FAR

Aim:

* Apply IASBs conceptual framework for Financial Reporting and identify and explain key ethical issues
* Prepare and present financial statements for single entities (60%)
* Prepare and present consolidated f/s for group scenarios (30%)
* Describe principal differences between UK GAAP and IFRS
* Prepare simple extracts from financial statements in accordance with UK GAAP for both single entity and consolidated financial statements

Q1: Single company accounts prep from TB (SPL, SPLOCI, SOFP, SOCIE or Notes)

Q2: Explanation of accounting treatment for various accounting standards

Q3: Mixed or Simple topic question requiring extracts and/ or calculations possibly with an explain element. This could include extracts from a statement of cash flows or a full question on preparing or reviewing a statement cash flows

Could be other topics (e.g NCA, leases, provisions, revenue, grants, SOCIE, group issues)

Q4: Preparation of consolidated accounts for a single group (either SPL never SPLOCI, sometimes a SOCIE (NCI, RE) or SOFP

**Topic 1**

Ethics Question Approach

* State ethical issues and principals at risk (with reasoning)- look at the issue and the circumstances
* Use an internal approach first (I.e speak to the individual you have an issue with) (or if auditor- audit senior, partner, ethics partner)
* If the FD refuses then speak to the audit committee (plc) or board of directors (ltd.)
* Contact ICAEW line for advice
* Seek legal advice
* Resign as last resort
* Document everything

Change in accounting policy

Only allowed if required if IFRS or results in financial statements providing more relevant and reliable information (but this is rare unless there was a major change in business operations)

Must account for retrospectively

Prior Period Errors

Material omissions or misstatements arising from a failure to use or misuse of information that was available or could reasonably be expected to have been obtained

Account for retrospectively (usually an issue with inventory- restate PY COGs and add/ deduct from RE)

Accounting estimates

Where judgment is used (e.g Bad debt allowances, warranty provisions, depreciation, inventory)

Changes arise from new information or new developments (not corrections of errors)

Account for prospectively (make change now and going forward)

F/S are used to make economic decisions:

* Decide when to buy, hold or sell an equity investment
* Assess the stewardship or accountability of management
* Assess security for amounts lent to the entity

Under IAS 8 these must be disclosed where there is a material change

Conceptual standards (not actually accounting standards- so in a conflict IFRS will prevail)

Chapters form the foundation on which the f/s are produced (replacing the IASB framework)

Purpose:

* Assist the board in the development of future IFRss
* Promote harmonisation of regulations
* Assist in developing national standards
* Assist auditors in forming an opinion as to whether f/s comply with IFRSs

Financial Capital Maintenance: A profit is made if there is an increase in net assets or equity excluding the effects of contributions from, or distributions to the owners.

A profit is only earned if capital at the end of the period exceeds the uprated values for opening capital and transactions in the year

Physical capital maintenance: Profit is earned only after that productive capacity has been maintained (i.e profit is measured as an increase in operating capabilities- resources exist to produce more units per day than before)

**Topic 2**

**IAS 12- Income tax**

Estimated tax is shown as an expense in the SPL and a CL in the SOFP

If there is a change in the amount actually paid the over or under provision is adjusted under the expenses in the following FS. CL is not changed (that is what is estimated to be paid out)

UK GAAP

Presentation of financial statements is primarily dealt with by the following:

* Companies Act 2006
* FRS 102

In the UK, the companies Act sets out balance sheet and profit and loss account formats. In general terms the requirements are similar to those of IAS 1

