but also the letter of national law in most EU member countries.

Somewhat less egregious (due to its, in comparison, less material nature) is the related error of simply incorporating the assets and liabilities recognized and measured as per national "GAAP" by an acquired business without fully adjusting both to IFRS. That this procedure is often (either explicitly or implicitly) required by the national legislation (statutory accounting standards) of many countries, unfortunately also makes it a fairly common error.

[**13**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote13anc)**:**Merger, acquisition and consolidation accounting are relatively complex issues not commonly a part of an average practitioner’s job description. Also, since they relate more to reporting than accounting procedures, besides a few, basic example, these issues are not dealt with herein in any great detail.

[**14**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote14anc)**:**Excepting serial acquirers, companies do not generally employ people capable taking on tasks this far beyond common accounting practice. Consequently, it is common practice for management (who bears final responsibility for the quality for financial reports, whatever the result) to rely on consultants or other experts who (aside from their independence) bring their professional qualifications and experience to the table. Aside from making the accountant’s job significantly less complicated, this approach has the advantage that the IASB (IFRS 3.BC55) considered it to be standard practice.

[**15**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote15anc)**:**This general statement is, obviously, more complicated in practice. For example, if the legally entity was, as a legal entity, quoted on an exchange, it would have IFRS responsibility. Similarly if it were a segment (IFRS 8) or it had an IFRS reporting responsibility for some other reason (such the existence of a material minority interest). The statement is, however, applicable to the average entity with a consolidation responsibility based in IFRS.

[**16**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote16anc)**:**Although it spells out several relatively specific criteria, IFRS (IAS 27.10 a–b) only requires a consolidated report form publicly traded companies or companies that are in the process (have registered with a regulator for the purpose) of becoming publicly traded. This obligation, however, applies both to widely held companies and those majority-owned by one (small group of) individual(s).

**Important:** IAS 27 explicitly applies to publicly traded companies (or companies in the process of becoming publicly traded) only. Nevertheless, national statute occasionally mandates IFRS for a broader group of (non-public) entities. Consequently, it is relatively common for privately owned companies to shift their legal domicile (at least at holding company level) to countries with less onerous requirements. While this practice may violate the spirit (possibly letter) of local law, it does not violate the spirit (or letter) of IFRS. Likewise, since it mandates IFRS similarly, it violates nether the spirit or letter of EU 1606/2002 (the IFRS implementing regulation in the EU).

[**17**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote17anc)**:**Besides being controversial, consolidation (or rather, its avoidance), is one of the more common accounting errors. Given the difficulties involved, a detailed discussion of the when and why is far beyond the scope of this publication. As a rule of thumb, the accountant should consolidate any entity (legal or otherwise, formally recognized or not) over which management (their friends, family or anyone who can share in the entity’s profit) has operating control.

[**18**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote18anc)**:**This line item is presented for demonstration purposes only. It would not (because of its zero balance) be disclosed on an actual balance sheet.

[**19**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote19anc)**:**Since IFRS requires an opening prior-period balance sheet, in practice (at least) three balance sheets would have to be drafted.

[**20**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote20anc)**:**Since it applies to the consolidated (economic) entity, if the lessee and lessor are both part of the same economic entity, IAS 17 is not generally applicable even if they are two separate legal entities.

[**21**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote21anc)**:**It is not even necessary (IFRIC 14) for the “leased asset” to be a single, particular asset. For example, if a company leased machine A, which the lessor, during the lease term, replaced it with machine B (serving the same purpose), the “leased asset” would be machines A and B taken together.

[**22**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote22anc)**:**Since IFRS does not quantify „major part“ in practice (IAS 8.12) it is quantified as 75% or more because that is how it is defined under US GAAP (FAS 52.7.c).

[**23**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote23anc)**:**Since IFRS does not quantify „ substantially all “ in practice (IAS 8.12) it is quantified as 90% or more because that is how it is defined under US GAAP (FAS 52.7.d).

[**24**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote24anc)**:**Technically (IAS 17.27), the company should use the same methods regardless of why the lease became a finance lease. Nevertheless, the above statement holds in practice (primarily because it is simpler and makes most auditors happy).

[**25**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote25anc)**:**Since economic life is the term over which an asset is useful to the average company using it in a standard manner, it is not readily determinable for the accountant (whose knowledge is company specific). As a short-cut, companies thus use their own useful life, and assume that it approximates economic.

From the auditor perspective, economic life is determinable (since auditors are able to compare how similar assets are used by their various clients). Providing this information would, however, be a violation of the prohibition on consulting services, if it were provided to a particular audit client.

[**26**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote26anc)**:**Since determining an incremental borrowing rate usually requires a bank offer (or some other equally unpleasant accounting task) common practice is to evaluate the other indicators first, and only perform this test if none of them are clearly positive. For example, it the lease term had been two years shorter or longer, this step would not have been necessary.

[27](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=29#sdfootnote27anc): When they are not material, it is common practice to aggregate them with investments.

# Liabilities

Liabilities, depending on their characteristics, can be broken down into „regular” payables, accrued liabilities and provisions.

## Measurement

In general, all liabilities are to be discounted (measured at amortized cost method using the effective interest method) except those measured at fair value. Short-term [**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote1sym) trade payables, where the difference between current and nominal value is not material, are an exception (IAS 39.AG79) and may be reported at nominal value.

## Extinguishment

IAS 39. AG57: A financial liability (or part of it) is extinguished when the debtor either:

a. Discharges the liability (or part of it) by paying the creditor [**[2]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote2sym) , normally with cash, other financial assets, goods or services; or

b. Is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor (if the debtor has given a guarantee this condition may still be met).

## Current (short-term) liabilities [[3]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote3sym)

Current liabilities are liabilities payable within 12 months of the balance sheet date (by the end of the current operating cycle [**[4]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote4sym) ).

### Examples

On 4/15/Y1, XYZ purchased goods on credit from ABC (supplier # 8, invoice # 6) for 10,000 on 30 day credit and paid on time.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/15/Y1 / 15.4.R1 | | Post. ref. | Dr. | Cr. |
| Goods on hand | | 1.1.4.4 | 10,000 |  |
|  | Trade payable | 2.1.1 |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 5/15/Y1 / 15.5.R1 | | Post. ref. | Dr. | Cr. |
| Trade payable | | 2.1.1 | 10,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 10,000 |

Same facts, except the payment terms were 2/10 net 30.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/15/Y1 / 15.4.R1 | | Post. ref. | Dr. | Cr. |
| Goods on hand | | 1.1.4.4 | 10,000 |  |
|  | Trade payable | 2.1.1 |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 5/15/Y1 / 15.5.R1 | | Post. ref. | Dr. | Cr. |
| Trade payable | | 2.1.1 | 10,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 9,800 |
|  | Goods on hand | 1.1.4.4 |  | 200 |

### Quantity discount

On 1/4/Y1, XYZ purchased 10 units of merchandise # 24 for 10,000. On purchasing 100 units, it was entitled to a 10% discount. On the basis of its historical experience, XYZ estimated it would purchase at least that amount year-end.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/4/Y1 / 4.1.R1 | | Post. ref. | Dr. | Cr. |
| Goods on hand | | 1.1.4.4 | 9,000 |  |
| Discount allowance | | 2.1.1.1.(1.2) | 1,000 |  |
|  | Trade payable | 2.1.1 |  | 10,000 |

After ordering the 100 the item, the supplier credited its account.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 9/15/Y1 / 15.9.R1 | | Post. ref. | Dr. | Cr. |
| Trade payable | | 2.1.1 | 10,000 |  |
|  | Discount allowance | 2.1.1.1.(1.2) |  | 10,000 |

### Extended credit terms

On 4/15/Y1, XYZ purchased a machine for 10,600. Payment was due 10/15/Y1 and the goods normally sold for of 10,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 4/15/Y1 / 15.4.R1 | | Post. ref. | Dr. | Cr. |
| Machine | | 1.3.3.1.1 | 10,000 |  |
| Deferred interest | | 2.1.1.1.(1.3) | 600 |  |
|  | Trade payable | 2.1.1 |  | 10,600 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/30/Y1 / 30.6.R1 | | Post. ref. | Dr. | Cr. |
| Interest expense | | 6.2.1 | 250 |  |
|  | Deferred interest | 2.1.1.1.(1.3) |  | 250 |

On 6/30/Y1, XYZ purchased a machine valued at 10,000. Payment was due in 24 months and it agreed to make quarterly interest only payments.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/30/Y1 / 30.6.R1 | | Post. ref. | Dr. | Cr. |
| Machine | | 1.3.3.1.1 | 10,000 |  |
| Deferred interest | | 2.1.1.1.(1.3) | 1,600 |  |
|  | Trade payable | 2.1.1 |  | 11,600 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/30/Y1 / 30.6.R1 | | Post. ref. | Dr. | Cr. |
| Trade payable | | 2.1.1 | 200 |  |
| Interest expense | | 6.2.1 | 200 |  |
|  | Cash in bank | 1.1.1.2 |  | 200 |
|  | Deferred interest | 2.1.1.1.(1.3) |  | 200 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y2 / 31.12.R2 | | Post. ref. | Dr. | Cr. |
| Trade payable | | 2.1.1 | 10,200 |  |
| Interest expense | | 6.2.1 | 200 |  |
|  | Cash in bank | 1.1.1.2 |  | 10,200 |
|  | Deferred interest | 2.1.1.1.(1.3) |  | 200 |

On 6/30/Y1, XYZ purchased a machine valued at 10,000. It agreed to pay 11,600 in 24 months and decided to apply the effective interest method on a quarterly basis.

|  |  |  |  |
| --- | --- | --- | --- |
| **P** | **Present value** | **Discount rate** | **Interest income** |
| **A** | **B = B(B+1) + D** | **C** | **D = B \* C** |
| 1 | 10,000 | 1.87%\* | 187 |
| 2 | 10,187 | 1.87% | 191 |
| - | - | - | - |
| 7 | 11,177 | 1.87% | 209 |
| 8 | 11,387 | 1.87% | 213 |
|  |  |  | 1,600 |
|  | \* 1.87257% |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/30/Y1 / 30.6.R1 | | Post. ref. | Dr. | Cr. |
| Machine | | 1.3.3.1.1 | 10,000 |  |
| Deferred interest | | 2.1.1.1.(1.3) | 1,600 |  |
|  | Trade payable | 2.1.1 |  | 11,600 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 9/30/Y1 / 30.9.R1 | | Post. ref. | Dr. | Cr. |
| Interest expense | | 6.2.1 | 187 |  |
|  | Deferred interest | 2.1.1.1.(1.3) |  | 187 |

#### Instalments

Same facts, except the company agreed to pay 1,362 quarterly for the 8 quarters.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **P** | **Rate** | **Receivable** | **Interest** | **Payment** | **Principle** |
| **A** | **B** | **C = C(C+1) - F** | **D = B \* C** | **E** | **F = E – D** |
| 1 | 1.94% | 10,000 | 194 | 1,362 | 1,167 |
| 2 | 1.94% | 8,833 | 172 | 1,362 | 1,190 |
| - | - | - | - | - | - |
| 7 | 1.94% | 2,646 | 51 | 1,362 | 1,310 |
| 8 | 1.94% | 1,336 | 26 | 1,362 | 1,336 |
|  |  |  | 894 | 10,894 | 10,000 |
|  | \* 1.94265% | | | |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 6/30/Y1 / 30.6.R1 | | Post. ref. | Dr. | Cr. |
| Machine | | 1.3.3.1.1 | 10,000 |  |
| Deferred interest | | 2.1.1.1.(1.3) | 894 |  |
|  | Trade payable | 2.1.1 |  | 10,894 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 9/30/Y1 / 30.9.R1 | | Post. ref. | Dr. | Cr. |
| Trade payable | | 2.1.1 | 1,362 |  |
| Interest expense | | 6.2.1 | 194 |  |
|  | Cash in bank | 1.1.1.2 |  | 1,362 |
|  | Deferred interest | 2.1.1.1.(1.3) |  | 194 |

### Bonds (debentures)

On 1/1/Y1, XYZ sold 10,000, 30-year (series 12) bonds with a nominal value of 1,000 and 6% coupon for 7,525,594.

|  |  |  |  |
| --- | --- | --- | --- |
| **P.** | **Cash flow** | **Discount rate** | **Present value** |
| **A** | **B** | **C** | **D = B / (1 + B)[A]** |
| 1 | 600,000 | 8.25% | 554,273 |
| 2 | 600,000 | 8.25% | 512,030 |
| - | - | - | - |
| 29 | 600,000 | 8.25% | 60,220 |
| 30 | 10,600,000 | 8.25% | 982,808 |
|  |  |  | 7,525,594 |
|  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **P** | **Net obligation** | **Discount rate** | **Interest expense** | **Interest payment** | **Discount amortization** |
| **A** | **B(B+1) = B + F** | **C** | **D = B x C** | **E** | **F = D - E** |
| 1 | 7,525,594 | 8.25% | 620,861 | 600,000 | 20,861 |
| 2 | 7,546,455 | 8.25% | 622,583 | 600,000 | 22,583 |
| - | - | - | - | - | - |
| 29 | 9,600,137 | 8.25% | 792,011 | 600,000 | 192,011 |
| 30 | 9,792,148 | 8.25% | 807,852 | 600,000 | 207,852 |
|  |  |  |  |  | 2,474,406 |
|  |  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 7,525,594 |  |
| Discount | | 2.2.1.(12) | 2,474,406 |  |
|  | Bonds | 2.2.1.12 |  | 10,000,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Interest expense | | 6.2.1 | 620,861 |  |
|  | Cash in bank | 1.1.1.2 |  | 600,000 |
|  | Discount | 2.2.1.(12) |  | 20,861 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/30 / 31.12.30 | | Post. ref. | Dr. | Cr. |
| Interest expense | | 6.2.1 | 807,852 |  |
| Bonds | | 2.2.1.12 | 10,000,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 10,600,000 |
|  | Discount | 2.2.1.(12) |  | 207,852 |

|  |  |  |
| --- | --- | --- |
| **Balance sheet** | | |
| - etc. - | | |
|  | Bonds payable | 10,000,000 |
|  | Discount | (2,474,406) |
|  | Net bonds payable | 7,525,594 |
| - etc. - | | |

#### Debt issue costs

Same facts, except XYZ paid its investment bank a 200,000 underwriting fee [**[5]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote5sym) .

|  |  |  |  |
| --- | --- | --- | --- |
| P. | Cash flow | Discount rate | Present value |
| A | B | C | D = B / (1 + B)**[A]** |
| 1 | 600,000 | 8.49%\* | 553,071 |
| 2 | 600,000 | 8.49% | 509,812 |
| - | - | - | - |
| 29 | 600,000 | 8.49% | 56,547 |
| 30 | 10,600,000 | 8.49% | 920,860 |
|  |  |  | 7,325,594 |
| \*8.48517742% | | |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| P. | Obligation | Net obligation | Discount rate | Interest expense |
| A | B | C(C+1)=C+F | D | E = C \* D |
| 1 | 10,000,000 | 7,325,594 | 8.49% | 621,590 |
| 2 | 10,000,000 | 7,347,183 | 8.49% | 623,422 |
| - | - | - | - | - |
| 29 | 10,000,000 | 9,559,758 | 8.49% | 811,162 |
| 30 | 10,000,000 | 9,770,920 | 8.49% | 829,080 |
|  |  |  |  |  |
|  |  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Interest payment** | **Discount amortization** | **Attributable to discount** | **Discount** | **Attrib. deferred charge** | **Deferred charge** |
| **F** | **G = E - F** | **H=Gx92.52%** | **I(I+1)=I+H** | **J=Gx7.48%** | **K(K+1)=K+J** |
| 600,000 | 21,590 | 19,975 | 2,474,406 | 1,615 | 200,000 |
| 600,000 | 23,422 | 21,670 | 2,454,431 | 1,752 | 198,385 |
| - | - | - | - | - | - |
| 600,000 | 211,162 | 195,371 | 407,320 | 15,791 | 32,923 |
| 600,000 | 229,080 | 211,949 | 211,949 | 17,131 | 17,131 |
|  | 2,674,406 |  |  |  |  |
|  |  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 7,325,594 |  |
| Discount | | 2.2.1.(12) | 2,474,406 |  |
| Deferred charge | | 2.2.1.(12.1) | 200,000 |  |
|  | Bonds | 2.2.1.12 |  | 10,000,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Interest expense | | 6.2.1 | 621,590 |  |
|  | Cash in bank | 1.1.1.2 |  | 600,000 |
|  | Deferred charge | 2.2.1.(12.1) |  | 1,615 |
|  | Discount | 2.2.1.(12) |  | 19,975 |

## Long-term loans

On 1/1/Y1, XYZ Inc. borrowed 100,000 from its bank at 8% payable annually. It repaid the principle in 5 years.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 100,000 |  |
|  | Long-term loan | 2.2.3 |  | 100,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 3.21.R1 | | Post. ref. | Dr. | Cr. |
| Interest expense | | 6.2.1 | 2,000 |  |
|  | Interest payable | 2.1.1.4 |  | 2,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Interest expense | | 6.2.1 | 2,000 |  |
| Interest payable | | 2.1.1.4 | 6,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 8,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y5 / 31.12.R5 | | Post. ref. | Dr. | Cr. |
| Long-term loan | | 2.2.3 | 100,000 |  |
| Interest expense | | 6.2.1 | 2,000 |  |
| Interest payable | | 2.1.1.4 | 6,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 108,000 |

On 1/1/Y1, XYZ borrowed 100,000 and agreed to repay the loan in 5 yearly installments of 25,046.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 100,000 |  |
|  | Long-term loan | 2.2.3 |  | 100,000 |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **P** | **Discount rate** | **Loan balance** | **Interest expense** | **Payment** | **Principal reduction** |
| **A** | **B** | **C, C = C -F** | **D = C x B** | **E** | **F = E - D** |
| 1 | 8% | 100,000 | 8,000 | 25,046 | 17,046 |
| 2 | 8% | 82,954 | 6,636 | 25,046 | 18,409 |
| 3 | 8% | 64,545 | 5,164 | 25,046 | 19,882 |
| 4 | 8% | 44,663 | 3,573 | 25,046 | 21,473 |
| 5 | 8% | 23,190 | 1,855 | 25,046 | 23,190 |
|  |  |  | 25,228 | 125,228 | 100,000 |
|  |  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 3.21.R1 | | Post. ref. | Dr. | Cr. |
| Long-term loan | | 2.2.3 | 17,046 |  |
| Interest expense | | 6.2.1 | 8,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 25,046 |

## Discount (premium) allocation

On 1/1/Y1, XYZ sold a zero coupon 10,000 note, payable on 12/31/ Y1 for 9,160

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 9,160 |  |
| Discount | | 2.1.1.(5) | 840 |  |
|  | Note | 2.1.1.5 |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Interest expense | | 6.2.1 | 210 |  |
|  | Interest payable | 2.1.1.4 |  | 210 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Note | | 2.1.1.5 | 10,000 |  |
| Interest expense | | 6.2.1 | 210 |  |
| Interest payable | | 2.1.1.4 | 630 |  |
|  | Cash in bank | 1.1.1.2 |  | 10,000 |
|  | Discount | 2.1.1.(5) |  | 840 |

On 1/1/Y1, XYZ sold a zero coupon note with a nominal value of 10,000, payable on 12/31/Y3 for 7,829.

