

Teacher Guidance for 9706 Accounting on International Accounting Standards

Cambridge International AS & A Level

Accounting 9706

For examination from 2023





Copyright © UCLES 2020 (updated October 2023)

Cambridge Assessment International Education is part of the Cambridge Assessment Group. Cambridge Assessment is the brand name of the University of Cambridge Local Examinations Syndicate (UCLES), which itself is a department of the University of Cambridge.

UCLES retains the copyright on all its publications. Registered Centres are permitted to copy material from this booklet for their own internal use. However, we cannot give permission to Centres to photocopy any material that is acknowledged to a third party, even for internal use within a Centre.

Contents

[Introduction 4](#_Toc46916878)

[IAS 1: Presentation of financial statements 6](#_Toc46916879)

[IAS 2: Inventories 12](#_Toc46916880)

[IAS 7: Statement of cash flows 16](#_Toc46916881)

[IAS 8: Accounting policies, changes in accounting estimates and errors 19](#_Toc46916882)

[IAS 10: Events after the reporting period 21](#_Toc46916883)

[IAS 16: Property, plant and equipment 23](#_Toc46916884)

[IAS 36: Impairment of assets 28](#_Toc46916885)

[IAS 37: Provisions, contingent liabilities and contingent assets 31](#_Toc46916886)

[IAS 38: Intangible assets 33](#_Toc46916887)

[Appendix 1: Statement of changes in equity 36](#_Toc46916888)

[Appendix 2: Financial statements for other forms of business (AS Level) 37](#_Toc46916889)

[Appendix 3: Financial statements for other forms of business (A Level) 42](#_Toc46916890)

[Appendix 4: Resources for photocopying 45](#_Toc46916891)

Introduction

This document is designed to help teachers in their delivery of International Accounting Standards (IAS) to learners of Cambridge International AS & A Level Accounting. Its aims are:

* to give a definitive indication of areas learners will need to be aware of in relation to the IAS for future Cambridge International A Level Accounting examinations
* to provide illustrative examples for learners and teachers.

The guidance presented in this document is primarily aimed at teachers. Only those standards identified in the Cambridge International AS & A Level Accounting syllabus will be considered, as listed in the following table.

International Accounting Standards

Candidates will be required to have a basic knowledge of the following standards and how these standards relate to topics in the syllabus.

| **IAS** | **Topic** |
| --- | --- |
| IAS 1 | Presentation of financial statements |
| IAS 2 | Inventories |
| IAS 7 | Statement of cash flows |
| IAS 8 | Accounting policies, changes in accounting estimates and errors |
| IAS 10 | Events after the reporting period |
| IAS 16 | Property, plant and equipment |
| IAS 36 | Impairment of assets |
| IAS 37 | Provisions, contingent liabilities and contingent assets |
| IAS 38 | Intangible assets |

Use of this document

The model financial statements in this document are given to help you and your learners apply the relevant standards, at the appropriate level, to a course of study. They are provided for illustrative and informative purposes only.

Every effort has been made to make sure that the document is complete in terms of the relevant requirements of International Financial Reporting Standards (IFRS) and IAS. However, as the standards are constantly changing, you should review professional documents as they become available in order to maintain current working knowledge of the standards.

Users of financial statements

Financial statements are used by a variety of groups for a variety of reasons. The framework surrounding IAS identifies the typical user groups of accounting statements. The table below identifies the user groups (stakeholders) and gives likely reasons for the user groups to refer to financial statements.

| **Main users** | **Reasons for use** |
| --- | --- |
| **Owners** | * to assess efficiency of the stewardship of management * to assess performance in relation to payment of dividend |
| **Managers** | * to assess efficiency of their strategies by comparing with previous years or with similar businesses |
| **Investors** | * to assess past performance as a basis for future investment |
| **Employees** | * to assess performance as a basis of future wage and salary negotiations * to assess performance as a basis for continuity of employment and job security |
| **Lenders** | * to assess performance in relation to the security of their loan to the business * to assess the performance in relation to payment of the interest (finance cost) on the loan provided |
| **Suppliers** | * to assess performance in relation to receiving payment of their liability |
| **Customers** | * to assess performance in relation to the likelihood of continuity of trading |
| **Government** | * to assess performance in relation to compliance with regulations and assessment of taxation liabilities |
| **Public and environmental bodies** | * to assess performance in relation to ethical trading |

Qualitative characteristics

As shown above, financial statements are prepared for a variety of reasons. The Conceptual Framework for Financial Reporting developed by the International Accounting Standards Board (IASB) sets out the qualitative characteristics of the financial statements that makes them useful to the users:

Fundamental qualitative characteristics

* **Relevance** – the information influences the economic decisions of users.
* **Faithful representation** – the information must be complete, neutral and free from errors.

Enhancing qualitative characteristics

* **Comparability** – the information enables comparisons with similar information about other entities and with similar information about the same entity over time to identify and evaluate trends.
* **Verifiability** – the information is faithfully represented and can be verified, providing assurance to the user that it is both credible and reliable.
* **Timeliness** – the information is provided to the users within a timescale suitable for their decision-making purposes.
* **Understandability** – the information is readily understandable by users, which is facilitated through appropriate classification, characterisation and presentation of information.