**Discontinued operations (IFRS 5- NCAs Held for sale and Discontinued ops)**

* A component of an entity that either has been disposed of or is classified as held for sale and
  + Represents a separate major line of business or geographical area of operations or
  + Is part of a single coordinated plan to dispose of a separate major line business or geographical area of operations or
  + Is a subsidiary acquired exclusively with a view to resale
* A component of an entity comprising operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. (relevance)
* A discontinued operation must either
  + Have been disposed of- disclosures will be made in the period in which the disposal takes place, or
  + Be held for sale- disclosures will be first made in the period in which the decision to dispose of it is made (provided it is highly probably that it will be sold within 12 months of classification)
* An entity should disclose a single amount in the statement of profit or loss comprising the total of:
  + The post-tax profit/ loss of discontinued operations
  + And any post-tax gain/ loss on related assets
* An entity should also disclose an analysis of this single amount into:
  + The revenue, expenses and pre-tax profit or loss of discontinued operations
  + The related income tax expense
  + Post-tax gain or loss on related assets
* In the statement of cash flows, discontinued operations cash flows should be split into
  + Operating
  + Investing
  + Financing
* If any non-current assets held for sale have not been finally disposed of, they must be shown in the statement of financial position separately from all other assets (non-current assets held for sale)

**Foreign Currency Transactions**

*Initial recognition*: A foreign currency transaction should be initially recorded at the exchange rate applicable at the date of the transaction (i.e spot rate)

*Reporting at subsequent year ends*

a) Restate foreign currency monetary items at the closing rate

b) Do not restate non-monetary items (e.g NCA, Inventories). They are carried at historical cost in a foreign currency using the exchange rate at the date of the transaction (historical rate)

c) Restate non- monetary items which are carried at fair value in a foreign currency using the exchange rates that existed when the fair values were measured (i.e the spot rate at the date of valuation)

Exchange rate differences should be recognised in profit or loss in the period in which they arise

Where a monetary item has not been settled at the end of a period, it should be restated using the closing exchange rate and any gain or loss taken to profit or loss.

Where a gain or loss on a non-monetary item is recognised in other comprehensive income, any related exchange difference should also be recognised in other comprehensive income.

**Topic 3**

**Property, plant and equipment- IAS 16**

* Held for use in the production or supply of goods or services, for rental to others or for administrative purposes
* Expected to be used during more than one period
* There is no definition of what constitutes an item of PPE (will be for each entity to develop its own definitions). In general, if an entity will use an item to help generate income for greater than one operating cycle then it will be PPE.
* Subsequent costs:
  + Repairs and maintenance expenditure should not be capitalised but should be recognised in profit or loss, as incurred
  + Replacement parts should be capitalised provided they enhance economic benefits. The original cost of the items they replace should be derecognised at the time of replacement
  + The different parts of an asset which have different useful economic lives, can be treated as separate components and capitalised separately

**Depreciation**

* Depreciation: means of spreading the cost of a NCA over its useful life
* Depreciation should commence when the asset is in the location and condition necessary for it to be capable of operating in the manner intended (even if the asset is actually put into use at a later date)
* Residual values and useful lives must be reviewed annually. Any change must be treated as a change in accounting estimate

**Revaluation model**

**Land and buildings**: FV is determined from market based evidence by appraisal by professionally qualified valuers

**Plant and equipment** FV is usually their MV determined by appraisal

**Specialised items of PPE:** FV is determined by using a depreciated replacement cost (no market based evidence of FV)

***Accounting for revaluations****:*

Increase in value:

a) Increase (DEBIT) original asset cost to FV

b) Removed the acc depreciation to date (DEBIT\_

c) Revaluation gain is recognised within other comprehensive income (OCI) and the revaluation surplus in equity

Decreases in value (without previous increase)

DEBIT: Profit or loss expense

CREDIT: PPE (carrying amount)

Decreases in value reversing a previous increase

Where such a decrease reverses an earlier revaluation increase on the same asset that was recognised in other comprehensive income, the deficit should be:

a) Recognised in other comprehensive income to the extent of any remaining balance on revaluation surplus relating to that asset

b) Any excess is recognised in the profit or loss

Increases in value reversing a previous decrease

Where an increase reverses an earlier revaluation decrease on the same asset where the loss was recognised in profit or loss, the surplus should be recognised in profit or loss, but only to the extent of the previous decrease.

The credit to the reval surplus/ OCI should be the amount as if the previous downward revaluation had never taken place.