|  |  |  |  |
| --- | --- | --- | --- |
| **P.** | **Net value** | **Discount rate** | **Interest expense / Premium amort.** |
|  | **A(A+1) = A + C** | **B** | **C = A x B** |
| 1 | 7,829 | 8.50% | 665 |
| 2 | 8,495 | 8.50% | 722 |
| 3 | 9,217 | 8.50% | 783 |
|  |  |  | 2,171 |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 7,829 |  |
| Discount | | 2.1.1.(5) | 2,171 |  |
|  | Note | 2.2.3.3 |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Interest expense | | 6.2.1 | 166 |  |
|  | Discount | 2.1.1.(5) |  | 166 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1 / 31.3.R1 | | Post. ref. | Dr. | Cr. |
| Note | | 2.2.3.3 | 10,000 |  |
| Interest expense | | 6.2.1 | 196 |  |
|  | Cash in bank | 1.1.1.2 |  | 10,000 |
|  | Discount | 2.1.1.(5) |  | 196 |

On 1/1/Y1 XYZ sold a note 10,000, 12% coupon note payable on 31/12/Y3 for 10,894.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **P.** | **Net value** | **Discount rate** | **Interest expense** | **Interest paid** | **Premium amort.** |
|  | **A(A+1) = A + C** | **B** | **C = A x B** | **D** | **E = D - C** |
| 1 | 10,894 | 8.50% | 926 | 1,200 | 274 |
| 2 | 10,620 | 8.50% | 903 | 1,200 | 297 |
| 3 | 10,323 | 8.50% | 877 | 1,200 | 323 |
|  |  |  |  |  | 894 |
|  |  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 10, 894 |  |
|  | Note | 2.2.3.3.1 |  | 10,000 |
|  | Premium | 2.2.3.(3) |  | 894 |

### Liability plus “unstated rights or privileges”

On 1/1/Y1, XYZ sold ABC a 100,000 zero coupon note payable on 12/31/Y3 for 100,000. The same day, the companies entered into an agreement making ABC an exclusive supplier of product X. If XYZ had borrowed from the bank, it estimated it would have paid 12%. If ABC had bought a comparable note on the market, it determined it would have received 11%.

|  |  |  |  |
| --- | --- | --- | --- |
| **XYZ calculates discount** | | **ABC calculates discount** | |
| Nominal value: | 100,000 | Nominal value: | 100,000 |
| 100,000 / (1+12%)**[3 ]**= | 71,178 | 100,000 / (1+11%)**[3 ]**= | 73,119 |
| Discount : | 28,822 | Discount : | 26,881 |
|  |  |  |  |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **XYZ** | | | **ABC** | | |
|  | **A = A + C** | **B** | **C = A x B** | **A = A + C** | **B** | **C = A x B** |
| 1 | 71,178 | 12% | 8,541 | 73,119 | 11% | 8,043 |
| 2 | 79,719 | 12% | 9,566 | 81,162 | 11% | 8,928 |
| 3 | 89,286 | 12% | 10,714 | 90,090 | 11% | 9,910 |
|  |  |  | 28,822 |  |  | 26,881 |
|  |  |  |  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 (XYZ) | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 100,000 |  |
| Discount | | 2.2.3.(3) | 28,822 |  |
|  | Note | 2.2.3.3 |  | 100,000 |
|  | Deferred interest | 2.2.9 |  | 28,822 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 (ABC) | | Post. ref. | Dr. | Cr. |
| Note | | 1.2.2.3 | 100,000 |  |
| Deferred interest | | 1.5.4.2 | 26,881 |  |
|  | Cash in bank | 1.1.1.2 |  | 100,000 |
|  | Discount | 1.2.2.(3) |  | 26,881 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 (XYZ) | | Post. ref. | Dr. | Cr. |
| Deferred interest | | 2.2.9 | 9,607 |  |
| Interest expense | | 6.2.1 | 8,541 |  |
|  | Cost of sales | 5.1.4 |  | 9,607 |
|  | Discount | 2.2.3.(3) |  | 8,541 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 (ABC) | | Post. ref. | Dr. | Cr. |
| Revenue | | 4 | 8,960 |  |
| Discount | | 1.2.2.(3) | 8,043 |  |
|  | Interest revenue | 6.2.1 |  | 8,960 |
|  | Deferred interest | 1.5.4.2 |  | 8,043 |

### Asset acquired for financial instrument

On 1/1/Y1, XYZ registered 10,000 negotiable, 5-year notes with a nominal value of 1,000 paying a 9% coupon to be issued on an as needed basis. During 2YY1, it issued 5,000 notes and they began to trade on a secondary market. On 3/14/Y2, XYZ exchanged 50 yet un-issued notes for a machine with fair value of 50,000. That day the notes it had already issued were trading at 990.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/14/Y2 / 14.3.R2 | | Post. ref. | Dr. | Cr. |
| Machine | | 1.3.3.1.1 | 49,500 |  |
| Discount | | 2.2.3.(3) | 500 |  |
|  | Notes payable | 2.2.3.3 |  | 50,000 |

On 1/1/Y1, XYZ bought a machine with a fair value of 10,000. In exchange it gave the machine’s manufacturer a non-negotiable, zero coupon note with a nominal value of 12,544 payable 12/31/Y2.

|  |  |  |  |
| --- | --- | --- | --- |
| **P.** | **Net value** | **Discount rate** | **Interest expense / Premium amort.** |
|  | **A(A+1) = A + C** | **B** | **C = A x B** |
| 1 | 10,000 | 12% | 1,200 |
| 2 | 11,200 | 12% | 1,344 |
|  |  |  | 2,544 |
|  |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Machine | | 1.3.3.1.1 | 10,000 |  |
| Discount | | 2.2.3.(3) | 2,544 |  |
|  | Notes payable | 2.2.3.3 |  | 12,544 |

## Provisions

IAS 37.14: A provision shall be recognised when:

(a) an entity has a present obligation (legal or constructive [**[6]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote6sym) ) as a result of a past event;

(b) it is probable [**[7]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote7sym) that an outflow of resources embodying economic benefits [**[8]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote8sym) will be required to settle the obligation; and

(c) a reliable estimate can be made [**[9]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote9sym) of the amount of the obligation.

If these conditions are not met, no provision shall be recognised.

### Provisions are generally recognized for

Bonuses and compensated absences

Product warranties

Coupons, premiums, etc.

Damages: defects, environmental, etc.

Litigation

Onerous contracts

Self or under-insurance

Expropriation, nationalization, theft, etc.

Restructuring

### Provisions are not recognized for

Repairs and maintenance

Risks assumed by insurance companies

Hedged risks

Expected changes in law

General business risk

#### Example

On 3/15/Y2, XYZ learned that it was the defendant in a product liability suit filed by a customer that purchased a defective product on 12/15/Y1. After consulting legal, XYZ’s accountant determined that the entity would (with a probability in excess of 90%) pay damages of between 100,000 and 500,000. Although legal‘s estimate was 150,000, after weighing the available facts [**[10]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote10sym) , she recognized 246,663.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Litigation | | 6.4.11 | 246,663 |  |
|  | Litigation provision | 2.1.4.5 |  | 246,663 |
| Recognition of litigation provision | | Recorded by PS on 1/15/R2 | | |

The footnotes would also contain additional disclosure such as: at year-end 1, the company was a party to several legal processes where it stood both in the position of plaintiff and defendant. If the company were not to succeed in any of these processes (a result with a probability of less than 3.2%) it is estimated that it would pay out damages of between 5,896,256 and 9,984,699. If, on the other hand, the company were successful in all cases (a result with a probability of approaching than 4.8%), it would be entitled to receive damages of between 4,967,455 and 12,677,934. The amount recognized in the balance sheet (753.917) represents the most likely outcome of all of cases. Although they were created with due care after examining and weighing all available evidence and all reasonable foreseeable risks and circumstances, these estimates may prove to be less than wholly accurate in light of events and circumstances that cannot, at present, be predicted or fully quantified [**[11]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote11sym) .

#### Allowances, funds, provisions and reserves

Careless translations of the following items occasionally cause complications. Properly [**[12]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote12sym) they should be translated and disclosed as follows:

|  |  |  |
| --- | --- | --- |
| **XYZ Inc. Statement of financial position As of December 31, 2YY1** |  |  |
| **Assets** | X 1,000,000 | |
| Cash |  | 10 |
| Total receivables | 20 |  |
| *Allowance for bad debt* | *(5)* |  |
| Net receivables |  | 15 |
| Inventory |  | 30 |
| Investments and financial instruments |  | 100 |
| *Pension fund (assets restricted for employee post-retirement benefits)* | *5* |  |
| *Sinking fund (assets restricted for debt retirement)* | *15* |  |
| *Total funds (restricted assets)* |  | *20* |
| Property, plant and equipment |  | 120 |
| Intangible assets |  | 200 |
| Total assets |  | 375 |
|  |  |  |
| **Liabilities and Equity** |  |  |
| Payables |  | 15 |
| Short-term loans |  | 5 |
| *Litigation provision* | *3* |  |
| *Asset disposal provision* | *7* |  |
| *Total provisions* |  | *10* |
| Bonds payable |  | 50 |
| Total liabilities |  | 80 |
| Paid in capital |  | 150 |
| Unappropriated retained earnings | 100 |  |
| *Appropriated retained earnings (reserves)* | *45* |  |
| Total retained earnings |  | 145 |
| Total equity |  | 295 |
| Total liabilities and equity |  | 375 |
|  |  |  |

[**1**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote1anc): Although IAS 39 does not explicitly state that short-term shall be defined as 12 months or less, this is clearly its intent.

[**2**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote2anc): AG58: If an issuer of a debt instrument repurchases that instrument, the debt is extinguished even if the issuer is a market maker in that instrument or intends to resell it in the near term.

[**3**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote3anc): Since it is logical to discuss accruals as a single topic (rather and as accrued assets and accrued liabilities), the entire discussion is presented under Accruals, near the beginning of this publication.

[**4**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote4anc): If an entity’s operating cycle clearly differs, it can (IAS 1.69.a and 70) select a different “annual” period than 12-months. However since this choice must (IAS 1.36) be disclosed, the reasons explained and a disclaimer that the resulting reports are not comparable (with entities using a 12 month year) provided, it is rarely used in practice.

[**5**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote5anc): IAS 39.43: “When a financial asset or financial liability is recognised initially, an entity shall measure it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.”

[**6**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote6anc): For example, a multinational company spills toxic waste in a country without strict environmental laws. Although it is not legally obligated, expectations (supplier, customer, non-governmental organization, public) leave it with a constructive obligation to clean up.

[**7**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote7anc): 50% or more certain.

[**8**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote8anc): Commonly, the benefit is cash, but occasionally it can be a building, machine, patent, beneficial agreement, etc.

[**9**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote9anc): When it is impossible to make an exact estimate, the most likely amount is recognized and the range (including a discussion of how it was determined) is disclosed in the footnotes.

[**10**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote10anc): Facts: the plaintiff was demanding 500,000. The entity’s council was prepared to offer 100,000 to settle immediately and the legal departments best estimate was at most 150,000. However, after examining three prior cases, the accountant learned that, legal’s initial estimate was 64.442% lower than the eventual, paid-out amount. She further confirmed her own estimate by doing an internet search of similar cases which found that in eight comparable situations, the minimum payout was 180,000, maximum 425,000 and average 253.728. She presented her methodology to the auditor, who did not have any qualifications.

[**11**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote11anc): Obviously, since published financial reports are, in addition to investors, read by opposing parties in legal proceedings, these disclosures are always submitted to the legal department for re-drafting. It is thus reasonable to expect the final text to be considerably less succinct.

[**12**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=28#sdfootnote12anc): Although fairly simple in concept, the difference between allowances, funds, provisions and reserves causes all manner of practical complications. Rather than conceptual, the primary reason is linguistic: native English speakers (even some with an accounting background) often consider these expressions (together with accruals and adjustments) to be interchangeable.

Obviously, this publication cannot correct these semantic inconsistencies. Instead, the above example is presented to facilitate communication. When faced with someone who seems to be using the term “adjustment” (et. al ) in an odd manner, one would simply have that person point to where his or her “adjustment” would appear on this balance sheet restoring (assuming that person actually knows what he or she is “adjusting” and why) clarity to the conversation.

# Equity

From a theoretical perspective, equity is simply the difference between assets and liabilities. Being a relatively simple area, the accounting for equity does not, generally cause serious complications.

## Paid-in capital, share capital (IFRS)

On 1/1/Y1, the company initially offers its equity to the public and raises 1,000,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 1,000,000 |  |
|  | Paid in equity | 3.1 |  | 1,000,000 |

## Additional paid in capital

Same facts, except the company issued 10,000, 1 par value shares and decided to recognize that par value separately.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 1,000,000 |  |
|  | Paid in equity | 3.1.1 |  | 10,000 |
|  | Additional paid in equity | 3.1.2 |  | 990,000 |

## Legal capital

Same facts, except the laws of the country where the initial offering occurred, obligate the company to recognize legal capital of 10,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 1,000,000 |  |
|  | Legal capital | 3.1.1.1 |  | 10,000 |
|  | Additional paid in equity | 3.1.2 |  | 990,000 |

## Retained earnings

At year-end, XYZ determined that during Y1, it recognized revenue of 1,000,000 and expenses (excluding depreciation) of 500,000. Next it measured and recognized depreciation for the period[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=39#sdfootnote1sym). Finally, it closed out its nominal accounts[**[2]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=39#sdfootnote2sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Revenue | | 1.1.1.2 | 1,000,000 |  |
|  | Suspense account | 3.2.3 |  | 1,000,000 |
| Suspense account | | 3.2.3 | 500,000 |  |
|  | Expenses | 3.1.1.1 |  | 500,000 |
| Depreciation, COS | | 5.1.3.2.1 | 100,000 |  |
| Depreciation, Selling | | 5.2.10 | 25,000 |  |
| Depreciation, Admin | | 5.3.8 | 75,000 |  |
|  | Acc. Dep., Machine | 1.3.3.1.(1) |  | 100,000 |
|  | Acc. Dep., Storefront | 1.3.2.(2) |  | 25,000 |
|  | Acc. Dep., Offices | 1.3.3.(4) |  | 75,000 |
| Suspense account | | 3.2.3 | 200,000 |  |
|  | Depreciation, COS | 5.1.3.2.1 |  | 100,000 |
|  | Depreciation, Selling | 5.2.10 |  | 25,000 |
|  | Depreciation, Admin | 5.3.8 |  | 75,000 |
| Suspense account | | 3.2.3 | 300,000 |  |
|  | Retained earnings | 3.2 |  | 300,000 |

### Appropriated retained earnings (reserves)

Same facts, except company’s host country requires it to set aside 10% of its profit as a “legal reserve” (statutory appropriation). Since this reserve cannot be paid out as dividends, the company must disclose the amount in its IFRS report.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Suspense account | | 3.2.3 | 300,000 |  |
|  | Retained earnings | 3.2.1 |  | 2,000 |
|  | Legal capital[**[3]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=39#sdfootnote3sym) | 3.2.2 |  | 298,000 |

### Other comprehensive income

Other comprehensive income resembles retained earnings in being an accumulation prior periods’ income. It differs by comprising only these, specifically defined, items:

1. Gains (loss) on available-for-sale financial instruments

2. Gains (loss) on instruments used to hedge cash flow

3. Gains (loss) on translation of foreign operations

4. Accumulated pension liability adjustments

5. Changes in revaluation surplus

#### Examples

On 1/1/Y1, XYZ purchased shares for 10,000 and classified them as available-for-sale. On 12/31/Y1, and 12/31/Y2, the sale date, the shares were trading at 12 and 15.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Investment in stock | | 1.2.1.2 | 10,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | |  |  |  |
| Investment in stock | | 1.2.1.2 | 2,000 |  |
|  | Gain in OCI | 8.1 |  | 2,000 |
| Gain in OCI | | 8.1 | 2,000 |  |
|  | Accumulated OCI | 3.3.1 |  | 2,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y2 / 31.12.R2 | |  |  |  |
| Investment in stock | | 1.2.1.2 | 3,000 |  |
|  | Gain in OCI | 8.1 |  | 3,000 |
| Cash in bank | | 1.1.1.2 | 15,000 |  |
|  | Investment in stock | 1.2.1.2 |  | 15,000 |
| Reclassification | | 8.6 | 5,000 |  |
|  | Gain | 6.3.2 |  | 5,000 |
| Gain in OCI | | 8.1 | 3,000 |  |
|  | Accumulated OCI | 3.3.1 |  | 3,000 |
| Gain | | 6.3.2 | 5,000 |  |
|  | Suspense account | 3.2.3 |  | 5,000 |
| Accumulated OCI | | 3.3.1 | 5,000 |  |
|  | Reclassification / Reklasifikace | 8.6 |  | 5,000 |
| Suspense account | | 3.2.3 | 5,000 |  |
|  | Retained earnings | 3.2.1 |  | 5,000 |

|  |  |  |  |
| --- | --- | --- | --- |
| **XYZ Inc.**  **Statement of changes in financial position**  **For the year ended December**3**1, 2YY5** | | | |
|  | | R1 / Y1 | R2 / Y2 |
| Revenue | | 100,000 | 120,000 |
| Expenses | | 60,000 | 75,000 |
| Gain on sale of investment | |  | **5,000** |
| Net income | | 28,000 | 35,000 |
|  | |  |  |
| Other comprehensive income | |  |  |
|  | Unrealized gain | 2,000 | 3,000 |
|  | Reclassification |  | **(5,000)** |
| Comprehensive income | | 29,400 | 33,600 |
|  | |  |  |

Same facts, except the company recognizes deferred taxes (30% rate).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Investment in stock | | 1.2.1.2 | 10,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 10,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | |  |  |  |
| Investment in stock | | 1.2.1.2 | 2,000 |  |
|  | Gain in OCI | 8.1 |  | 2,000 |
| Gain in OCI | | 8.1 | 2,000 |  |
|  | Accumulated OCI | 3.3.1 |  | 2,000 |
| Income tax expense | | 7 | 600 |  |
|  | Deferred tax liability | 2.2.7 |  | 600 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y2 / 31.12.R2 | |  |  |  |
| Investment in stock | | 1.2.1.2 | 3,000 |  |
|  | Gain in OCI | 8.1 |  | 3,000 |
| Income tax expense | | 7 | 900 |  |
|  | Deferred tax liability | 2.2.7 |  | 900 |
| Cash in bank | | 1.1.1.2 | 15,000 |  |
|  | Investment in stock | 1.2.1.2 |  | 15,000 |
| Reclassification / Reklasifikace | | 8.6 | 5,000 |  |
|  | Gain | 6.3.2 |  | 5,000 |
| Deferred tax liability | | 2.2.7 | 1,500 |  |
|  | Taxes payable | 2.1.2.2.4 |  | 1,500 |
| Gain in OCI | | 8.1 | 3,000 |  |
|  | Accumulated OCI | 3.3.1 |  | 3,000 |
| Gain | | 6.3.2 | 5,000 |  |
|  | Suspense account | 3.2.3 |  | 5,000 |
| Accumulated OCI | | 3.3.1 | 5,000 |  |
|  | Reclassification / Reklasifikace | 8.6 |  | 5,000 |
| Suspense account | | 3.2.3 | 5,000 |  |
|  | Retained earnings | 3.2.1 |  | 5,000 |

### Other capital accounts

Treasury stock

Subscribed stock (shares issued but not fully paid)

Donated capital

Non-controlling (minority) interest

Shares held reserved for options and sales contracts

#### Disclosure

In addition to a Statement of Financial Position (Balance Sheet) and Statement of Changes in Financial Position (Income Statement), IFRS requires entities to publish a Statement of Changes in Equity. Since it is self-explanatory, the statement is presented here without commentary.

|  |  |
| --- | --- |
| **XYZ Inc.  Statement of changes in equity As of December**3**1, 2YY5** | |
|  |  |
| Beginning retained earnings | 1,300 |
| Net income for period | 600 |
| Common dividend | (200) |
| Preferred dividend | (100) |
| Ending retained earnings | 1,600 |
| Beginning common stock | 10,000 |
| Common stock issued 9/30/Y1 | 5,000 |
| Ending common stock | 15,000 |
| Beginning additional paid in capital | 40,000 |
| Additional capital paid-in | 20,000 |
| Ending additional paid in capital | 60,000 |
| Total ending equity | 76,600 |
|  |  |

Including a prior period adjustment, reserves and comprehensive income

|  |  |  |
| --- | --- | --- |
| **XYZ Inc.  Statement of changes in equity As of December**3**1, 2YY5** | | |
|  |  |  |
| Beginning retained earnings | 1,400 |  |
| Prior period adjustment | 100 |  |
| Adjusted retained earnings |  | 1,300 |
| Net income for period |  | 600 |
| Common dividend | (200) |  |
| Preferred dividend | (100) |  |
|  |  | (300) |
| Ending retained earnings |  | 1,600 |
| Appropriated plant expansion | (200) |  |
| Retained earnings appropriated by law | (100) |  |
|  |  | (300) |
| Unappropriated retained earnings |  | 1,300 |
| Beginning accumulated OCI | 350 |  |
| Gains on securities |  | 125 |
| Loss on cash flow hedge |  | (50) |
| Foreign currency adjustments |  | 25 |
| Reclassification adjustment |  | (50) |
| Other comprehensive income | 50 | 50 |
| Comprehensive income |  | 650 |
| Ending accumulated OCI | 400 |  |
|  |  |  |

**IAS 1**

|  |  |  |  |
| --- | --- | --- | --- |
| **XYZ Group**  **Statement of changes in equity**  **For the year ended**3**1 December 20X7** | | | |
|  | Share capital | Retained earnings | Translation of foreign operations |
| **Balance at 1 January 20X6** | 600,000 | 118,100 | (4,000) |
| Changes in accounting policy | – | 400 | – |
| Restated balance | 600,000 | 118,500 | (4,000) |
| **Changes in equity for 20X6** |  |  |  |
| Dividends | – | (10,000 | – |
| Total recognized income and expense for the year(h) | – | 53,200 | 6,400 |
| **Balance at**3**1 December 20X6** | 600,000 | 161,700 | 2,400 |
| **Changes in equity for 20X7**Issue of share capital | 50,000 | – | – |
| Dividends | – | (15,000) | – |
| Total recognized income and expense for the year(i) | – | 96,600 | 3,200 |
| Transfer to retained earnings | – | 200 | – |
| **Balance at**3**1 December 20X7** | 650,000 | 243,500 | 5,600 |
|  |  |  |  |

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **XYZ Group**  **Statement of changes in equity**  **For the year ended**3**1 December 20X7** | | | | | |
| Available for- sale assets | Cash flow hedges | Revaluation surplus | Total | Minority interest | Total equity |
| 1,600 | 2,000 | – | 717,700 | 29,800 | 747,500 |
| – | – | – | 400 | 100 | 500 |
| 1,600 | 2,000 | – | 718,100 | 29,900 | 748,000 |
|  |  |  |  |  |  |
| – | – | – | (10,000) | – | (10,000) |
| 16,000 | (2,400) | 1,600 | 74,800 | 18,700 | 93,500 |
| 17,600 | (400) | 1,600 | 782,900 | 48,600 | 831,500 |
| – | – | – | 50,000 | – | 50,000 |
| – | – | – | (15,000) | – | (15,000) |
| (14,400) | (400) | 800 | 85,800 | 21,450 | 107,250 |
| – | – | (200) | – | – | – |
| 3,200 | (800) | 2,200 | 903,700 | 70,050 | 973,750 |
|  |  |  |  |  |  |

[**1**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=39#sdfootnote1anc)To keep it simple, XYZ calculates its non-cash expenses only once per period, at year-end.

[**2**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=39#sdfootnote2anc) In many continental European countries, year-end closing involves closing both income statement (nominal) and balance sheet (real) accounts (in that the latter are opened again opened at the beginning of the next period with the same balances). Anglos-Saxon practice, closing just nominal accounts, thus seems odd to continental accountants (even though it does not lead to any practical differences).

**Note:** law, in some countries, obligates companies to pay out a set portion of profit as dividends (or to present period profit at the shareholder meeting, where shareholders approve dividends). As a result, it is fairly common (in these countries) to divide retained earnings into “profit for the period” (the period just ended) and “profit for prior periods” (the periods ended previously to the period that just ended). Since this is a legal, rather than IFRS, issue, it is beyond the scope of this publication.

[**3**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=39#sdfootnote3anc) Fortunately, net income, as calculated by the national standards of the host country, was considerably lower than IFRS net income.

Obviously, this publication cannot correct these semantic inconsistencies. Instead, the above example is presented to facilitate communication. When faced with someone who seems to be using the term “adjustment” (et. al ) in an odd manner, one would simply have that person point to where his or her “adjustment” would appear on this balance sheet restoring (assuming that person actually knows what he or she is “adjusting” and why) clarity to the conversation.

# Income statement

## Income statement by function

IFRS (IAS 1.86) does not prescribe the exact content or structure of an income statement, merely its minimum content (IAS 1.82 and 83). Consequently, the entity shall add line items (IAS 1.83) if it is relevant to an understanding of its performance.

## Example

|  |  |  |
| --- | --- | --- |
| **XYZ Inc. Statement of changes in financial position For the year ended December 31, 2YY5** | | |
|  | X 1,000,000 | |
|  | 2YY2 | 2YY1 |
| Net revenue | CU[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote1sym): 20,000 | CU17,000 |
| Cost of sales | 10,000 | 10,000 |
| Gross profit | 10,000 | 7,000 |
| Selling expenses | 550 | 700 |
| Delivery | 100 | 110 |
| Total selling expenses | 650 | 810 |
| Officer compensation | 1,500 | 1,000 |
| Staff salaries | 250 | 500 |
| Rent and deprecation | 200 | 600 |
| Other administrative expenses | 150 | 200 |
| Marketing and advertising | 900 | 1,200 |
| Research and development | 3,000 | 900 |
| Total G&A | 6,000 | 4,400 |
| Total SG&A | 6,650 | 5,210 |
| Operating income | 3,350 | 1,790 |
| Dividends and interest received | 10 | 90 |
| Sale of investments | 450 | (30) |
| Interest paid | (150) | (100) |
| Disposal gain (loss) | 350 | (80) |
| Corporate restructuring charge | (1,200) | 0 |
| Result of peripheral activities | (540) | (120) |
| Income before taxes | 2,810 | 1,670 |
| Income taxes | 422 | 251 |
| Net income | CU2,389 | CU1,420 |
|  |  |  |

Other recognised income and expense[**[2]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote2sym): (IAS 1.83) can be presented separately from the income statement (before tax or net of tax).

|  |  |  |
| --- | --- | --- |
|  |  |  |
| Exchange differences on translating foreign operations | 4,000 | 8,000 |
| Available-for-sale financial assets | (18,000) | 20,000 |
| Cash flow hedges | (500) | (3,000) |
| Gains on property revaluation | 600 | 2,700 |
| Actuarial gains (losses) on defined benefit pension plans | (500) | 1,000 |
| Share of other recognised income and expense of associates | 400 | (700) |
| Other recognised income and expense for the year, net of tax | (14,000) | 28,000 |
|  |  |  |

Example (IAS 1.IG 1 - 7)

|  |  |  |
| --- | --- | --- |
| **XYZ Group Statement of recognised income & expense For the year ended**3**1 December 20X7** | | |
|  | x 1000 currency units | |
|  | 20X7 | 20X6 |
| Revenue | 390,000 | 355,000 |
| Cost of sales | (245,000) | (230,000) |
| Gross profit | 145,000 | 125,000 |
| Other income | 20,667 | 11,300 |
| Distribution costs | (9,000) | (8,700) |
| Administrative expenses | (20,000) | (21,000) |
| Other expenses | (2,100) | (1,200) |
| Finance costs | (8,000) | (7,500) |
| Share of profit of associates | 35,100 | 30,100 |
| Profit before tax | 161,667 | 128,000 |
| Income tax expense | (40,417) | (32,000) |
| Profit for the year from continuing operations | 121,250 | 96,000 |
| Loss for the year from discontinued operations | – | (30,500) |
| PROFIT FOR THE YEAR | 121,250 | 65,500 |
| Other recognised income and expense |  |  |
| Exchange differences on translating foreign operations | 5,334 | 10,667 |
| Available-for-sale financial assets | (24,000) | 26,667 |
| Cash flow hedges | (667) | (4,000) |
| Gains on property revaluation | 933 | 3,367 |
| Actuarial gains (losses) on defined benefit pension plans | (667) | 1,333 |
| Share of other recognised income and expense of associates | 400 | (700) |
| Income tax relating to components of other recognised income and expense | 4,667 | (9,334) |
| Other recognised income and expense for the year, net of tax | (14,000) | 28,000 |
| Total Recognised Income and Expense for the Year | 107,250 | 93,500 |
|  |  |  |
| Profit attributable to: |  |  |
| Equity holders of the parent | 97,000 | 52,400 |
| Minority interest | 24,250 | 13,100 |
|  | 121,250 | 65,500 |
| Total recognised income and expense attributable to: |  |  |
| Equity holders of the parent | 85,800 | 74,800 |
| Minority interest | 21,450 | 18,700 |
|  | 107,250 | 93,500 |
| Earnings per share (in currency units): |  |  |
| Basic and diluted | 0.46 | 0.30 |
|  |  |  |

## Example of nature of expense income statement

|  |  |  |
| --- | --- | --- |
| **XYZ Group Statement of profit or loss for the year ended**3**1 December 20X7** | | |
|  | 20X7 | 20X6 |
| Revenue | 390,000 | 355,000 |
| Other income | 20,667 | 11,300 |
| Changes in inv. of finished goods and work in progress | (115,100) | (107,900) |
| Work performed by the entity and capitalised | 16,000 | 15,000 |
| Raw material and consumables used | (96,000) | (92,000) |
| Employee benefits expense | (45,000) | (43,000) |
| Depreciation and amortisation expense | (19,000) | (17,000) |
| Impairment of property, plant and equipment | (4,000) | – |
| Other expenses | (6,000) | (5,500) |
| Finance costs | (15,000) | (18,000) |
| Share of profit of associates(d) | 35,100 | 30,100 |
| Profit before tax | 161,667 | 128,000 |
| Income tax expense | (40,417) | (32,000) |
| Profit for the year from continuing operations | 121,250 | 96,000 |
| Loss for the year from discontinued operations | – | (30,500) |
| PROFIT FOR THE YEAR | 121,250 | 65,500 |
| Profit attributable to: |  |  |
| Equity holders of the parent | 97,000 | 52,400 |
| Minority interest | 24,250 | 13,100 |
|  | 121,250 | 65,500 |
| Earnings per share (in currency units): |  |  |
| Basic and diluted | 0.46 | 0.30 |
|  |  |  |

## Recognition

An income statement[[3]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote3sym): is generally dividend into these basic classifications[[4]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote4sym): :

1. Revenue

2. Cost of sales

3. Selling expenses (distribution costs)

4. Administrative (general) expenses

5. Other (non-operating) items

6. Income tax expenses

## Revenue[[5]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote5sym):

While it is not disallowed to present separate amounts[[6]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote6sym): for “revenue generated by the sale of merchandise”, “revenue generated by the sale of products”, “service revenue”, etc., it is more common to present a single “revenue” line item, in that the additional information is presented in the context of segment reporting (IFRS 8).

## Net revenue

Cash discounts and returns and allowances[**[7]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote7sym): are deducted from revenue to arrive at net revenue, which is presented on the income statement[**[8]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote8sym): .

## Cost of sales

1. Direct material and merchandise

a. Raw material: material (including purchased semi-finished goods) that becomes a physical part of the finished product from industrial commodities to purchased parts.

b. Merchandise: items purchased for resale on which no manufacturing will be performed.

2. Direct wages

Wages and other benefits (overtime, social security taxes and fees, health insurance, safety and hazard insurance, meals, clothing, aids, etc.) paid to employees for the time spent manufacturing (production activity).

3. Indirect manufacturing costs (manufacturing overhead)

a. Fixed: depreciation, rent and other costs that do not change in relation to production volume such as property taxes, etc.

b. Variable: factory (production) supplies (consumables), repairs and maintenance (MRE), quality control and inspection, utilities (electricity, hydrocarbons, water, sewage, waste removal, etc.), supervisor salaries, setup (re-tooling not capitalized as installation) and other costs do change in relation to production volume, etc.

## Selling expenses (distribution costs)

1. Salesperson’s salaries and commission

2. Sales staff wages and salaries

3. Rent & depreciation of sales assets

4. Delivery (shipping, freight out) and warehousing

5. Shrinkage

6. Travel, training and entertainment

7. Tradeshows and exhibits

8. Item specific advertising

9. Other items that are demonstrably related to the sales activity

## Administrative (general) expenses

1. Officer compensation

a. Base salary

b. Performance based pay (bonuses, premiums)

c. Fringe benefits

d. Pensions and Other Postretirement Benefits

e. Share-based payment arrangement (IFRS 2)

2. Office staff compensation

Same items (a. – e.) as with officers, if applicable

3. Rent & depreciation

4. Professional services

5. Marketing (advertising, public relations, etc.)

6. Research and development

## Non-operating items (gains, losses, other revenue and expense)

1. Other revenue

a. Interest

- Discount (premium), deferred interest amortization

b. Dividends

c. Rent

d. Royalties, licensing fees, etc.

e. Other items related to peripheral activities

2. Other expenses

a. Interest

- Discount (premium), deferred interest amortization

3. Gains

a. Fair value investments (realized, unrealized)

b. Derivates (held for speculation)

c. Foreign currency adjustments (not including foreign operations)

d. Asset disposal

e. Grants (non-reciprocal receipts)

f. Remeasurement (up) of investment property (IAS 40)

g. Etc.

4. Losses

a. Fair value investments (realized, unrealized)

b Derivates (held for speculation)

c. Foreign currency adjustments (not including foreign operations)

d. Inventory write-down (off)

e. Asset impairment charges

f. Asset disposal

g. Remeasurement (down) of investment property (IAS 40)

h. Etc.

## Income tax expenses

Income tax expenses (including deferred taxes) as recognized under IAS 12.

### Earnings per share

Since earnings per share is not “booked” (merely disclosed as supplemental information to net income), it is not discussed in this publication.

# Additional items

## Statement of cash flow

Since the Statement of Cash Flow is not “booked” (but rather calculated from changes in balance sheet items r on the basis of supplemental information), it is not discussed in this publication.

|  |  |  |
| --- | --- | --- |
| **XYZ Inc. Statement of cash flow (example using the direct method) As of December 31, 2XX1** | | |
| Cash flows from operating activities |  |  |
| Cash received from customers | 6,000 |  |
| Cash received as interest | 300 |  |
| Cash received as dividends | 200 |  |
| Insurance proceeds received | 200 |  |
| Cash provided by operations |  | 6,700 |
| Cash paid to suppliers and employees | (3,500) |  |
| Interest paid | (400) |  |
| Income taxes paid | (800) |  |
| Cash paid to settle lawsuit | (500) |  |
| Cash used in operations |  | (5,200) |
| Net cash provided by operations |  | 1,500 |
| Cash flows from investing activities |  |  |
| Proceeds from sale of plant capacity | 800 |  |
| Capital expenditure | (5,000) |  |
| Payment for company X (net) | (800) |  |
| Net cash flow from investing activities |  | (5,000) |
| Cash flows from financing activities |  |  |
| Borrowings under line of credit | 500 |  |
| Proceeds from sale of long-term debt | 2,300 |  |
| Proceeds from issuance of common stock | 6,000 |  |
| Principle payments under capital lease | (3,000) |  |
| Dividends paid | (250) |  |
| Net cash flow from financing activities |  | 5,050 |
| Net change in cash |  | 1,550 |
| Cash at beginning of period |  | 450 |
| Cash at end of period |  | 2,000 |
|  |  |  |

|  |  |  |
| --- | --- | --- |
| **XYZ Inc. Statement of cash flow (example using the indirect method) As of December 31, 2XX1** | | |
|  |  |  |
| Net income |  | 950 |
| Plus (minus) items not effecting cash |  |  |
| Depreciation and amortization | 500 |  |
| Allowance for losses on accounts receivable | 100 |  |
| Gain on sale of facility | (50) |  |
| Undistributed earnings in affiliate | (100) |  |
| Reversal of provision | 125 |  |
| Change in assets |  |  |
| Increase in accounts receivable | (200) |  |
| Decrease in inventory | 200 |  |
| Increase in pre-paid expenses | (25) |  |
| Decrease in accounts payable & accrued expenses | (250) |  |
| Increase in interest and income taxes payable | 50 |  |
| Increase in deferred taxes | 150 |  |
| Increases in other liabilities | 50 |  |
| Total non-cash items |  | 550 |
| Net cash provided by operations |  | 1,500 |
|  |  |  |

## Foreign currencies

The accounting for foreign currencies can be dividend into transactions (cash, buying, selling, borrowing or passive investments in a foreign currency) and investments[**[9]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote9sym): (foreign currency operations consolidated or accounted for using the equity method).

### Examples

### Transactions

On 12/15/Y1, XYZ bought 200,000 units of a foreign currency (FC) from its bank. The same day the FC was trading at 109 FC to 1 CR (currency of record). On 12/31/Y1, the end of XYZ’s fiscal year, the FC was trading at 112. On 1/15/Y2, the FC was trading at 100 and XYZ paid it out to buy goods valued at FC 200,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/15/Y1 / 15.12.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank (FC) | | 1.1.1.2.CM | 1, 835 |  |
|  | Cash in bank | 1.1.1.2.ÚM |  | 1, 835 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Forex loss | | 6.4.5 | 49 |  |
|  | Cash in bank (FC) | 1.1.1.2.CM |  | 49 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/15/Y2 / 15.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank (FC) | | 1.1.1.2.CM | 214 |  |
|  | Forex gain | 6.3.1 |  | 214 |
| Inventory | | 1.1.4.5 | 2,000 |  |
|  | Cash in bank (FC) | 1.1.1.2.CM |  | 2,000 |

Same facts, except XYZ bought goods costing FC 200,000 and paid in the FC.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/15/Y1 / 15.12.R1 | | Post. ref. | Dr. | Cr. |
| Inventory | | 1.1.4.5 | 1, 835 |  |
|  | Trade payable in FC | 1.1.1.2.CM |  | 1, 835 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Trade payable in FC | | 1.1.1.2.CM | 49 |  |
|  | Forex gain | 6.3.1 |  | 49 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/15/Y2 / 15.1.R2 | | Post. ref. | Dr. | Cr. |
| Trade payable in FC | | 1.1.1.2.CM | 1,786 |  |
| Forex loss | | 6.4.5 | 214 |  |
|  | Cash in bank | 1.1.1.2 |  | 2,000 |

Same facts, except the company sold the goods.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/15/Y1 / 15.12.R1 | | Post. ref. | Dr. | Cr. |
| Trade receivable, FC | | 1.1.3.CM | 1, 835 |  |
|  | Revenue | 4 |  | 1, 835 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Forex loss | | 6.4.5 | 49 |  |
|  | Trade receivable, FC | 1.1.3.CM |  | 49 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/15/Y2 / 15.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 2,000 |  |
|  | Forex gain | 6.3.1 |  | 214 |
|  | Trade receivable, FC | 1.1.3.CM |  | 1,786 |

Same facts, except XYZ bought 1000 shares of ABC for FC 200. On 12/31, the shares were trading for FC 210 and it sold them for FC 195 on 1/15/Y2.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/15/Y1 / 15.12.R1 | | Post. ref. | Dr. | Cr. |
| Investment | | 1.2.1.2 | 1, 835 |  |
|  | Cash in bank | 1.1.1.2 |  | 1, 835 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Investment | | 1.2.1.2 | 85 |  |
|  | Gain | 6.3.2 |  | 85 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/15/Y2 / 15.1.R2 | | Post. ref. | Dr. | Cr. |
| Investment | | 1.2.1.2 | 30 |  |
|  | Gain | 6.3.2 |  | 30 |
| Cash in bank | | 1.1.1.2 | 1,950 |  |
|  | Investment | 1.2.1.2 |  | 1,950 |

Same facts, except the investment was classified as available-for-sale[[10]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote10sym): .