**Depreciation of revalued assets**

Where an asset has been revalued the depreciation charge is based on the revalued amount, less residual value from the date of the valuation. The revalued asset is depreciated over its remaining useful life. The whole of the depreciation charge is recognised in the P&L.

IAS 16 permits and it is best practice to make a transfer between reserves of the excess depreciation arising as a result of the revaluation.

Amount of transfer= annual depreciation charge now (based on revaluation) less annual depreciation charge prior to valuation

DEBIT Revaluation surplus

CREDIT RE

**Impairment indicators**

If an assets carrying value in the F/S is higher than its recoverable amount, the asset is judged to have been impaired

Asset should be lower of the **carrying amount** and the **recoverable amount**

The recoverable amount should be the higher of the **value in use** and the **FV-CTS**

The impairment loss is charged to P/L

If the asset has been previously revalued upward:

* Impairment loss is first charged to other comprehensive income to the extent that there is revaluation surplus remaining for that asset (clear to zero)
* Any further impairment is charged to profit or loss as an expense

Depreciation charges in future accounting period will be to set off the revised carrying amount, less RV over remaining useful life.

**Borrowing costs**

The financing or borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset form part of the cost of that asset.

*Borrowing costs that must be capitalised*

(interest should be capitalised)

a) Funds specifically borrowed for construction- investment income from any specific funds invested

b) weighted average of general borrowings used to finance the construction of the entity

Capitalisation should commence when entity:

* Incurs expenditures for the asset
* Incurs borrowing costs
* Undertakes activities that are necessary to prepare the asset for intended use or sale

**De-recognition of PPE**

DEBIT Cash (proceeds)

CREDIT Asset Cost (remove)

DEBIT Accumulated depreciation (remove)

DEBIT/CREDIT Loss/ Gain on disposal (P/L)

Any balance remaining in the revaluation surplus relating to that asset must be transferred to retained earnings:

DEBIT Revaluation surplus (to clear to zero)

CREDIT Retained earnings

**Assets held for sale**

Needs to be revalued at the LOWER OF the **carrying amount** or the **FV-CTS**

Any write down hits expenses

NCA classified as held for sale **are not depreciated/ amortised**

Disclosed:

* As a single amount separately from other assets
* On the face of the statement of FP
* And Normally as current assets

**Intangible asset**

An identifiable non-monetary asset without physical substance

General Rule: If internally generated- cannot recognise as an intangible (it is difficult to find a reliable measure of cost- they cannot be identified separately from the cost of developing the business as a whole)

EXCEPT: Development costs that meet ‘PIRATE’ criteria must be capitalised

**Research and development**

**Research** expenditure is always expensed as incurred

An intangible generated during the **development phase** must be capitalised (provided criteria are met)

Capitalise only directly attributable expenditure incurred from the date the criteria are met

Once the product/ item is available for use, begin to amortise the capitalised development expenditure

**Intangibles**

Revaluation: Can be revalued to fair value but only when an active market exists

Active market:

* All items are homogeneous
* Willing buyers/ sellers
* Prices are available to the public

DEBIT: Intangible Asset (increase from cost valuation)

DEBIT: Accumulated amortisation (clear balance to zero)

CREDIT: Revaluation surplus

*Amortisation:* Amortisation of an intangible asset will only occur if the asset has a finite life and begins when it is deemed ready for its intended use

*Impairment:* An intangible asset that has indefinite life is not amortised, but rather subject to an annual impairment review

For each class of intangible assets, disclosure should distinguish between internally- generated intangibles and purchased intangibles. The amount of research and development expenditure that has been charged as an expense in the period should be disclosed.

**SUBSTANCE OVER FORM**

Certain types of contracts, where a company leases an asset from another company, are very similar in substance to the outright purchase of that asset. This is true, even if legal title to the asset never passes to the lesee. If these leases are accounted for in accordance with the strict legal form, a company’s assets and liabilities are likely to be understated, with the consequent impact on gearing and other ratios.

Failing to record the true substance of the transaction is an example of ‘off-balance sheet,’ financing.