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/15/Y1 / 15.12.R1 | | Post. ref. | Dr. | Cr. |
| Investment | | 1.2.1.2 | 1, 835 |  |
|  | Cash in bank | 1.1.1.2 |  | 1, 835 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Investment | | 1.2.1.2 | 85 |  |
|  | OCI gain | 8.1 |  | 85 |
| OCI gain | | 8.1 | 85 |  |
|  | Accumulated OCI | 3.3.1 |  | 85 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/15/Y2 / 15.1.R2 | | Post. ref. | Dr. | Cr. |
| Investment | | 1.2.1.2 | 30 |  |
|  | OCI gain | 8.1 |  | 30 |
| OCI gain | | 8.1 | 30 |  |
|  | Accumulated OCI | 3.3.1 |  | 30 |
| Cash in bank | | 1.1.1.2 | 1,950 |  |
|  | Investment | 1.2.1.2 |  | 1,950 |
| Reclassification | | 8.6 | 115 |  |
|  | Gain | 6.3.2 |  | 115 |
| Accumulated OCI | | 3.3.1 | 115 |  |
|  | Reclassification | 8.6 |  | 115 |

Same facts, except XYZ acquired 1000 notes with an 8% coupon (payable to the holder of record each 12/31) for FC 200 each. For simplicity, it is assumed the notes were acquired at nominal value (in practice, a discount or premium would also have to be amortized).

|  |  |  |  |
| --- | --- | --- | --- |
| **FC purchase price** | **Exchange rate** | **CR purchase price** | **Forex gain (loss)** |
| **A** | **B** | **C = A / B** | **D = (C+1) – C** |
| 200,000 | 109 | 1,835 |  |
| 200,000 | 112 | 1,786 | (49) |
| 200,000 | 100 | 2,000 | 214 |

|  |  |  |  |
| --- | --- | --- | --- |
| **FC market price** | **Fair value in CR** | **Total Gain (loss)** | **Fair value gain / loss** |
| **E** | **F = B x E** | **G = (F+1)– F** | **H=G – D** |
| 200,000 | 1,835 |  |  |
| 210,000 | 1,875 | 40 | 89 |
| 195,000 | 1,950 | 75 | (139) |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/15/Y1 / 15.12.R1 | | Post. ref. | Dr. | Cr. |
| Investment | | 1.2.2.2 | 1, 835 |  |
|  | Cash in bank | 1.1.1.2 |  | 1, 835 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 143 |  |
|  | Interest revenue | 6.1.1 |  | 143 |
| Forex loss | | 6.4.5 | 49 |  |
|  | Investment | 1.2.2.2 |  | 49 |
| Investment | | 1.2.2.2 | 89 |  |
|  | OCI gain | 8.1[**[11]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote11sym): |  | 89 |
| OCI gain | | 8.1 | 89 |  |
|  | Accumulated OCI | 3.3.1 |  | 89 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/15/Y2 / 15.1.R2 | | Post. ref. | Dr. | Cr. |
| Investment | | 1.2.2.2 | 214 |  |
|  | Forex gain | 6.3.1 |  | 214 |
| OCI loss | | 8.1 | 139 |  |
|  | Investment | 1.2.2.2 |  | 139 |
| Accumulated OCI | | 3.3.1 | 139 |  |
|  | OCI loss | 8.1 |  | 139 |
| Cash in bank | | 1.1.1.2 | 1,950 |  |
|  | Investment | 1.2.2.2 |  | 1,950 |
| Loss | | 6.4 | 50 |  |
|  | Reclassification | 8.6 |  | 50 |
| Reclassification | | 8.6 | 50 |  |
|  | Accumulated OCI | 3.3.1 |  | 50 |

#### Fair value hedge

Same facts, except on 12/15/Y1, XYZ bought goods to be paid for in 30 days in the FC in 30 days. The same day, it entered into a forward contract allowing it to buy the FC at 109. The agreement allowed net settlement. On 1/15/Y2 it paid the invoice and settled the forward.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/15/Y1 / 15.12.R1 | | Post. ref. | Dr. | Cr. |
| Inventory | | 1.1.4.5 | 1, 835 |  |
| Forward[**[12]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote12sym): | | 1.2.3.1 | 0 |  |
|  | FC trade payable | 2.1.1 |  | 1, 835 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| FC trade payable | | 2.1.1 | 49 |  |
|  | Offsetable gain | 6.3.9 |  | 49 |
| Offsetable gain | | 6.3.9 | 49 |  |
|  | Forward | 1.2.3.1 |  | 49 |

Since the gain and loss (in a fair value hedge) are offset, the company, for simplicity’s sake, decided to use a single account. If one were bored (and wanted to increase the likelihood of an error), he could also use two accounts.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| FC trade payable | | 2.1.1 | 49 |  |
|  | Offsetable gain | 6.3.9 |  | 49 |
| Offsetable loss | | 6.4.13 | 49 |  |
|  | Forward | 1.2.3.1 |  | 49 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/15/Y2 / 15.1.R2 | | Post. ref. | Dr. | Cr. |
| Offsetable gain | | 6.3.9 | 214 |  |
|  | FC trade payable | 2.1.1 |  | 214 |
| Forward | | 1.2.3.1 | 214 |  |
|  | Offsetable gain | 6.3.9 |  | 214 |
| FC trade payable | | 2.1.1 | 2,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 2,000 |
| Cash in bank | | 1.1.1.2 | 165 |  |
|  | Forward | 1.2.3.1 |  | 165 |

Same facts, except XYZ entered into a forward on FC 200,000 at 107.8167 (paid a 20 premium).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/15/Y1 / 15.12.R1 | | Post. ref. | Dr. | Cr. |
| Inventory | | 1.1.4.5 | 1, 835 |  |
|  | FC trade payable | 2.1.1 |  | 1, 835 |
| Def. hedging cost | | 1.1.5.3.4 | 20 |  |
|  | Forward | 2.1.3.2 |  | 20 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| FC trade payable | | 2.1.1 | 49 |  |
|  | Offsetable gain | 6.3.9 |  | 49 |
| Offsetable gain | | 6.3.9 | 49 |  |
|  | Forward | 1.2.3.1 |  | 49 |
| Hedging costs | | 6.2.2 | 10 |  |
|  | Def. hedging cost | 1.1.5.3.4 |  | 10 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/15/Y2 / 15.1.R2 | | Post. ref. | Dr. | Cr. |
| Offsetable gain | | 6.3.9 | 214 |  |
|  | FC trade payable | 2.1.1 |  | 214 |
| Forward | | 1.2.3.1 | 214 |  |
|  | Offsetable gain | 6.3.9 |  | 214 |
| FC trade payable | | 2.1.1 | 2,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 2,000 |
| Cash in bank | | 1.1.1.2 | 145 |  |
|  | Forward | 1.2.3.1 |  | 145 |
| Hedging costs | | 6.2.2 | 10 |  |
|  | Def. hedging cost | 1.1.5.3.4 |  | 10 |

#### Cash flow hedge

Same facts, except XYZ forecast it would buy goods valued at FC 200,000 (it was, however, under no obligation to do so). On 1/15/Y2, XYZ bought the goods and resold them on 2/1/Y2 XYZ for CR 2,500.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/15/Y1 / 15.12.R1 | | Post. ref. | Dr. | Cr. |
| Forward[**[13]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote13sym): | | 1.2.3.1 | 0 |  |
|  | Forward | 1.2.3.1 |  | 0 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| OCI loss | | 8.2 | 49 |  |
|  | Forward | 2.1.3.1 |  | 49 |
| Accumulated OCI | | 8.2 | 49 |  |
|  | OCI loss | 8.2 |  | 49 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/15/Y2 / 15.1.R2 | | Post. ref. | Dr. | Cr. |
| Forward | | 2.1.3.1 | 214 |  |
|  | OCI gain | 8.2 |  | 214 |
| OCI loss | | 8.2 | 214 |  |
|  | Accumulated OCI | 8.2 |  | 214 |
| Cash in bank | | 1.1.1.2 | 165 |  |
|  | Forward | 1.2.3.1 |  | 165 |
| Inventory | | 1.1.4.5 | 2,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 2,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/1/Y2 / 1.2.R2 | | Post. ref. | Dr. | Cr. |
| Accounts receivable | | 1.1.3 | 2,500 |  |
|  | Revenue | 4 |  | 2,500 |
| Cost of goods sold | | 5.1.4 | 2,000 |  |
|  | Inventory | 1.1.4.5 |  | 2,000 |
| Accumulated OCI | | 8.2 | 165 |  |
|  | Cost of goods sold | 5.1.4 |  | 165 |

### Investments (Functional currency)

Local currency: the currency of the country where the entity is domiciled and does its primary business.

Foreign currency: the currency of the country other than the one where the entity is domiciled and does its primary business.

Currency of record (accounting currency): the currency in which the entity keeps its primary accounts.

Reporting (presentation) currency: the currency in which the entity drafts a financial report (submitted to its parent of published).

Functional currency: the currency of the country where the entity does its primary business when different from the country of domicile[**[14]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote14sym): .

#### Methods

Prior to consolidation, it is necessary for all the financial statements of all the entities to be in the same currency. This translation can be accomplished using one of two methods: the “current rate” and the “monetary / non-monetary” methods.

The current rate method is used where the parent and subsidiary have different functional currencies to convert the subsidiary’s functional currency to the parent’s functional currency.

The monetary / non-monetary method (also known as re-measurement) is use when they have the same functional currencies, but different currencies of record (accounting currencies) to convert the currency of record to the functional currency.

### Current rate method

Assets and liabilities: at the exchange rate current on the balance sheet date

Revenues, expenses, gains, and losses: at the exchange rate current on the date of the transaction

A weighted average rate for period may be used if a high volume of transactions exists.

Retained earnings: at the weighted average exchange rate for the period [**[15]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote15sym): .

Paid-in-capital: at the exchange rate that was current on the date the investment was made (the historical rate).

#### Example

On 1/1/Y1, XYZ acquired a 100% interest in ABC for 375,000[[16]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote16sym): units of a foreign currency [[17]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote17sym): . At the time, the exchange rate between the FC (which was both ABC’s functional currency and currency of record) and the parent’s functional currency (which was also its reporting currency and currency of record) was 25:1.

|  |  |  |  |
| --- | --- | --- | --- |
| **ABC Unconsolidated balance sheet As at 1/1/R1** | | | |
|  | FC-S / FM-D | Ex | FC-M / FM-M |
|  | A | B | C = A / B |
| Cash | 6,250 | 25 | 250 |
| Receivables | 6,250 | 25 | 250 |
| Inventory | 12,500 | 25 | 500 |
| Current assets | 25,000 |  | 1,000 |
| PP&E | 350,000 | 25 | 14,000 |
| Total assets | 375,000 |  | 15,000 |
|  |  |  |  |
| Payables | 0 | 25 | 0 |
| Loans | 0 | 25 | 0 |
| Total liabilities | 0 |  | 0 |
| Common stock | 50,000 | 25 | 2,000 |
| Additional paid in capital | 200,000 | 25 | 8,000 |
| Retained earnings | 100,000 | 25 | 5,000 |
| Total equity | 350,000 |  | 14,000 |
| Liabilities and equity | 375,000 |  | 15,000 |
|  |  |  |  |

On 12/31/R1, prior to consolidation, ABC converted its balance sheet and income statement to its parent’s functional currency.

|  |  |  |  |
| --- | --- | --- | --- |
| **ABC Unconsolidated balance sheet As at 12/31/R1** | | | |
|  | FCS / FMD | Ex | FCM / FMM |
|  | A | B | C = A / B |
| Cash | 6,250 | 27 | 500 |
| Receivables | 6,250 | 27 | 700 |
| Inventory | 12,500 | 27 | 800 |
| Current assets | 25,000 |  | 2,000 |
| Property plant and equipment | 350,000 | 27 | 16,000 |
| Total assets | 375,000 |  | 18,000 |
|  |  |  |  |
| Payables | 0 | 27 | 0 |
| Loans | 0 | 27 | 0 |
| Total liabilities | 0 |  | 0 |
| Common stock | 50,000 | 25 | 2,000 |
| Additional paid in capital | 200,000 | 25 | 8,000 |
| Retained earnings | 200,000 | 26 | 7,692 |
| Exchange rate difference | 0 |  | 308 |
| Total equity | 350,000 |  | 17,000 |
| Liabilities and equity | 375,000 |  | 18,000 |
|  |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| **ABC Unconsolidated income statement For the year ended 12/31/R1** | | | |
|  | ABC |  | ABC-XYZ |
| Revenue | 312,000 | 26 | 52,000 |
| Expenses | 104,000 | 26 | 17,000 |
| Depreciation | 78,000 | 26 | 13,000 |
| Taxes | 26,000 | 26 | 4,000 |
| Net income | 104,000 |  | 18,000 |
|  |  |  |  |

Once the conversion was complete, the company proceeded as in any other consolidation (see: Consolidation)

#### Monetary/non-monetary method

* Common non-monetary items
* Securities carried at cost (not fair value)
* Inventories (except those carried at fair value)
* Accruals (prepaid expenses)
* Property, plant and equipment (accumulated depreciation)
* Intangible assets / (accumulated depreciation)
* Deferred items
* Common stock
* Preferred stock
* Revenues and expenses related to non-monetary items
* Cost of goods sold
* Depreciation of property, plant, and equipment
* Amortization of intangible assets
* Common monetary items
* Cash, cash equivalents, receivables, payables
* Investments, other assets, liabilities carried at fair value
* Revenue and expenses not related to non-monetary items

[1](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote1anc): Currency unit (€, $, £, ¥)

[2](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote2anc): Also known as Comprehensive Income.

[3](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote3anc): Assuming a function of expense income statement is presented.

[4](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote4anc): Other recognized income and expense (IAS 1.83) is (more commonly) presented as a separate statement.

[5](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote5anc): See: Derecognition of inventory and recognition of revenue and Unearned revenue.

[6](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote6anc): Common practice under various national accounting systems.

[7](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote7anc): See: Cash discounts, returns and allowances, delivery and related costs.

[8](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote8anc): If either of these amounts is significant, additional footnote disclosure is provided.

[**9**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote9anc): IFRS does not employ this terminology. Instead IAS 21 refers to transactions and translations. Unfortunately, the manner in which the standard presents foreign currencies makes it (along with IAS 12, 39 a IFRS 4) a prime example of how unintelligible, impenetrable and (for the uninitiated) unserviceable accounting text can be (if someone really puts in the effort). Consequently, the terminology presented here is sourced from general accounting literature and US GAAP standard FAS 52 (which, while conceptually identical, provides a clear, concise and practically applicable discussion).

[**10**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote10anc): IFRS (IAS 39.AG83) considers shares to be a „non-monetary“ investment.

[**11**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote11anc): Since the gain and loss are cumulated, it is simply easier to use one account.

[**12**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote12anc): Although (since the forward had no value) this entity was totally unnecessary, the company’s accountant (influenced, as he was, by his experience with legalistic, national standards of his youth) was opined that the company aught to formally recorded every transaction even when it has no effect on its financial statements.

[**13**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote13anc): Since it had a zero value, the company was not obligated to record. It did so primarily out expediency (and so it would not forget to re-measured it at period end).

[**14**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote14anc): IFRS (IAS 27.9-14) goes into considerable depth discussing the functional currency. In practice, this topic does not, generally, cause any significant complications. The reason is that the functional currency and the local currency are usually the same. The only situation where they commonly differ is when the entity is domiciled in a country (for example to utilize advantageous legislation) different for the one in which it does its primary business.

[**15**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote15anc): While not explicitly mentioned, this procedure is implicitly required for this and the following item.

[**16**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote16anc): For simplicity’s sake, it is assumed that the fair value of ABC’s assets was equal to their carving amount (net book value).

[**17**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=37#sdfootnote17anc): Acronyms used: FC (foreign currency), LC (local currency), CR (currency or record, a.k.a. accounting currency), RC (reporting currency), FC (functional currency), P (parent), S (subsidiary). For example, the parent’s (XYZ’s) functional currency would be FC-P while the subsidiary’s (ABC’s) accounting currency would be CR-S.

## 

## De-recognition of inventory and recognition of revenue

At the moment (or at least in the period) of delivery[**[1]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote1sym) , an entity derecognizes inventory (against cost of sales) and recognizes revenue (against cash or receivables). Accounting policy for inventory derecognition is, as a result, not determined primarily by applying IAS 2, but rather by applying IAS 18[**[2]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote2sym).

### Services

Under IFRS (IAS 2.19) service providers have an obligation to apply inventory accounting. However, since services lack physical substance, rather than recording costs associated with services as “inventory” they often (though not always) record them as „accruals“. Unless this procedure violates either IAS 2[**[3]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote3sym) or 18[**[4]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote4sym) , it is generally considered acceptable.

### Delivery goods, rendering services

The moment of delivery is generally on the basis of:

1. The transfer of the risks and rewards of ownership, or

2. The contractual terms of the agreement[**[5]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote5sym).

#### Examples

#### Sale of goods

On 12/30/Y1 customer # 456 will-called merchandise # 321 valued at 2,000 from XYZ. The customer paid on 2/1/Y2.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/30/Y1**/**30.12.R1 | | Post. ref. | Dr. | Cr. |
| Receivable | | 2.1.1.1.456 | 2,000 |  |
|  | Revenue | 4 |  | 2,000 |
| Cost of sales | | 5.1.4 | 1,000 |  |
|  | Merchandise inventory | 1.1.4.5.321 |  | 1,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/1/Y2**/**2.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 2,000 |  |
|  | Receivable | 2.1.1.1.456 |  | 2,000 |

#### Goods in transit

Same facts except XYZ delivered the goods on 1/2/Y2 (at period end they were in transit).

|  |  |  |  |
| --- | --- | --- | --- |
| 12/30/Y1**/**30.12.R1 | Post. ref. | Dr. | Cr. |
| No entry[**[6]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote6sym) |  |  |  |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/2/Y2**/**2.1.R2 | | Post. ref. | Dr. | Cr. |
| Receivable | | 2.1.1.1.456 | 2,000 |  |
|  | Revenue | 4 |  | 2,000 |
| Cost of sales | | 5.1.4 | 1,000 |  |
|  | Merchandise inventory | 1.1.4.5.321 |  | 1,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/1/Y2**/**2.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 2,000 |  |
|  | Receivable | 2.1.1.1.456 |  | 2,000 |

Same facts except XYZ released the goods on 12/30/Y1 to a third party shipper.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/30/Y1**/**1.30.R1 | | Post. ref. | Dr. | Cr. |
| Receivable | | 2.1.1.1.456 | 2,000 |  |
|  | Revenue | 4 |  | 2,000 |
| Cost of sales | | 5.1.4 | 1,000 |  |
|  | Merchandise inventory | 1.1.4.5.321 |  | 1,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/1/Y2**/**2.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 2,000 |  |
|  | Receivable | 2.1.1.1.456 |  | 2,000 |

Same facts except XYZ paid the freight charges.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/30/Y1**/**1.30.R1 | | Post. ref. | Dr. | Cr. |
| Receivable | | 2.1.1.1.456 | 2,000 |  |
|  | Revenue | 4 |  | 2,000 |
| Cost of sales | | 5.1.4 | 1,000 |  |
|  | Merchandise inventory | 1.1.4.5.321 |  | 1,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/1/Y2**/**2.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 2,000 |  |
|  | Receivable | 2.1.1.1.456 |  | 2,000 |

Same facts except the customer had seven calendar days for quality control and had a right to return any goods not up to specifications.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/8/Y2**/**8.1.R2 | | Post. ref. | Dr. | Cr. |
| Receivable | | 2.1.1.1.456 | 2,000 |  |
|  | Revenue | 4 |  | 2,000 |
| Cost of sales | | 5.1.4 | 1,000 |  |
|  | Merchandise inventory | 1.1.4.5.321 |  | 1,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/1/Y2**/**2.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 2,000 |  |
|  | Receivable | 2.1.1.1.456 |  | 2,000 |

Same facts except the customer confirmed acceptance on 1/4/Y2.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/4/Y2**/**4.1.R2 | | Post. ref. | Dr. | Cr. |
| Receivable | | 2.1.1.1.456 | 2,000 |  |
|  | Revenue | 4 |  | 2,000 |
| Cost of sales | | 5.1.4 | 1,000 |  |
|  | Merchandise inventory | 1.1.4.5.321 |  | 1,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/1/Y2**/**2.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 2,000 |  |
|  | Receivable | 2.1.1.1.456 |  | 2,000 |

#### Installation

Same facts except XYZ was obligated to install the merchandise and the customer had the right to refuse delivery if the installation was not up to spec. XYZ completed installation on 1/12/Y2.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/12/Y2**/**12.1.R2 | | Post. ref. | Dr. | Cr. |
| Receivable | | 2.1.1.1.456 | 2,000 |  |
|  | Revenue | 4 |  | 2,000 |
| COS, merchandise | | 5.1.4 | 1,000 |  |
| COS, parts[**[7]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote7sym) | | 5.1.5 | 50 |  |
| COS, wages | | 5.1.2 | 100 |  |
| COS, overhead | | 5.1.3 | 75 |  |
|  | Merchandise inventory | 1.1.4.5.321 |  | 1,000 |
|  | Inventory, parts | 1.1.4.5.2 |  | 50 |
|  | Wages and salaries | 2.1.2.2.1 |  | 100 |
|  | Unallocated overhead | 1.1.4.3.3 |  | 75 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/1/Y2**/**2.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 2,000 |  |
|  | Receivable | 2.1.1.1.456 |  | 2,000 |

Same facts except XYZ sold the installation as a stand-alone service for which XYZ was entitled to 500.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/30/Y1**/**30.12.R1 | | Post. ref. | Dr. | Cr. |
| Receivable | | 2.1.1.1.456 | 2,000 |  |
|  | Revenue | 4 |  | 2,000 |
| Cost of sales | | 5.1.4 | 1,000 |  |
|  | Merchandise inventory | 1.1.4.5.321 |  | 1,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/12/Y2**/**12.1.R2 | | Post. ref. | Dr. | Cr. |
| Receivable | | 2.1.1.1.456 | 500 |  |
|  | Revenue | 4 |  | 500 |
| COS, parts | | 5.1.5 | 50 |  |
| COS, wages | | 5.1.2 | 100 |  |
| COS, overhead | | 5.1.3 | 75 |  |
|  | Inventory, parts | 1.1.4.5.2 |  | 50 |
|  | Wages and salaries | 2.1.2.2.1 |  | 100 |
|  | Unallocated overhead | 1.1.4.3.3 |  | 75 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/1/Y2**/**2.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 2,000 |  |
|  | Receivable | 2.1.1.1.456 |  | 2,000 |

#### Sale of goods plus supplemental service

Same facts as first example (will-call sale) except that XYZ agreed to provide basic servicing from 1.1.Y2 to 12/31/Y3. It estimated the fair value of the service to be 400. The customer did not, however, require any service during this period.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/30/Y1**/**1.30.R1 | | Post. ref. | Dr. | Cr. |
| Receivable | | 2.1.1.1.456 | 2,000 |  |
|  | Merchandise revenue | 4.3.2 |  | 1,600 |
|  | Unearned revenue | 2.1.2.1.3 |  | 400 |
| Cost of sales | | 5.1.4 | 1,000 |  |
|  | Merchandise inventory | 1.1.4.5.321 |  | 1,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 2/1/Y2**/**2.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 2,000 |  |
|  | Receivable | 2.1.1.1.456 |  | 2,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y2**/**31.3.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 50 |  |
|  | Service revenue | 4.4 |  | 50 |

Etc.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y3**/**31.12.R3 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 50 |  |
|  | Service revenue | 4.4 |  | 50 |

Same facts except on 3/15/R3 the customer had a service event that required a service call[[8]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote8sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/15/R3 **/**15.3.R3 | | Post. ref. | Dr. | Cr. |
| COS, parts | | 5.1.5 | 10 |  |
| COS, wages | | 5.1.2 | 25 |  |
| COS, overhead | | 5.1.3 | 15 |  |
|  | Inventory, parts | 1.1.4.5.2 |  | 10 |
|  | Wages and salaries | 2.1.2.2.1 |  | 25 |
|  | Unallocated overhead | 1.1.4.3.3 |  | 15 |

Same facts except the customer required additional service. The service technician provided them, but the customer was charged an additional 500.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/15/R3 **/**15.3.R3 | | Post. ref. | Dr. | Cr. |
| Receivable | | 2.1.1.1.456 | 500 |  |
|  | Revenue | 4 |  | 500 |
| COS, parts | | 5.1.5 | 60 |  |
| COS, wages | | 5.1.2 | 125 |  |
| COS, overhead | | 5.1.3 | 90 |  |
|  | Inventory, parts | 1.1.4.5.2 |  | 60 |
|  | Wages and salaries | 2.1.2.2.1 |  | 125 |
|  | Unallocated overhead | 1.1.4.3.3 |  | 75 |

## Services

### Single act service

On 12/14/Y1, XYZ received an electronic instrument for repair. On 12/15/R1, technician # 320 diagnosed the problem (wage cost of 125[**[9]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote9sym) ). From 12/16 to 12/17/Y1 technicians 320 and 321 repaired the instrument using parts # 47, 53 and 86 costing 250. Finally XYZ allocated indirect manufacturing costs of 350. The customer will called the finished repair on 12/18/Y1 and paid 1,500.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/18/Y1**/**18.12.R1 | | Post. ref. | Dr. | Cr. |
| Cash | | 2.1.1.1 | 1,500 |  |
|  | Revenue | 4 |  | 1,500 |
| COS, parts | | 5.1.5 | 250 |  |
| COS, wages | | 5.1.2 | 400 |  |
| COS, overhead | | 5.1.3 | 350 |  |
|  | Inventory, parts | 1.1.4.5.2.74 |  | 50 |
|  | Inventory, parts | 1.1.4.5.2.53 |  | 85 |
|  | Inventory, parts | 1.1.4.5.2.86 |  | 115 |
|  | Wages and salaries | 2.1.2.2.1.320 |  | 125 |
|  | Wages and salaries | 2.1.2.2.1.321 |  | 115 |
|  | Wages and salaries | 2.1.2.2.1.321 |  | 160 |
|  | Unallocated overhead | 1.1.4.3.3 |  | 350 |

Same facts except the customer # 789 picked up the repair on 1/2/Y2.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/18/Y1**/**18.12.R1 | | Post. ref. | Dr. | Cr. |
| Receivable | | 2.1.1.1.789 | 1,500 |  |
|  | Revenue | 4 |  | 1,500 |
| COS, parts | | 5.1.5 | 250 |  |
| COS, wages | | 5.1.2 | 275 |  |
| COS, overhead | | 5.1.3 | 350 |  |
|  | Inventory, parts | 1.1.4.5.2.74 |  | 50 |
|  | Inventory, parts | 1.1.4.5.2.53 |  | 75 |
|  | Inventory, parts | 1.1.4.5.2.86 |  | 125 |
|  | Wages and salaries | 2.1.2.2.1.320 |  | 175 |
|  | Wages and salaries | 2.1.2.2.1.321 |  | 100 |
|  | Unallocated overhead | 1.1.4.3.3 |  | 325 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y3**/**31.12.R3 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 1,500 |  |
|  | Receivable | 2.1.1.1.789 |  | 1,500 |

Same facts except the instrument’s fair value was only 2,000. Since the cost of the repair was almost equal to that value, the criteria for revenue recognition[**[10]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote10sym) was not met (the job number of the repair was 654).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/18/Y1**/**18.12.R1 | | Post. ref. | Dr. | Cr. |
| Inventory, WIP | | 1.1.4.3.654 | 1,000 |  |
|  | Inventory, parts | 1.1.4.5.2.74 |  | 50 |
|  | Inventory, parts | 1.1.4.5.2.53 |  | 75 |
|  | Inventory, parts | 1.1.4.5.2.86 |  | 125 |
|  | Wages and salaries | 2.1.2.2.1.320 |  | 175 |
|  | Wages and salaries | 2.1.2.2.1.321 |  | 100 |
|  | Unallocated overhead | 1.1.4.3.3 |  | 325 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/2/Y2**/**2.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash | | 2.1.1.1 | 1,500 |  |
|  | Revenue | 4 |  | 1,500 |
| COS, parts | | 5.1.5 | 250 |  |
| COS, wages | | 5.1.2 | 400 |  |
| COS, overhead | | 5.1.3 | 350 |  |
|  | Inventory, WIP | 1.1.4.3.654 |  | 1,000 |

Same facts except the customer did not pay. The entity (according to the agreement) took control over the asset, sold it to pay off the debt and remitted the difference to the customer.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/2/Y2**/**2.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash | | 2.1.1.1 | 1,800 |  |
|  | Revenue | 4 |  | 1,500 |
|  | Customer credit | 1.1.5.5 |  | 300 |
| COS, parts | | 5.1.5 | 250 |  |
| COS, wages | | 5.1.2 | 400 |  |
| COS, overhead | | 5.1.3 | 350 |  |
|  | Inventory, WIP | 1.1.4.3.654 |  | 1,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/31/Y2**/**31.1.R2 | | Post. ref. | Dr. | Cr. |
| Customer credit | | 1.1.5.5 | 300 |  |
|  | Cash | 2.1.1.1 |  | 300 |

Same facts except the entity was entitled to retain the entire sales amount.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/2/Y2**/**2.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash | | 2.1.1.1 | 1,800 |  |
|  | Revenue | 4 |  | 1,500 |
|  | Contract penalty | 6.1.4.1 |  | 300 |
| COS, parts | | 5.1.5 | 250 |  |
| COS, wages | | 5.1.2 | 400 |  |
| COS, overhead | | 5.1.3 | 350 |  |
|  | Inventory, WIP | 1.1.4.3.654 |  | 1,000 |

Same facts except the entity was unable to sell the instrument and instead abandoned it. It also paid 50 to have it shipped to a dump.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/2/Y2**/**2.1.R2 | | Post. ref. | Dr. | Cr. |
| Loss | | 6.4.11 | 1,050 |  |
|  | Inventory, WIP | 1.1.4.3.654 |  | 1,000 |
|  | Cash | 2.1.1.1 |  | 50 |

## Initial direct costs

On 12/15/R1, Mr. Smith signed a life insurance contract on his wife with agent # 271. As part of the agreement, Mr. Smith agreed to pay a down payment of three monthly payments prior to 12/31/Y1. On 12/17/Y1, the insurance company sent Mrs. Smith to its doctor (supplier # 987) to determine whether she had any pre-existing condition that would preclude insurance (cost 10,000). The same day, since the insuree and payee were different natural persons, the insurance company hired a detective (supplier # 457) for a background check on Mr. Smith (cost 15,000). The insurance agreement had a term of five years and came into force on 1/1/R2. On 1/5/R2, the insurance company paid for the services it had received.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/15/Y1**/**15.12.R1 | | Post. ref. | Dr. | Cr. |
| WIP, initial direct costs | | 1.1.4.3.2.1 | 5,000 |  |
|  | Agent’s fee payable | 2.1.1.1.271 |  | 5,000 |

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| 12/17/Y1**/**17.12.R1 | | Post. ref. | Dr. | Cr. |
| WIP, initial direct costs | | 1.1.4.3.2.1 | 10,000 |  |
|  | Payable, doctor | 2.1.1.1.987 |  | 10,000 |

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| 12/20/Y1**/**20.12.R1 | | Post. ref. | Dr. | Cr. |
| WIP, initial direct costs | | 1.1.4.3.2.1 | 15,000 |  |
|  | Agent’s fee payable | 2.1.1.1.457 |  | 15,000 |

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| --- | --- | --- | --- | --- |
| 12/21/Y1**/**21.12.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 12,000 |  |
|  | Unearned premiums | 2.1.2.1.1 |  | 12,000 |

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| --- | --- | --- | --- | --- |
| 1/5/Y2**/**5.1.R2 | | Post. ref. | Dr. | Cr. |
| Agent’s fee payable | | 2.1.1.1.271 | 5,000 |  |
| Payable, doctor | | 2.1.1.1.987 | 10,000 |  |
| Agent’s fee payable | | 2.1.1.1.457 | 15,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 30,000 |

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| 1/31/Y2**/**31.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 3,000 |  |
| Unearned premiums | | 2.1.2.1.1 | 200 |  |
|  | Revenue | 4.4 |  | 3,200 |
| COS, initial direct | | 5.1.6 | 500 |  |
|  | WIP, initial dir. costs | 1.1.4.3.2.1 |  | 500 |

### Accruals

Same facts except the insurance company, which considered itself to be a service provider, decided to recognize the items as “accruals” rather than “work in process”.

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| 12/15/Y1**/**15.12.R1 | | Post. ref. | Dr. | Cr. |
| Deferred expenses | | 1.1.5.4 | 5,000 |  |
|  | Agent’s fee payable | 2.1.1.1.271 |  | 5,000 |

### Multiple-act service

On 12/15/R1, DEF accepted an automobile for repair. The same day mechanic # 47 determined that the repair would require replacing parts costing 7,350 and 9,100 and that associated labor would be 9,250 and 8,100. Since it had the first part in stock, the first portion of the repair was performed on 12/16. The second part arrived from overseas on 1/10.R2 and the repair was completed on 1/12. Since it was deemed to provide the most accurate basis for measuring stage of completeness (IAS 18.24.c), the entity calculated percentage of completion on the basis of direct labor. Since it earned a profit on both parts and labor, it allocated indirect costs (IAS 2.19) on the basis both (using coefficient of 0.75). The customer accepted and paid for the repair on 1/20/R2.

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| 12/15/Y1**/**15.12.R1 | | Post. ref. | Dr. | Cr. |
| WIP, initial direct costs | | 1.1.4.3.2.1 | 1,500 |  |
|  | Wages and salaries | 2.1.2.2.1.47 |  | 1,500 |

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| --- | --- | --- | --- | --- |
| 12/16/Y1**/**16.12.R1 | | Post. ref. | Dr. | Cr. |
| Receivable | | 2.1.1.1 | 43,575 |  |
|  | Revenue | 4 |  | 43,575 |
| COS, initial direct | | 5.1.6 | 800 |  |
| COS, parts | | 5.1.5 | 7,350 |  |
| COS, wages | | 5.1.2 | 9,250 |  |
| COS, overhead | | 5.1.3 | 12,450 |  |
|  | WIP, initial direct costs | 1.1.4.3.2.1 |  | 800 |
|  | Inventory, parts | 1.1.4.5.2.53 |  | 7,350 |
|  | Wages and salaries | 2.1.2.2.1.320 |  | 9,250 |
|  | Unallocated overhead | 1.1.4.3.3 |  | 12,450 |

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| --- | --- | --- | --- | --- |
| 12/16/Y1**/**16.12.R1 | | Post. ref. | Dr. | Cr. |
| Cash on hand | | 1.1.1.1 | 88,725 |  |
|  | Receivable | 2.1.1.1 |  | 43,575 |
|  | Revenue | 4 |  | 45,150 |
| COS, initial direct | | 5.1.6 | 700 |  |
| COS, parts | | 5.1.5 | 9,100 |  |
| COS, wages | | 5.1.2 | 8,100 |  |
| COS, overhead | | 5.1.3 | 12,900 |  |
|  | WIP, initial direct costs | 1.1.4.3.2.1 |  | 700 |
|  | Inventory, parts | 1.1.4.5.2.53 |  | 9,100 |
|  | Wages and salaries | 2.1.2.2.1.320 |  | 8,100 |
|  | Unallocated overhead | 1.1.4.3.3 |  | 12,900 |

Same facts except the customer picked up the vehicle after the first act.

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| 12/15/Y1**/**15.12.R1 | | Post. ref. | Dr. | Cr. |
| WIP, initial direct costs | | 1.1.4.3.2.1 | 1,500 |  |
|  | Wages and salaries | 2.1.2.2.1.47 |  | 1,500 |

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| --- | --- | --- | --- | --- |
| 12/16/Y1**/**16.12.R1 | | Post. ref. | Dr. | Cr. |
| Receivable | | 2.1.1.1 | 43,575 |  |
|  | Revenue | 4 |  | 43,575 |
| COS, initial direct | | 5.1.6 | 1,500 |  |
| COS, parts | | 5.1.5 | 7,350 |  |
| COS, wages | | 5.1.2 | 9,250 |  |
| COS, overhead | | 5.1.3 | 12,450 |  |
|  | WIP, initial direct costs | 1.1.4.3.2.1 |  | 1,500 |
|  | Inventory, parts | 1.1.4.5.2.53 |  | 7,350 |
|  | Wages and salaries | 2.1.2.2.1.320 |  | 9,250 |
|  | Unallocated overhead | 1.1.4.3.3 |  | 12,450 |

Same facts except the mechanic # 47 was not able to diagnose the problem and the entity returned the automobile without charge.

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| 12/15/Y1**/**15.12.R1 | | Post. ref. | Dr. | Cr. |
| Unsuccessful diagnostics | | 6.4.11 | 1,500 |  |
|  | Wages and salaries | 2.1.2.2.1.47 |  | 1,500 |

### Completed contract

On 12/14/R1, XYZ entered into agreement # 85 to move Mr. Smith’s household from Prague to Brisbane, Australia. On 12/15/R1, XYZ’s employees loaded Mr. Smith’s household into a container, rented from ABC (supplier # 25) for 2,500. The container arrived in Hamburg on 12/16/Y1 where it was accepted by DEF (supplier # 32). DEF transported the container to Sydney (at a cost to XYZ of 20,000), where it arrived on 1/18/R2. On 1/20/Y2, GHI (supplier # 35) accepted the container and transported it (at a cost to XYZ of 25,000) to Brisbane. The container was finally unloaded on 1/21/Y2 and Mr. Smith paid 90,000 on 1/31/R2.