**Lease**

**Financing lease:** A lease that transfers substantially all the risks and rewards of ownership

* Ownership passes
* Option to purchase at a price significantly below a FV
* Lease term is for a major part of asset’s life
* PV of minimum lease payments substantially all of the asset’s fair value

Asset is of a specialised nature

Inception of the lease: is the earlier of the date of the lease agreement and the date of commencement by the parties to the principle provisions of the lease

Accounting for finance leases

(1) Initial recognition

DEBIT: Asset account (PPE)

CREDIT: Finance Lease liabilities

The lower of the FV and the PV of the minimum lease payments at the inception of the lease (day 1). The **initial**  deposit if any counts as one of the lease payments and hence is included in the cost of the asset.

(2) Depreciating the asset

DEBIT: Depreciation expense

CREDIT: Accumulated depreciation

The asset should be depreciated over the shorter if the **lease term or the asset’s useful life**.

If the PV of minimum lease payments (PVMLP) is substantially all of the FV of the asset then it can be considered a finance lease

Interest payments:

**The actuarial method**

Interest is charged at a constant percentage on the outstanding liability, thus matching interest to the loan balance. To apply the actuarial method, the rate of interest implicit in the lease is required.

**Presentation**

The lease liability needs to be split between current and non-current portions. The current liability will be equal to the net capital repaid during the next year

**Sale and leaseback as a finance lease:**

In substance there is no sale

1) Remove asset from PPE and calculate the P/L on disposal and recognise as deferred income (liability)

DEBIT Cash (w/ proceeds)

CREDIT PPE (Carrying amount)

CREDIT Deferred income (Balancing amount)

2) Re-recognise the asset and lease liability at lower of FV v PVMLP (in the normal way for accounting for a finance lease

DEBIT PPE

CREDIT Finance lease liability

3) Amortise the deferred income over the lease term

**Operating lease-** A lease other than a finance lease. The lessee doesn’t own the leased asset either legally or in substance. The lessee is simply renting the asset and the rental expense is charged to the statement of profit or loss.

Rental expense should be charge on a straight- line basis, even if payments are not made in such a way.

**Sale and leaseback as a operating lease:**

* In substance there is a sale and there is a genuine profit or loss to be recognised
* Remove asset recognise profit or loss on disposal
* Normal profit or loss (FV-CA) is recognised immediately in profit or loss
* If the Selling price is below FV and the loss is compensated for by future operating lease payments below market level, then defer and amortise the loss; otherwise recognise loss immediately
* If the selling price is above fair value, defer and amortise excess profit (Selling price- FV). Remain of profit or loss (FV-CA) can be recognised immediately

**Government Grants**

IAS 20 requires that a grant is recognised in the profit or loss in the same period as the associated costs/ expense for which the grant was intended to compensate.

Presentation of grants:

* Set up the grant as deferred income
* Or Deduct the grant in arriving at the carrying amount of the asset (netting off ag. depreciation)

Grants related to income

* A credit in profit or loss (either separately, or under a general heading such as ‘other income,’)
* A deduction from the related expense

**Topic 4**

**REVENUE**

Income arising in the course of an entity’s ordinary activities

1) Identify contract with the customer

2) Identify performance obligations- promise to transfer a good or service

3) Determine transaction price- discounting is not required where consideration is due in less than one year

4) Allocate transaction price to performance obligations

5) Recognise revenue when performance obligation satisfied

**Satisfaction of a performance obligation over time**

(a) Customer simultaneously receives and consumes the benefits

(b) The entity’s performance creates or enhances an asset (e.g WIP- that the customer controls as the asset is created/ enhanced

(c) The entity’s performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for the performance completed date.

For each performance obligation satisfied over time, revenue should be recognised by measuring progress towards complete satisfaction of that performance obligation

A contract asset is recognised when the entity’s right to consideration is conditional on something other than the passage of- future performance for instance

A receivable is recognised when the entity’ right to consideration is unconditional except for the passage of time.

Where revenue has been invoiced a receivable is recognised. Where revenue has been earned but not invoiced, it is recognised as a contract asset.