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| --- | --- | --- | --- | --- |
| 12/15/Y1**/**15.12.R1 | | Post. ref. | Dr. | Cr. |
| Inventory, CIP[**[11]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote11sym) | | 1.1.4.3.2.85 | 2,500 |  |
|  | Trade payable | 2.1.1.1.25 |  | 2,500 |

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| --- | --- | --- | --- | --- |
| 12/16/Y1**/**16.12.R1 | | Post. ref. | Dr. | Cr. |
| Contract in progress | | 1.1.4.3.2.85 | 15,000 |  |
|  | Wages Payable[**[12]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote12sym) | 2.1.2.2.1 |  | 5,000 |
|  | Unallocated variable overhead | 1.1.4.3.2.2.3 |  | 1,000 |
|  | Unallocated fixed overhead | 1.1.4.3.2.2.4 |  | 9,000 |

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| 1/18/Y2**/**18.1.R2 | | Post. ref. | Dr. | Cr. |
| Inventory, CIP | | 1.1.4.3.2.85 | 20,000 |  |
|  | Trade payable | 2.1.1.1.32 |  | 20,000 |

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| 1/21/Y2**/**21.1.R2 | | Post. ref. | Dr. | Cr. |
| Receivable | | 1.1.3.1.85 | 90,000 |  |
|  | Revenue | 4.4 |  | 90,000 |
| COS, rental | | 5.1.3.2.2 | 2,500 |  |
| COS, direct wages | | 5.1.2 | 5,000 |  |
| COS, fuel | | 5.1.1 | 1,000 |  |
| COS, indirect costs | | 5.1.7 | 9,000 |  |
| COS, subcontractor | | 5.1.8 | 45,000 |  |
|  | Inventory, CIP | 1.1.4.3.2.85 |  | 37,500 |
|  | Trade payable | 2.1.1.1.35 |  | 25,000 |

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| --- | --- | --- | --- | --- |
| 1/31/Y2**/**31.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 90,000 |  |
|  | Receivable | 1.1.3.1.85 |  | 90,000 |

Same facts except that on the way from Sydney to Brisbane, the vehicle crashed and the cargo burned. XYZ estimated that Mr. Smith suffered a loss of 150,000. It also determined that it could claim (on the basis of the contract for transport) 50,000 from GHI and (on the basis of its general insurance contract) 1,490,000 from JKL (supplier # 4), its insurance company.

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| --- | --- | --- | --- | --- |
| 1/22/Y2**/**20.1.R2 | | Post. ref. | Dr. | Cr. |
| Insurance claim | | 1.1.5.6.1.4 | 1,490,000 |  |
| Contract claim | | 1.1.5.6.2.35 | 50,000 |  |
|  | Provision, customer | 2.1.4.3.85 |  | 1,500,000 |
|  | Inventory, CIP | 1.1.4.3.2.85 |  | 2,500 |
|  | Inventory, CIP | 1.1.4.3.2.85 |  | 15,000 |
|  | Inventory, CIP | 1.1.4.3.2.85 |  | 20,000 |
|  | Gain | 6.3.5 |  | 2,500 |

On 1/31/Y2, XYZ received 149,000 from the insurance company and 50,000 from GHI. On 6/30/Y2, it settled with Mr. Novak, paying out 900,000 in actual damages and 500,000 for pain and suffering. The same day, it returned 104,000 to the insurance company.

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| 1/31/Y2**/**31.1.R2 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 1,540,000 |  |
|  | Insurance claim | 1.1.5.6.1.4 |  | 1,490,000 |
|  | Contract claim | 1.1.5.6.2.35 |  | 50,000 |

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| --- | --- | --- | --- | --- |
| 6/30/Y2**/**30.6.R2 | | Post. ref. | Dr. | Cr. |
| Provision, customer | | 2.1.4.3. 85 | 1,400,000 |  |
| Insurance claim | | 1.1.5.6.1.4 | 100,000 |  |
| Interest expense | | 6.2.1 | 4,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 1,504,000 |

Same facts except (for formality’s sake) XYZ decided to reverse the original inaccurate estimate.

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| 1/22/Y2**/**20.1.R2 | | Post. ref. | Dr. | Cr. |
| Provision, customer | | 2.1.4.3 | 1,500,000 |  |
|  | Insurance claim | 1.1.5.6.1.4 |  | 1,490,000 |
| Insurance claim | | 1.1.5.6.1.4 | 1,390,000 |  |
|  | Provision, customer | 2.1.4.3 |  | 1,400,000 |

## Long-term (construction) contracts

### The percentage-of-completion method

IAS 11.22: When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract shall be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the balance sheet date...

### Zero-profit method

When the outcome of a construction contract is uncertain (cannot be reliably estimated), revenue is only recognized to the extent of expenses[**[13]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote13sym).

### Early contract stage

IAS 11.33: During the early stages of a contract it is often the case that the outcome of the contract cannot be estimated reliably. Nevertheless, it may be probable that the entity will recover the contract costs incurred. Therefore, contract revenue is recognised only to the extent of costs incurred that are expected to be recoverable. As the outcome of the contract cannot be estimated reliably, no profit is recognised. …

### Losses

IAS 11.32: An expected loss on the construction contract shall be recognised as an expense immediately …

IAS 11.33: However, even though the outcome of the contract cannot be estimated reliably, it may be probable that total contract costs will exceed total contract revenues. In such cases, any expected excess of total contract costs over total contract revenue for the contract is recognised as an expense immediately in accordance with IAS 11.36 When it is probable that total contract costs will exceed total contract revenue, the expected loss shall be recognised as an expense immediately.

### Accounting procedures and policies

Traditionally, percentage of completion was determined on the basis of actual work performed and both revenue and expenses were calculated on the basis of this percentage. Currently, common practice is to record actual expenses (as incurred) and calculate revenue on the basis of these. This method cannot, however, be properly called “percentage of completion” but should rather be referred to as “cost-to-cost basis”[**[14]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote14sym).

#### Examples

On 1/1/Y1, XYZ was retained for long-term construction project # 123. It agreed to complete the project in two years for a total fee of 3,000,000 (for simplicity, it is assumed no interest was capitalized) and estimated a cost to complete of 2,000,000. It invoiced the contractee 250,000 quarterly, which the contractee promptly paid. The entity elected to use a cost-to-cost basis and did not, as a result, determine the physical stage of completion.

On 2/1/Y1, it incurred its first cost (of 1,000). During the remainder of the first year it incurred additional costs of 900,000 in total. It completed the project by 12/31/R2, incurring additional year two costs of 1,100,000.

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| --- | --- | --- | --- | --- |
| 1/1/Y1 / 1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 250,000 |  |
|  | Contract billings | 2.2.8.2.123 |  | 250,000 |

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| --- | --- | --- | --- | --- |
| 1/2/Y1 / 2.1.R1 | | Post. ref. | Dr. | Cr. |
| Contract in progress | | 1.5.3.1.1.123 | 1,000 |  |
|  | Payable | 2.1.1.1 |  | 1,000 |

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| --- | --- | --- | --- | --- |
| 2/2/Y1 / 2.2.R1 | | Post. ref. | Dr. | Cr. |
| Payable | | 2.1.1.1 | 1,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 1,000 |

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| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| COS, Long-term project | | 1.1.1.2 | 900,000 |  |
|  | Contract in progress | 1.5.3.1.123 |  | 900,000 |
| Contract billings | | 2.2.8.2.123 | 1,000,000 |  |
| Contract receivable | | 1.5.3.2.123 | 350,000 |  |
|  | Revenue, Long-term project | 4.5 |  | 1,350,000[**[15]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote15sym) |

Same facts, except the contractee paid 375,000 quarterly.

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| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| COS, Long-term project | | 1.1.1.2 | 900,000 |  |
|  | Contract in progress | 1.5.3.1.123 |  | 900,000 |
| Contract billings | | 2.2.8.2.123 | 1,000,000 |  |
|  | Unearned contract revenue | 2.2.8.2.1 |  | 600,000 |
|  | Revenue, Long-term project | 4.5 |  | 1,350,000 |

Same facts, except XYZ funded the project with a 5% bank loan.

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| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
| COS, Long-term project | | 1.1.1.2 | 900,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 42,857 |
|  | Contract in progress | 1.5.3.1.123 |  | 857,143 |
| Contract billings | | 2.2.8.2.123 | 1,000,000 |  |
|  | Unearned contract revenue | 2.2.8.2.1 |  | 600,000 |
|  | Revenue, Long-term project | 4.5 |  | 1,350,000 |

### Percentage of completion, special accounts

Traditional percentage of completion accounting requires the following special accounts[**[16]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote16sym).

1. Contract in progress (CIP)

2. Billings (on contract in progress)

#### Examples

1/1/Y1, ABC contracted XYZ to construct a building. The contract was a fixed-fee agreement including clear and binding conditions allowing an exact calculation of the stage of completion. The total contract amount was 4,000,000 and estimated costs to complete (including interest) were 3,000,000. 1/1/Y1, ABC paid an advance of 1,000,000 and XYZ financed the remainder using a dedicated line of credit. During 2YY1, XYZ completed 35% of contract # 01/14, incurring costs (including 2,000 interest) of 1,200,000. During Y2, XYZ completed the contract, incurring costs (including interest of 80,000) of 1,800,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 1,000,000 |  |
|  | Billings on contract | B.1/14 |  | 1,000,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1 - 12/31/Y1 / 1.1.R1 – 31.12.R1 | | Post. ref. | Dr. | Cr. |
| Contract in progress | | CIP.1/14 | 1,200,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 1,198,000 |
| Cash in bank | | 1.1.1.2 | 198,000 |  |
|  | Line of credit | 2.2.3.1 |  | 198,000 |
|  | Line of credit | 2.2.3.1 |  | 2,000 |

On 12/31/Y1, to prepare its income statement, XYZ calculated revenue (total contract amount x % of completion = revenue) and cost of sales (total remaining costs x % of completion = cost of sales[**[17]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote17sym) ). Since it used special accounts, it did not record these amounts in its general ledger, but simply reported them in its income statement.

|  |  |  |
| --- | --- | --- |
| Revenue | 4.000.000 X 35% = | 1,400,000 |
| Cost of Sales | 3,000,000 X 35% = | 1,050,000 |
| Gross profit |  | 350,000 |
|  | | |

To balance its balance sheet, it compared Billings (B.1/14) with the Contract in progress (CIP 1/14) and simply recorded the difference as a receivable.

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| --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | Post. ref. | Dr. | Cr. |
| Contract in progress[**[18]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote18sym) | 1.5.3.1.1 | 200,000 |  |

Same facts, except the customer pre-paid 1,500,000 (XYZ did not capitalize any interest).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 12/31/Y1 / 31.12.R1 | | Post. ref. | Dr. | Cr. |
|  | Unearned contract revenue | 2.2.8.2.1 |  | 300,000 |

## Non-monetary transactions

* Non-monetary exchanges can be divided:
* Exchange of non-financial asset for financial instrument [**[19]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote19sym)
* Credit purchase / sale
* Instalment purchases / sales (including leasing)
* Purchase / sale for financial instrument
* Exchange of non-financial asset for non-financial asset
* Exchange of productive asset
* Exchange of sellable goods
* Barter sales
* Offsetting (netting) of financial instruments
* Exchange of services
* Exchange of service for good
* Exchange of service for service
* Non-reciprocal transactions
* Gifts, grants, donations, contributions and subsidies

### Measurement and disclosure

The accounting for a non non-monetary exchange depends on whether it the exchange had / did not have commercial substance[**[20]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote20sym).

IAS 16.25: … An exchange has commercial substance if:

(a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or

(b) the entity-specific value of the portion of the entity’s operations affected by the transaction changes as a result of the exchange; and

(c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

#### Examples

On 1/1/Y1, XYZ exchanged personal vehicle # 12 with a net book value of 8,000, for a delivery van with a fair value of 8,500 (to which is assigned ID # 47).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.2.2.3.(12) | 12,000 |  |
|  | Automobile | 1.3.2.2.3.12 |  | 20,000 |
| Delivery equipment | | 1.3.2.2.3.47 | 8,500 |  |
|  | Gain on disposal | 6.3.4 |  | 500 |

Same facts, except the asset surrendered was also a delivery van (from a different manufacturer). Since both assets had the same configuration of cash flows (they were used in the same manner) the transaction lacked commercial substance.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.2.2.3.(12) | 12,000 |  |
|  | Automobile | 1.3.2.2.3.12 |  | 20,000 |
| Delivery equipment | | 1.3.2.2.3.47 | 8,000 |  |

Same facts, except the value of the asset received was 12,000. Since the difference in the value of the two assets was material when compared to the value of the asset surrendered (IAS 16.25.c), the transaction had commercial substance.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.2.2.3.(12) | 12,000 |  |
|  | Automobile | 1.3.2.2.3.12 |  | 20,000 |
| Delivery equipment | | 1.3.2.2.3.47 | 12,000 |  |
|  | Gain on disposal | 6.3.4 |  | 4,000 |

Same facts, except the fair value of the asset received was 7,900. Since the difference was not material, the transaction lacked commercial substance.

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| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.2.2.3.(12) | 12,000 |  |
|  | Automobile | 1.3.2.2.3.12 |  | 20,000 |
| Delivery equipment | | 1.3.2.2.3.47 | 8,000 |  |

Same facts, except the fair value of the asset received was 7,600. Since the difference was material, the transaction had commercial substance.

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| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Accumulated depreciation | | 1.3.2.2.3.(12) | 12,000 |  |
|  | Automobile | 1.3.2.2.3.12 |  | 20,000 |
| Delivery equipment | | 1.3.2.2.3.47 | 7,600 |  |
| Loss on disposal | | 6.4.8 | 400 |  |

Same facts, except the company surrender a machine (which it manufactured for 20,000) in return for the van with a value of 40,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Delivery equipment | | 1.3.2.2.3.47 | 40,000 |  |
|  | Revenue | 4 |  | 40,000 |
| Cost of sales | | 5.1 | 20,000 |  |
|  | Inventory | 1.1.4.4 |  | 20,000 |

Same facts, except the company itself manufactures vans and it sold the van it had received on 1/15Y1 for 40,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Inventory | | 1.1.4.5.47 | 20,000 |  |
|  | Inventory | 1.1.4.4 |  | 20,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/15/Y1**/**15.1.R1 | | Post. ref. | Dr. | Cr. |
| Trade receivable | | 1.1.3 | 40,000 |  |
|  | Revenue | 4 |  | 40,000 |
| Cost of sales | | 5.1 | 20,000 |  |
|  | Inventory | 1.1.4.5.47 |  | 20,000 |

Same facts, except the company provides advertising services and was able to determine that the cost of those services was 20,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Inventory | | 1.1.4.5.47 | 40,000 |  |
|  | Revenue | 4 |  | 40,000 |
| Cost of sales | | 5.1 | 20,000 |  |
|  | Service costs | 1.1.4.3.2 |  | 20,000 |

Same facts, except the company provides advertising services and what it received in return were also advertising services and it applied SIC 31.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Inventory | | 1.1.4.5.47 | 20,000 |  |
|  | Revenue | 4 |  | 20,000 |
| Cost of sales | | 5.1 | 20,000 |  |
|  | Service costs | 1.1.4.3.2 |  | 20,000 |

Same facts, except the company was not able to demonstrate that it sold the same services for cash to different, unrelated parties.

SIC 31 does not allow any revenue or expense to be recognized in this situation.

Same facts, except the companies tried to avoid this requirement by paying each other 40,000[**[21]**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote21sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 40,000 |  |
|  | Cash in bank | 1.1.1.2 |  | 40,000 |

## Donations and subsidies

On 1/1/R1, XYZ received a government grant of 100,000. In return, it promised to keep manufacturing at a plant (it had been planning to idle) for an unspecified period of time.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 100,000 |  |
|  | Government grant | 6.3.8.1 |  | 100,000 |

Same facts, except the government forgave a loan[[22]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote22sym).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Loan payable | | 2.2.3 | 100,000 |  |
|  | Government grant | 6.3.8.1 |  | 100,000 |

Same facts, except the company committed to maintain production for two years.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Cash in bank | | 1.1.1.2 | 100,000 |  |
|  | Deferred grant | 2.1.2.4 |  | 50,000 |
|  | Long-term deferred grant | 2.2.9 |  | 50,000 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 3/31/Y1**/**31.3.R1 | | Post. ref. | Dr. | Cr. |
| Deferred government | | 2.1.2.4 | 12,500 |  |
|  | Government grant | 6.3.8.1 |  | 12,500 |

On 1/1/Y1, the company received a building valued at 100,000 from a shareholder.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Building | | 1.3.2 | 100,000 |  |
|  | Grant / Dar | 6.3.8.1 |  | 100,000 |

Or[[23]](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote23sym)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Building | | 1.3.2 | 100,000 |  |
|  | Donated capital | 3.5.2 |  | 100,000 |

On 1/1/Y1, the company transferred, in lieu of cash, a building to a shareholder.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Unappropriated R/E | | 3.2.1 | 100,000 |  |
|  | Building | 1.3.2 |  | 100,000 |

Same facts, except the building was donated to charity.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Charitable contribution | | 5.3.7.3.1 | 100,000 |  |
|  | Building | 1.3.2 |  | 100,000 |

Same facts, except under IAS 36 the building’s value would have been 60,000.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1/1/Y1**/**1.1.R1 | | Post. ref. | Dr. | Cr. |
| Charitable contribution | | 5.3.7.3.1 | 60,000 |  |
| Impairment loss | | 6.4.3 | 40,000 |  |
|  | Building | 1.3.2 |  | 100,000 |

[**1**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote1anc): IAS 2.34: When inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised.

This requirement also implies that IAS 1 (which allows a “nature of expense” income statement including “Changes in inventories of finished goods and work in progress”, a non-revenue item presented in a way to make it appear as a result of a sale of goods or services) inconsistent with IAS 2. This internal conflict between the two standards is legacy of IFRS’s historical evolution and will, in the near future, be resolved by [**this project**](http://gaap.cz/main_page/link-to-IASB-fin-stmt-presentation.htm).

[**2**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote2anc): IAS 18.14: Revenue from the sale of goods shall be recognised when all the following conditions have been satisfied:

(a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;

(b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;

(c) the amount of revenue can be measured reliably;

(d) it is probable that the economic benefits associated with the transaction will flow to the entity; and

(e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

[**3**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote3anc): IAS 2.19: To the extent that service providers have inventories, they measure them at the costs of their production. These costs consist primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel, and attributable overheads. Labour and other costs relating to sales and general administrative personnel are not included but are recognised as expenses in the period in which they are incurred. The cost of inventories of a service provider does not include profit margins or non-attributable overheads that are often factored into prices charged by service providers.

[**4**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote4anc): IAS 18.20: When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction shall be recognised by reference to the stage of completion of the transaction at the end of the reporting period. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

(a) the amount of revenue can be measured reliably;

(b) it is probable that the economic benefits associated with the transaction will flow to the entity;

(c) the stage of completion of the transaction at the end of the reporting period can be measured reliably; and

(d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

[**5**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote5anc): When a transaction involves selling goods, IFRS (IAS 18.14) is precise and concrete, since determining, objectively, when risks and rewards of ownership transfer presents little practical challenge. Unfortunately, when it comes to services, IFRS (18.20) punts. Rather than practically applicable guidance, it resorts to platitudes and advises one to evaluate the stage of completion.

Fortunately, IAS 39.14 is quite specific ”An entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes a party to the contractual provisions of the instrument.” Since revenue must always be accompanied by a financial instrument (a receivable) or cash, service revenue may be recognized when an entity completes the service (or its part) and (as a result) gains a legally enforceable right to demand cash.

[**6**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote6anc): The entity could record goods in transit, but most companies would not do so (too much effort involved).

[**7**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote7anc): Individual expense items were accounted for using supplemental tables as shown in example: **Perpetual method, job costing, Simplified approach.**

[**8**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote8anc): If the entity is unable to estimate when and to what extent the customer will require the related service, it recognizes (IAS 18.Appendix.11) the revenue over the service period. The related service costs are expensed as incurred.

[**9**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote9anc): Wage costs comprise basic wages, overtime, social security, health insurance, etc. Since the entity accounts for these components of wage using supplemental tables, they are presented here as a single cost item.

[**10**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote10anc): It is probable (50% or more likely) that economic benefits will flow to the entity (IAS 18.20.b).

[**11**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote11anc): Without the successful completion of the final act (unloading the household at its final destination) the entire series of acts has no value, the final act is significantly more valuable then the remainder. In this case IAS 18.25 requires the entity to wait, and recognize revenue upon completion of that final act.

[**12**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote12anc): Wages are payable to several employees. For simplicity, they are presented here in the aggregate.

[**13**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote13anc): Although IFRS (IAS 11.32) does explicitly title this method, in literature it is commonly referred to as the Zero profit method to draw attention to its effect not only on net income but also revenue and expense.

[**14**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote14anc): Although IAS 11 explicitly states that long-term contracts shall be accounted for using the percentage of completion method, the cost-to-cost basis has its advantages: 1. it is easy to use, 2. it does not require special accounts and 3. most auditors find it less subjective and so accept it without qualification.

[**15**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote15anc): 900,000 / 2,000,000 X 3,000,000 = 1,350,000

[**16**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote16anc): Since they are not, in and of themselves, a formal component of the general ledger, the special accounts used herein are not listed in the sample chart of accounts.

[**17**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote17anc): Literature also often defines this calculation as total contract amount – gross profit x % of completion, the result is the same.

[**18**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote18anc): Since this is a special entry, it has only the one side.

[**19**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote19anc): The term “financial instrument” is used here in its general (a claim to cash that will be received in the future) rather than legal (a formal agreement between two or more parties on the basis of which a legally defensible claim can be made in the future) meaning.

[**20**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote20anc): Technically, IAS 18.12 continues to apply the traditional “similar / dissimilar” criterion to revenue generating non-monetary exchanges (barter sales). However, the 2003 revision of IAS 16 explicitly replaced this (inferior) criterion with (superior) “commercial substance”. Therefore, although it deals with property, plant and equipment, IAS 16’s (newer and superior) guidance must be (at minimum) considered when evaluating any non-monetary exchange (including barter sales).

[**21**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote21anc): Since recognizing revenue / expense in this situation would also be a violation of SIC 31, it would be an error under IAS 8.

[**22**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote22anc): IAS 20 is not applicable to tax credits, holidays, etc.

[**23**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=32#sdfootnote23anc): Although gifts and donation from non-owners cannot be directly credited to owner’s equity, IFRS is not explicit when it comes to gifts from owners (where the owners relative share of capital does not decrease as a result of the gift). Since crediting these gifts directly to capital is common practice under US GAAP, it would not be in conflict with IFRS

# Appendix

The [**chart of accounts**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=41) refered to in the publication is an example that was intentionally drafted to approximate, as closely as possible, a chart of accounts that would be mandatory under one of continental Europe’s national accounting systems (if it were consistent with IFRS).

In contrast to principles based IFRS, most national systems are based on a very ridged and fixed set of rules and procedures.

Since IFRS does not prescribe any specific accounting structures (charts of account, specific procedures, standardized financial statements, etc.), each entity is free to design an accounting system that enhances its uniqueness and individuality rather than denies it.

Consequently, a statement such as “[**the company decided to record the entire production line as a single asset**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=329&cislo_id=419#sdfootnote35sym)” may seem ridiculous to an accountant accustomed to a system that strictly defines the unit of account. However, most national accounting systems were first designed when the cutting edge of information technology was a sharp pencil and typewriter.

Today, when even the smallest company can afford a powerful databases and when the simplest accounting software offers flexibility, trying to apply an rigidly defined chart of accounts is like trying to make it down the autobahn in a carriage drawn by two (somewhat overworked) horses.

Nevertheless, besides “IFRS training” the most common search query is “[**IFRS Chart of Accounts**](http://www.google.com/#hl=en&gs_nf=1&cp=23&gs_id=94&xhr=t&q=IFRS+Chart+of+Accounts&pf=p&output=search&sclient=psy-ab&oq=%E2%80%9CIFRS+Chart+of+Accounts&aq=0&aqi=g2g-j1g-b1&aql=&gs_l=&pbx=1&bav=on.2,or.r_gc.r_pw.r_qf.,cf.osb&fp=93079f9b04cb97ac&bs=1)”. Since someone is evidently looking, one is presented (after all, demand always leads to some kind of supply).

|  |
| --- |
| The following chart was originally published in 2009 as a companion to [**IFRS Policies and Procedures**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=11&cislo_id=23).  It has since been revised and updated numerous times. The current version is [**available on this page**](http://www.gaap-cz.com/en/index.php?cont=odkaz&oddil=24&cislo_id=19). |