**Deferred consideration**

Goods are bought on interest free credit- ‘financing component.’

Where an extended period of credit is offered, the revenue receivable has two separate elements:

* The FV of the goods on the date of sale, for example the cash selling price
* Financing income

**Sale and repurchase**

Under a repurchase agreement an entity sells an asset and has an option to repurchase it.

(a) An obligation to repurchase (a forward contract)

(b) A right to repurchase (a call option)

(c) An obligation to repurchase at the customer’s request (a put option)

**Consignment sales**

The buyer of the goods undertakes to sell them on, but on behalf of the original seller.

**Inventories**

Inventories should be measured at the **lower of cost and NRV**

Any fixed overheads should be allocated to inventory units based on normal levels of production, excluding:

* Abnormal losses
* Storage costs (except for maturing items)
* Admin overheads
* Selling costs

**Techniques for the measurement of cost**

(a) **Standard costs:** These are set up to take account of normal levels of raw materials used, labour time etc.

(b) **Retail method:** Often used in the retail industry where there is a large turnover of inventory items, which nevertheless have similar profit margins.

Take the total selling price of inventories and deduct an overall average profit margin, thus reducing the value to an approximation of cost.

The percentage will take account of reduced price lines.

Sometimes different percentages are applied on a department basis

**Financial instruments**

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

**Financial Asset:**

* Cash
* Equity instrument of another entity
* A contractual right
  + To receive cash or another financial asset from another entity
  + To exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity
* Derivative

**Financial liability**

* A contractual obligation:
  + To deliver cash or another financial asset to another entity
  + To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity
* Derivative

**Equity instrument**

* A contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities

**Derivative**

* Value changes in response to an underlying variable
* Requires little or no initial new investment
* Is settled at a future date

**Recognition and measurement**

Measure at fair value plus transaction costs for asset or minus transaction costs for liabilities.

Financial assets/ most financial liabilities: are measured at amortised cost using the effective interest method

Amortised cost is:

* The initial amount recognised for the financial asset
* Plus any amortisation
* Less any repayments of the principle sum
* The amount amortised should be recognised as income/ expense in the statement of profit or loss.

**Fair Value**

Take following factors into account:

* The asset or liability being measured
* The principal or most advantageous market
* The highest and best use of the item
* Assumptions that market participants would use in valuing the item

Hierarchy of inputs

Level 1: Quoted prices in active markets for identical items

Level 2: Inputs other than quoted prices that are directly observable

Level 3: Unobservable inputs

Financial instruments should be classified according to their substance rather than their legal form:

* Financial liability= contractual obligation to deliver cash
* Anything with these characteristics will be classified as a financial liability
  + Classified as a liability not equity
  + Costs treated as finance costs not dividends

**Treasury shares**

Treasury shares are equity instruments reacquired by the entity which issued them. This is becoming a popular way for companies to give cash to shareholders; an alternative to paying dividends.

**Provision**

Liability of uncertain timing or amount

Criteria:

a) An entity has a present obligation (legal or constructive (where there is a valid expectation))

b) Probable outflow of resources (more than 50% likely)

c) Reliable estimate of the amount of the obligation

If the effect of the time value of money is material, then the provision should represent the present value of the obligation- it should be discounted at an appropriate rate

**Onerous contracts**

An onerous contract is a contract in which the unavoidable costs of meeting the obligations made under the contract exceed the economic benefits expected to be received under it

**Contingent liability- needs to be disclosed but not recognised in the accounts**

Possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity (not probable outflow, cannot be measured with sufficient accuracy)

**Contingent asset**

Arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the control of the entity

**Topic 5**

**EPS:** Only mandatory for listed entities

**Dividends and the impact on earnings**

Ordinary dividend: Ignore and use profit without adjusting for these

Dividends on EQUITY preference share (irredeemable preference shares): Reduce profit for these before using EPS

Dividends on preference shares included as LIABILITIES (redeemable- cumulative/ mandatory divs): Ignore these should already be included in the finance charge, therefore the profit figure has already been adjusted