|  |  |  |  |
| --- | --- | --- | --- |
| Account | Balance | Statement | Number (optional) |
| Assets | Dr | BS | 1 |
| Assets / Current assets | Dr | BS | 1.1 |
| Assets / Current / Cash and cash equivalents | Dr | BS | 1.1.1 |
| Assets / Current / Cash / Petty cash (currently on hand) | Dr | BS | 1.1.1.1 |
| Assets / Current / Cash / Cash in bank | Dr | BS | 1.1.1.2 |
| Assets / Current / Cash / Cash equivalents | Dr | BS | 1.1.1.3 |
| Assets / Current / Short-term investments | Dr | BS | 1.1.2 |
| Assets / Current / Short-term investments / Marketable securities | Dr | BS | 1.1.2.1 |
| Assets / Current / Short-term investments / Other short-term investments | Dr | BS | 1.1.2.2 |
| Assets / Current / Short-term investments / Derivatives | Dr | BS | 1.1.2.3 |
| Assets / Current / Receivables | Dr | BS | 1.1.3 |
| Assets / Current / Receivables / Trade receivables (accounts receivable) | Dr | BS | 1.1.3.1 |
| Assets / Current  / Receivables / Trade receivables / Deferred interest | Cr | BS | 1.1.3.1.(1) |
| Assets / Current / Receivables / Trade receivables / Bad debt allowance | Cr | BS | 1.1.3.1.(2) |
| Assets / Current / Receivables / Trade receivables / Returns and allowances | Cr | BS | 1.1.3.1.(3) |
| Assets / Current / Receivables / Other receivables | Dr | BS | 1.1.3.2 |
| Assets / Current / Inventory | Dr | BS | 1.1.4 |
| Assets / Current / Inventory / Raw material | Dr | BS | 1.1.4.1 |
| Assets / Current / Inventory / Production supplies | Dr | BS | 1.1.4.2 |
| Assets / Current / Inventory / Work-in-process | Dr | BS | 1.1.4.3 |
| Assets / Current / Inventory / Work-in-process / Products | Dr | BS | 1.1.4.3.1 |
| Assets / Current / Inventory / Work-in-process / Services | Dr | BS | 1.1.4.3.2 |
| Assets / Current / Inventory / Work-in-process / Unallocated overhead | Dr | BS | 1.1.4.3.3 |
| Assets / Current / Inventory / Finished goods | Dr | BS | 1.1.4.4 |
| Assets / Current / Inventory / Merchandise | Dr | BS | 1.1.4.5 |
| Assets / Current / Accrued, deferred and other items (accruals) | Dr | BS | 1.1.5 |
| Assets / Current / Accruals / Pre-paid expenses | Dr | BS | 1.1.5.1 |
| Assets / Current / Accruals / Accrued revenue | Dr | BS | 1.1.5.2 |
| Assets / Current / Accruals / Deferred items | Dr | BS | 1.1.5.3 |
| Assets / Current / Accruals / Taxes and fees | Cr | BS | 1.1.6 |
| Assets / Current / Accruals / Taxes and fees / VAT receivable (net) | Cr | BS | 1.1.6.1 |
| Assets / Current / Other current assets | Cr | BS | 1.1.7 |
| Assets / Investments and financial instruments | Dr | BS | 1.2 |
| Assets / Investments / Equity instruments (stocks) | Dr | BS | 1.2.1 |
| Assets / Investments / Equity / At fair value through profit and loss | Dr | BS | 1.2.1.1 |
| Assets / Investments / Equity / Fair value / Trading | Dr | BS | 1.2.1.1.1 |
| Assets / Investments / Equity / Fair value / Other | Dr | BS | 1.2.1.1.2 |
| Assets / Investments / Equity / Available-for-sale | Dr | BS | 1.2.1.2 |
| Assets / Investments / Equity / Investments | Dr | BS | 1.2.1.3 |
| Assets / Investments / Equity / Investments / Subsidiaries | Dr | BS | 1.2.1.3.1 |
| Assets / Investments / Equity / Investments / Associates | Dr | BS | 1.2.1.3.2 |
| Assets / Investments / Equity / Investments / Joint ventures | Dr | BS | 1.2.1.3.3 |
| Assets / Investments / Debt instruments (bonds) | Dr | BS | 1.2.2 |
| Assets / Investments / Debt / At fair value through profit and loss | Dr | BS | 1.2.2.1 |
| Assets / Investments / Debt / Fair value / Trading | Dr | BS | 1.2.2.1.1 |
| Assets / Investments / Debt / Fair value / Other | Dr | BS | 1.2.2.1.2 |
| Assets / Investments / Debt / Available-for-sale | Dr | BS | 1.2.2.2 |
| Assets / Investments / Debt / Held-to-maturity | Dr | BS | 1.2.2.3 |
| Assets / Investments / Derivatives | Dr | BS | 1.2.3 |
| Assets / Investments / Derivatives / Hedging | Dr/Cr | BS | 1.2.3.1 |
| Assets / Investments / Derivatives / Speculation | Dr | BS | 1.2.3.2 |
| Assets / Property, plant and equipment | Dr | BS | 1.3 |
| Assets / PP&E / Land (held as land) | Dr | BS | 1.3.1 |
| Assets / PP&E / Buildings and structures (including land integral to buildings) | Dr | BS | 1.3.2 |
| Assets / PP&E / Buildings and structures / Manufacturing facilities | Dr | BS | 1.3.2.1 |
| Assets / PP&E / Buildings and structures / Storefronts | Dr | BS | 1.3.2.2 |
| Assets / PP&E / Buildings and structures / Warehouses | Dr | BS | 1.3.2.3 |
| Assets / PP&E / Buildings and structures / Delivery equipment | Dr | BS | 1.3.2.4 |
| Assets / PP&E / Buildings and structures / Leasehold-improvements | Dr | BS | 1.3.2.5 |
| Assets / PP&E / Buildings and structures / Other | Dr | BS | 1.3.2.6 |
| Assets / PP&E / Buildings and structures / Accumulated depreciation | Cr | BS | 1.3.(2.x) |
| Assets / PP&E / Buildings and structures / Repairs and maintenance allowance | Cr | BS | 1.3.(2.x) |
| Assets / PP&E / Machinery and equipment / Machinery | Dr | BS | 1.3.3.1 |
| Assets / PP&E / Machinery and equipment / Equipment | Dr | BS | 1.3.3.2 |
| Assets / PP&E / Machinery and equipment / Tools | Dr | BS | 1.3.3.3 |
| Assets / PP&E / Machinery and equipment / Fixtures | Dr | BS | 1.3.3.4 |
| Assets / PP&E / Machinery and equipment / Spare parts inventory | Dr | BS | 1.3.3.5 |
| Assets / PP&E / Machinery and equipment / Vehicles | Dr | BS | 1.3.3.6 |
| Assets / PP&E / Machinery and equipment / Furniture and fixtures | Dr | BS | 1.3.3.7 |
| Assets / PP&E / Machinery and equipment / Management information systems | Dr | BS | 1.3.3.8 |
| Assets / PP&E / Machinery and equipment / Accumulated depreciation | Cr | BS | 1.3.(3.x) |
| Assets / PP&E / Machinery and equipment / Repairs and maintenance allowance | Cr | BS | 1.3.(3.x) |
| Assets / Intangible / Assets under capital (financial) lease | Dr | BS | 1.3.4 |
| Assets / Intangible / Assets under capital lease / Accumulated depreciation | Cr | BS | 1.3.(4) |
| Assets / Intangible assets | Dr | BS | 1.4 |
| Assets / Intangible / Legal intangible assets | Dr | BS | 1.4.1 |
| Assets / Intangible / Legal / Patents, copyrights, licenses, etc. | Dr | BS | 1.4.1.1 |
| Assets / Intangible / Separable intangible assets | Dr | BS | 1.4.2 |
| Assets / Intangible / Separable intangible assets / Distribution systems, lists, technology | Dr | BS | 1.4.2.1 |
| Assets / Intangible / Accumulated amortization | Dr | BS | 1.4.(2.x) |
| Assets / Intangible / Goodwill | Dr | BS | 1.4.3 |
| Assets / Other long-lived assets | Dr | BS | 1.5 |
| Assets / Other / Restricted assets | Dr | BS | 1.5.1 |
| Assets / Other / Assets to be disposed of | Dr | BS | 1.5.2 |
| Assets / Other / Long-term accruals | Dr | BS | 1.5.3 |
| Assets / Other / Long-term accruals / Long-term contract in progress | Dr | BS | 1.5.3.1 |
| Assets / Other / Long-term deferred items | Dr | BS | 1.5.4 |
| Assets / Other / Deferred items / Deferred tax assets | Dr | BS | 1.5.4.1 |
| Assets / Other / Deferred items / Other deferred items | Dr | BS | 1.5.4.2 |
| Assets / Other / Returnable deposits | Dr | BS | 1.5.5 |
| Assets / Other / Returnable deposits / Security deposits | Dr | BS | 1.5.5.1 |
| Liabilities | Cr | BS | 2 |
| Liabilities / Current | Cr | BS | 2.1 |
| Liabilities / Current / Payables | Cr | BS | 2.1.1 |
| Liabilities / Current / Payables / Accounts payable (trade payables) | Cr | BS | 2.1.1.1 |
| Liabilities / Current / Payables / Notes payable | Cr | BS | 2.1.1.2 |
| Liabilities / Current / Payables / Short-term loans | Cr | BS | 2.1.1.3 |
| Liabilities / Current / Payables / Lines of credit (revolving credit) | Cr | BS | 2.1.1.4 |
| Liabilities / Current / Payables / Other short/term obligations | Cr | BS | 2.1.1.5 |
| Liabilities / Current / Payables / Interest payable | Cr | BS | 2.1.1.6 |
| Liabilities / Current / Accrued, deferred and other items (accruals) | Cr | BS | 2.1.2 |
| Liabilities / Current / Accruals / Unearned revenue | Cr | BS | 2.1.2.1 |
| Liabilities / Current / Accruals / Unearned revenue / Deposits (pre-payments) | Cr | BS | 2.1.2.1.1 |
| Liabilities / Current / Accruals / Unearned revenue / Subscriptions | Cr | BS | 2.1.2.1.2 |
| Liabilities / Current / Accruals / Unearned revenue / Servicing fees | Cr | BS | 2.1.2.1.3 |
| Liabilities / Current / Accruals / Unearned revenue / Royalties (licensing fees) | Cr | BS | 2.1.2.1.4 |
| Liabilities / Current / Accruals / Accrued expenses | Cr | BS | 2.1.2.2 |
| Liabilities / Current / Accruals / Accrued expenses / Wages and salaries | Cr | BS | 2.1.2.2.1 |
| Liabilities / Current / Accruals / Accrued expenses / Utilities | Cr | BS | 2.1.2.2.2 |
| Liabilities / Current / Accruals / Accrued expenses / Utilities / Electricity | Cr | BS | 2.1.2.2.2.1 |
| Liabilities / Current / Accruals / Accrued expenses / Utilities / Natural gas | Cr | BS | 2.1.2.2.2.2 |
| Liabilities / Current / Accruals / Accrued expenses / Utilities / Water | Cr | BS | 2.1.2.2.2.3 |
| Liabilities / Current / Accruals / Accrued expenses / Utilities / Sewage | Cr | BS | 2.1.2.2.2.4 |
| Liabilities / Current / Accruals / Accrued expenses / Utilities / Waste removal | Cr | BS | 2.1.2.2.2.5 |
| Liabilities / Current / Accruals / Accrued expenses / Dividends payable | Cr | BS | 2.1.2.2.3 |
| Liabilities / Current / Accruals / Accrued expenses / Taxes and fees | Cr | BS | 2.1.2.2.4 |
| Liabilities / Current / Accruals / Deferred items | Cr | BS | 2.1.2.3 |
| Liabilities / Current / Accruals / Other deferred obligations | Cr | BS | 2.1.2.4 |
| Liabilities / Current / Withholdings | Cr | BS | 2.1.3 |
| Liabilities / Current / Withholdings / Employee related | Cr | BS | 2.1.3.1 |
| Liabilities / Current / Withholdings / Employee related / Social insurance | Cr | BS | 2.1.3.1.1 |
| Liabilities / Current / Withholdings / Employee related / Medical insurance | Cr | BS | 2.1.3.1.2 |
| Liabilities / Current / Withholdings / Employee related / Safety insurance | Cr | BS | 2.1.3.1.3 |
| Liabilities / Current / Withholdings / Taxes and fees | Cr | BS | 2.1.3.2 |
| Liabilities / Current / Withholdings / Taxes and fees / VAT payable (net) | Cr | BS | 2.1.3.2.1 |
| Liabilities / Current / Withholdings / Taxes and fees / Sales (turnover) taxes | Cr | BS | 2.1.3.2.2 |
| Liabilities / Current / Provisions | Cr | BS | 2.1.4 |
| Liabilities / Current / Provisions / Compensated absences | Cr | BS | 2.1.4.1 |
| Liabilities / Current / Provisions / Bonuses | Cr | BS | 2.1.4.2 |
| Liabilities / Current / Derivatives | Cr | BS | 2.1.5 |
| Liabilities / Current / Derivatives / Hedging | Cr | BS | 2.1.5.1 |
| Liabilities / Current / Derivatives / Speculation | Cr | BS | 2.1.5.2 |
| Liabilities / Long-term | Cr | BS | 2.2 |
| Liabilities / Long-term / Bonds | Cr | BS | 2.2.1 |
| Liabilities / Long-term / Obligations under capital (financial) lease | Cr | BS | 2.2.2 |
| Liabilities / Long-term / Debt | Cr | BS | 2.2.3 |
| Liabilities / Long-term / Debt / Loans | Cr | BS | 2.2.3.1 |
| Liabilities / Long-term / Debt / Long-term lines of credit | Cr | BS | 2.2.3.2 |
| Liabilities / Long-term / Debt / Notes | Cr | BS | 2.2.3.3 |
| Liabilities / Long-term / Derivatives | Cr | BS | 2.2.4 |
| Liabilities / Long-term / Derivatives / Hedging | Cr | BS | 2.2.4.1 |
| Liabilities / Long-term / Derivatives / Speculation | Cr | BS | 2.2.4.2 |
| Liabilities / Long-term / Employee pension plans | Cr | BS | 2.2.5 |
| Liabilities / Long-term / Accruals | Cr | BS | 2.2.6 |
| Liabilities / Long-term / Accruals / Unearned revenue | Cr | BS | 2.2.6 |
| Liabilities / Long-term / Accruals / Unearned revenue / Deposits and pre-payments | Cr | BS | 2.2.7.1 |
| Liabilities / Long-term / Accruals / Unearned revenue / Contract billings | Cr | BS | 2.2.7.2 |
| Liabilities / Long-term / Provisions | Cr | BS | 2.2.8 |
| Liabilities / Long-term / Provisions / Disposals | Cr | BS | 2.2.8.1 |
| Liabilities / Long-term / Provisions / Long-term bonuses and compensated absences | Cr | BS | 2.2.8.2 |
| Liabilities / Long-term / Provisions / Premiums and coupons | Cr | BS | 2.2.8.3 |
| Liabilities / Long-term / Provisions / Product warranties (general warrantee policy) | Cr | BS | 2.2.8.4 |
| Liabilities / Long-term / Provisions / Self insurance | Cr | BS | 2.2.8.5 |
| Liabilities / Long-term / Provisions / Defects | Cr | BS | 2.2.8.6 |
| Liabilities / Long-term / Provisions / Litigation | Cr | BS | 2.2.8.7 |
| Liabilities / Long-term / Provisions / Onerous contracts | Cr | BS | 2.2.8.8 |
| Liabilities / Long-term / Deferred tax liabilities | Cr | BS | 2.2.9 |
| Liabilities / Long-term / Other | Cr | BS | 2.2.10 |
| Equity | Cr | BS | 3 |
| Equity / Paid-in capital | Cr | BS | 3.1 |
| Equity / Paid-in capital / At par | Cr | BS | 3.1.1 |
| Equity / Paid-in capital / At par / Legal equity | Cr | BS | 3.1.1.1 |
| Equity / Paid-in capital / Additional paid-in capital | Cr | BS | 3.1.2 |
| Equity / Paid-in capital / Preferred equity | Cr | BS | 3.1.3 |
| Equity / Paid-in capital / Preferred equity / At par | Cr | BS | 3.1.3.1 |
| Equity / Paid-in capital / Preferred equity / Additional preferred capital paid-in | Cr | BS | 3.1.3.2 |
| Equity / Retained earnings | Cr | BS | 3.2 |
| Equity / Retained earnings / Unappropriated retained earnings | Cr | BS | 3.2.1 |
| Equity / Retained earnings / Appropriated retained earnings (reserves) | Cr | BS | 3.2.2 |
| Equity / Accumulated other comprehensive income | Cr | BS | 3.3 |
| Equity / Accumulated OCI / Gain (loss) on available-for-sale instruments | Cr | BS | 3.3.1 |
| Equity / Accumulated OCI / Gain (loss) on cash flow hedges | Cr | BS | 3.3.2 |
| Equity / Accumulated OCI / Exchange rate differences on foreign operations | Cr | BS | 3.3.3 |
| Equity / Accumulated OCI / Pension liability adjustments | Cr | BS | 3.3.4 |
| Equity / Accumulated OCI / Revaluation surplus (PP&E and intangible assets) | Cr | BS | 3.3.5 |
| Equity / Non-controlling (minority) interest | Cr | BS | 3.4 |
| Equity / Other equity items | Cr | BS | 3.5 |
| Equity / Other equity / treasury shares | Dr | BS | 3.5.(1) |
| Equity / Other equity / Subscribed equity | Dr | BS | 3.5.(2) |
| Revenue (sales) | Cr | IS | 4 |
| Revenue / Adjustments | Dr | IS | 4.(2) |
| Revenue / Adjustments / Cash discounts | Dr | IS | 4.(2.1) |
| Revenue / Adjustments / Returns and allowances | Dr | IS | 4.(2.2) |
| Revenue / Adjustments / Other adjustments | Dr | IS | 4.(2.3) |
| Revenue / Goods | Cr | IS | 4.3 |
| Revenue / Goods / Products | Cr | IS | 4.3.1 |
| Revenue / Goods / Merchandise | Cr | IS | 4.3.2 |
| Revenue / Services | Cr | IS | 4.4 |
| Revenue / Long-term contracts | Cr | IS | 4.5 |
| Expenses (operating) | Dr | IS | 5 |
| Expenses / Cost of sales (Cost of goods sold) | Dr | IS | 5.1 |
| Expenses / COS / Direct materials | Dr | IS | 5.1.1 |
| Expenses / COS / Direct materials / Purchases | Dr | IS | 5.1.1.1 |
| Expenses / COS / Direct materials / Delivery | Dr | IS | 5.1.1.2 |
| Expenses / COS / Direct materials / Delivery / Freight | Dr | IS | 5.1.1.2.1 |
| Expenses / COS / Direct materials / Delivery / Insurance | Dr | IS | 5.1.1.2.2 |
| Expenses / COS / Direct materials / Customs, duties, taxes and fees | Dr | IS | 5.1.1.3 |
| Expenses / COS / Direct materials / Customs, duties, taxes and fees / Customs | Dr | IS | 5.1.1.3.1 |
| Expenses / COS / Direct materials / Customs, duties, taxes and fees / Taxes | Dr | IS | 5.1.1.3.2 |
| Expenses / COS / Direct materials / Other acquisition costs | Dr | IS | 5.1.1.4 |
| Expenses / COS / Direct materials / Deductions | Cr | IS | 5.1.1.(5) |
| Expenses / COS / Direct materials / Deductions / Returns and allowances | Cr | IS | 5.1.1.(5.1) |
| Expenses / COS / Direct materials / Deductions / Vender credits and discounts | Cr | IS | 5.1.1.(5.2) |
| Expenses / COS / Direct wages | Dr | IS | 5.1.2 |
| Expenses / COS / Direct wages / Hourly wage and overtime | Dr | IS | 5.1.2.1 |
| Expenses / COS / Direct wages / Social, medical, safety and other insurance | Dr | IS | 5.1.2.2 |
| Expenses / COS / Direct wages / Employee meals and fringe benefits | Dr | IS | 5.1.2.3 |
| Expenses / COS / Indirect costs (manufacturing overhead) | Dr | IS | 5.1.3 |
| Expenses / COS / Indirect costs / Variable | Dr | IS | 5.1.3.1 |
| Expenses / COS / Indirect costs / Variable / Supervisor's salaries | Dr | IS | 5.1.3.1.1 |
| Expenses / COS / Indirect costs / Variable / Repairs and maintenance | Dr | IS | 5.1.3.1.2 |
| Expenses / COS / Indirect costs / Variable / Repairs and maintenance / Spare parts | Dr | IS | 5.1.3.1.2.1 |
| Expenses / COS / Indirect costs / Variable / Repairs and maintenance / Wages and salaries | Dr | IS | 5.1.3.1.2.2 |
| Expenses / COS / Indirect costs / Variable / Quality control and inspection | Dr | IS | 5.1.3.1.3 |
| Expenses / COS / Indirect costs / Variable / Setup, re-tooling | Dr | IS | 5.1.3.1.4 |
| Expenses / COS / Indirect costs / Variable / Utilities | Dr | IS | 5.1.3.1.5 |
| Expenses / COS / Indirect costs / Variable / Utilities / Electricity | Dr | IS | 5.1.3.1.5.1 |
| Expenses / COS / Indirect costs / Variable / Utilities / Hydrocarbons | Dr | IS | 5.1.3.1.5.2 |
| Expenses / COS / Indirect costs / Variable / Utilities / Water and sewage | Dr | IS | 5.1.3.1.5.3 |
| Expenses / COS / Indirect costs / Variable / Utilities / Waste removal | Dr | IS | 5.1.3.1.5.4 |
| Expenses / COS / Indirect costs / Variable / Utilities / Recycled waste | Cr | IS | 5.1.3.1.5.4.1 |
| Expenses / COS / Indirect costs / Variable / Production supplies | Dr | IS | 5.1.3.1.6 |
| Expenses / COS / Indirect costs / Variable / Production supplies / Fasteners | Dr | IS | 5.1.3.1.6.1 |
| Expenses / COS / Indirect costs / Variable / Production supplies / Lubricants | Dr | IS | 5.1.3.1.6.2 |
| Expenses / COS / Indirect costs / Variable / Production supplies / Tools | Dr | IS | 5.1.3.1.6.3 |
| Expenses / COS / Indirect costs / Variable / Production based depreciation | Dr | IS | 5.1.3.1.7 |
| Expenses / COS / Indirect costs / Fixed | Dr | IS | 5.1.3.2 |
| Expenses / COS / Indirect costs / Fixed / Depreciation | Dr | IS | 5.1.3.2.1 |
| Expenses / COS / Indirect costs / Fixed / Rent (leasing) | Dr | IS | 5.1.3.2.2 |
| Expenses / COS / Indirect costs / Fixed / Property taxes | Dr | IS | 5.1.3.2.3 |
| Expenses / COS / Indirect costs / Fixed / Insurance | Dr | IS | 5.1.3.2.4 |
| Expenses / COS / Indirect costs / Fixed / Amortization | Dr | IS | 5.1.3.2.5 |
| Expenses / COS / Indirect costs / Fixed / Other | Dr | IS | 5.1.3.2.6 |
| Expenses / COS / Merchandise | Dr | IS | 5.1.4 |
| Expenses / COS / Merchandise / Deductions | Cr | IS | 5.1.4.(1) |
| Expenses / COS / Merchandise / Deductions / Returns and allowances | Cr | IS | 5.1.4.(1.1) |
| Expenses / COS / Merchandise / Deductions / Vender credits and discounts | Cr | IS | 5.1.4.(1.2) |
| Expenses / COS / Service providers | Dr | IS | 5.1.5 |
| Expenses / COS / Service providers / Initial direct costs | Dr | IS | 5.1.5.1 |
| Expenses / COS / Service providers / Direct costs | Dr | IS | 5.1.5.2 |
| Expenses / COS / Service providers / Direct costs / Direct material (spare parts) | Dr | IS | 5.1.5.2.1 |
| Expenses / COS / Service providers / Direct costs / Wages and salaries | Dr | IS | 5.1.5.2.2 |
| Expenses / COS / Service providers / Indirect costs | Dr | IS | 5.1.5.3 |
| Expenses / COS / Service providers / Indirect costs / Fixed | Dr | IS | 5.1.5.3.1 |
| Expenses / COS / Service providers / Indirect costs / Variable | Dr | IS | 5.1.5.3.2 |
| Expenses / COS / Service providers / Indirect costs / Subcontractors | Dr | IS | 5.1.5.3.3 |
| Expenses / COS / Long-term contracts | Dr | IS | 5.1.6 |
| Expenses / Selling | Dr | IS | 5.2 |
| Expenses / Selling / Salespersons | Dr | IS | 5.2.1 |
| Expenses / Selling / Salespersons / Salaries | Dr | IS | 5.2.1.1 |
| Expenses / Selling / Salespersons / Commissions | Dr | IS | 5.2.1.2 |
| Expenses / Selling / Salespersons / Bonuses | Dr | IS | 5.2.1.3 |
| Expenses / Selling / Salespersons / Fringe benefits | Dr | IS | 5.2.1.4 |
| Expenses / Selling / Salespersons / Training | Dr | IS | 5.2.1.5 |
| Expenses / Selling / Salespersons / Recruiting | Dr | IS | 5.2.1.6 |
| Expenses / Selling / Sales staff wages and salaries | Dr | IS | 5.2.2 |
| Expenses / Selling / Delivery (distribution) | Dr | IS | 5.2.3 |
| Expenses / Selling / Delivery / Shipping and freight forwarding (third party) | Dr | IS | 5.2.3.1 |
| Expenses / Selling / Delivery / Delivery (internal shipping) | Dr | IS | 5.2.3.2 |
| Expenses / Selling / Delivery / Delivery / Direct costs (fuel wages, and related items) | Dr | IS | 5.2.3.2.1 |
| Expenses / Selling / Delivery / Delivery / Variable indirect (customs, duties, rentals, repairs, etc.) | Dr | IS | 5.2.3.2.2 |
| Expenses / Selling / Delivery / Delivery / Fixed indirect (depreciation) | Dr | IS | 5.2.3.2.3 |
| Expenses / Selling / Warehousing and logistics | Dr | IS | 5.2.3.3 |
| Expenses / Selling / Travel and entertainment | Dr | IS | 5.2.4 |
| Expenses / Selling / Tradeshows, exhibits, tastings and promotions | Dr | IS | 5.2.5 |
| Expenses / Selling / Premiums and coupons | Dr | IS | 5.2.6 |
| Expenses / Selling / Product warrantees | Dr | IS | 5.2.7 |
| Expenses / Selling / Shrinkage | Dr | IS | 5.2.8 |
| Expenses / Selling / Shrinkage / Shoplifting | Dr | IS | 5.2.8.1 |
| Expenses / Selling / Shrinkage / Goods damaged by customers | Dr | IS | 5.2.8.2 |
| Expenses / Selling / Uncollectible accounts expenses | Dr | IS | 5.2.9 |
| Expenses / Selling / Rent & depreciation | Dr | IS | 5.2.10 |
| Expenses / Selling / Other expenses | Dr | IS | 5.2.11 |
| Expenses / Selling / Other expenses / Utilities | Dr | IS | 5.2.11.1 |
| Expenses / Selling / Other expenses / Credit card fees | Dr | IS | 5.2.11.2 |
| Expenses / Administrative (general) expenses | Dr | IS | 5.3 |
| Expenses / Administrative / Officer compensation | Dr | IS | 5.3.1 |
| Expenses / Administrative / Officers / Base salary | Dr | IS | 5.3.1.1 |
| Expenses / Administrative / Officers / Performance based pay (bonuses, premiums) | Dr | IS | 5.3.1.2 |
| Expenses / Administrative / Officers / Fringe benefits | Dr | IS | 5.3.1.3 |
| Expenses / Administrative / Officers / Pensions and Other Postretirement Benefits | Dr | IS | 5.3.1.4 |
| Expenses / Administrative / Officers / Stock based compensation | Dr | IS | 5.3.1.5 |
| Expenses / Administrative / Officers / Stock / Grants | Dr | IS | 5.3.1.5.1 |
| Expenses / Administrative / Officers / Stock / Options and warrants | Dr | IS | 5.3.1.5.2 |
| Expenses / Administrative / Staff compensation | Dr | IS | 5.3.2 |
| Expenses / Administrative / Staff / Salaries | Dr | IS | 5.3.2.1 |
| Expenses / Administrative / Staff / Base salary | Dr | IS | 5.3.2.2 |
| Expenses / Administrative / Staff / Performance based pay (bonuses, premiums) | Dr | IS | 5.3.2.3 |
| Expenses / Administrative / Staff / Fringe benefits | Dr | IS | 5.3.2.4 |
| Expenses / Administrative / Staff / Pensions and Other Postretirement Benefits | Dr | IS | 5.3.2.5 |
| Expenses / Administrative / Training and recruiting | Dr | IS | 5.3.2.6 |
| Expenses / Administrative / Excessive spoilage | Dr | IS | 5.3.3 |
| Expenses / Administrative / Excess cost allocation caused by underutilized plant capacity | Dr | IS | 5.3.4 |
| Expenses / General / Professional services | Dr | IS | 5.3.5 |
| Expenses / General / Research and development | Dr | IS | 5.3.6 |
| Expenses / General / Marketing | Dr | IS | 5.3.7 |
| Expenses / General / Marketing / Advertising | Dr | IS | 5.3.7.1 |
| Expenses / General / Marketing / Public relations | Dr | IS | 5.3.7.2 |
| Expenses / General / Marketing / Public relations / Charitable contributions | Dr | IS | 5.3.7.2.1 |
| Expenses / General / Depreciation and amortization | Dr | IS | 5.3.8 |
| Expenses / General / Other expenses | Dr | IS | 5.3.9 |
| Other revenue, expenses, gains and losses | Cr | IS | 6 |
| Other revenue | Cr | IS | 6.1 |
| Other revenue / Interest revenue | Cr | IS | 6.1.1 |
| Other revenue / Dividends | Cr | IS | 6.1.2 |
| Other revenue / Rent | Cr | IS | 6.1.3 |
| Other revenue / Royalties | Cr | IS | 6.1.4 |
| Other expenses | Dr | IS | 6.2 |
| Other expenses / Interest expense | Dr | IS | 6.2.1 |
| Other expenses / Other financial expenses | Dr | IS | 6.2.2 |
| Gain | Cr | IS | 6.3 |
| Gain / Foreign exchange | Cr | IS | 6.3.1 |
| Gain / Investments | Cr | IS | 6.3.2 |
| Gain / Derivatives held for speculation | Cr | IS | 6.3.3 |
| Gain / Disposal of assets | Cr | IS | 6.3.4 |
| Gain / Contract gains | Cr | IS | 6.3.5 |
| Gain / Extinguishment of debt | Cr | IS | 6.3.6 |
| Gain / Restructuring or disposal | Cr | IS | 6.3.7 |
| Gain / Grants and donation | Cr | IS | 6.3.8 |
| Loss | Dr | IS | 6.4 |
| Loss / Inventory write-down | Dr | IS | 6.4.1 |
| Loss / Inventory write-down / Lower of cost or market charge | Dr | IS | 6.4.1.1 |
| Loss / Inventory write-down / Damaged or obsolete goods | Dr | IS | 6.4.1.2 |
| Loss / Asset impairment charge | Dr | IS | 6.4.2 |
| Loss / Asset impairment charge / Available for sale investment | Dr | IS | 6.4.2.1 |
| Loss / Asset impairment charge / PP&E, intangible assets | Dr | IS | 6.4.2.2 |
| Loss / Asset impairment charge / Goodwill | Dr | IS | 6.4.2.3 |
| Loss / Foreign exchange rate loss | Dr | IS | 6.4.3 |
| Loss / Investments held for trading | Dr | IS | 6.4.4 |
| Loss / Derivatives held for speculation | Dr | IS | 6.4.5 |
| Loss / Disposal of assets | Dr | IS | 6.4.6 |
| Loss / Extinguishment of debt | Dr | IS | 6.4.7 |
| Loss / Restructuring or disposal | Dr | IS | 6.4.8 |
| Loss / Litigation | Dr | IS | 6.4.9 |
| Income tax | Dr/Cr | IS | 7 |
| Other comprehensive income | Dr/Cr | IS | 8 |
| OCI / Gains (loss) on available-for-sale instruments | Dr/Cr | IS | 8.1 |
| OCI / Gains (loss) on cash flow hedges | Dr/Cr | IS | 8.2 |
| OCI / Gains (loss) foreign exchange on foreign operations | Dr/Cr | IS | 8.3 |
| OCI / Pension liability adjustments | Dr/Cr | IS | 8.4 |
| OCI / Changes in revaluation surplus | Cr | IS | 8.5 |
| OCI / Reclassification adjustment | Cr | IS | 8.6 |