IAS 1: Presentation of financial statements

IAS 1 was comprehensively revised and reissued in September 2007 and applies to accounting periods beginning on or after 1 January 2009. The objective of the standard is to prescribe the basis for presentation of general purpose financial statements, to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. The revision introduced some new terminology and changed the titles of financial statements:

* **'balance sheet'** became **'statement of financial position'**
* **'income statement'** became **'statement of profit or loss and other comprehensive income'**
* **'cash flow statement'** became **'statement of cash flows'**.

However, entities are not required to use the new titles in their financial statements, but all existing standards and interpretations are being amended to reflect the new terminology.

Presentation of financial statements

The standard covers a number of areas, including the background to the purpose of financial statements, the components of statements, and illustrations of the presentation of the statement of profit or loss and the statement of financial position.

The purpose of financial statements

Financial statements provide information, about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. To meet that objective, financial statements provide information about an entity:

* assets
* liabilities
* equity
* income and expenses, including gains and losses
* contributions by and distributions to owners (in their capacity as owners)
* cash flows.

The financial statements must ‘present fairly’ the financial position, financial performance and cash flows of an entity.

The components of the financial statements

A complete set of financial statements as set out in the standard, comprises:

* a statement of financial position at the end of the period
* a statement of profit or loss and other comprehensive income for the period
* a statement of changes in equity for the period
* a statement of cash flows for the period (see IAS 7)
* accounting policies and explanatory notes (see IAS 8)
* comparative information.

Accounting concepts

The standard requires compliance with a series of accounting concepts:

* **Going concern** – the presumption is that the entity will not cease trading in the foreseeable future. (This is generally taken to mean within the next 12 months).
* **Accrual basis of accounting** – with the exception of the statement of cash flows, the information is prepared under the accruals concept; income and expenditure are matched to the same accounting period.
* **Consistency of presentation** – the presentation and classification of items in the financial statements should be retained from one period to the next unless a change is justified by a change in circumstances or the requirement of a new IFRS.
* **Materiality and aggregation** – information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions by the primary users of the financial statements. Each material class of similar items should be presented separately in the financial statements. This would apply to a grouping such as current assets.
* **Offsetting** – assets and liabilities, and income and expenditure may not be offset unless required or permitted by an IFRS. For example, it is not permitted to offset a bank overdraft with another bank account not in overdraft.
* **Comparative information** – there is a requirement to show the figures from the previous period for all the amounts shown in the financial statements. This is designed to help users make relevant comparisons.

Structure and content of financial statements

IAS 1 identifies in detail how the financial statements should be presented. It also sets out some general principles that must be adopted in those statements:

* a clear identification of the financial statements (statement of profit or loss, statement of financial position, etc.)
* the name of the entity (e.g. XYZ Limited)
* the period covered by the financial statements (year ended, etc.)  
  **Note**: Statements are usually prepared on an annual basis. If this is not the case, the reason for the change (for example to a short accounting period) must be disclosed and state that the figures may not be comparable with previous data.
* the currency used (e.g. £s, $s)
* the level of rounding used (e.g. if the statements are presented in thousands, millions). For assessment purposes the figures will be presented in whole numbers for financial statements and not rounded up or down.

Statement of profit or loss and other comprehensive income

The standard requires certain data to be identified and detailed on the face of the statement of profit or loss. The information included in the statement can be summarised, rather than detailing every single item. The following are required:

* revenue
* finance costs
* the charge for tax.

The statement ends by showing the profit or loss for the period.

Expenses may be analysed:

* **by nature** – raw materials, staffing costs, depreciation, etc. **OR**
* **by function** – cost of sales, administrative expenses, distribution costs, etc.

Analysing by nature may be more applicable for a manufacturing company. The method used will depend on which one provides the **more reliable and relevant information**.

The example on the following page uses analysis by **function**. Note that:

* it is presumed that the entity is operating on a continuing basis
* the information is in summarised form
* revenue is the sales revenue less sales returns
* cost of sales is the total of opening inventory, purchases less purchases returns, and less closing inventory.
* distribution costs include, costs of selling and delivering goods to customers, for example, delivery vehicle running costs, drivers’ wages, warehouse costs
* administrative expenses include, expenses other than the direct costs of production and distribution costs, for example, office costs, heat and light, etc.

**Example statement of profit or loss**

| **XYZ Limited**  **Statement of profit or loss for the year ended 31 December 2020** | | |
| --- | --- | --- |
|  | **31 December 2020**  **$000** | **31 December 2019**  **$000** |
| Revenue | 101 000 | 80 000 |
| Cost of Sales | (60 000) | (45 000) |
| Gross Profit | 41 000 | 35 000 |
| Distribution Costs | (8 000) | (7 000) |
| Administrative Expenses | (11 000) | (10 000) |
| Profit from Operations | 22 000 | 18 000 |
| Finance Costs | (3 000) | (2 000) |
| Profit before Tax | 19 000 | 16 000 |
| Tax | (4 500) | (4 000) |
| Profit for the Year | 14 500 | 12 000 |

**Notes**:

* Note the end point of this statement. Unlike previous statements, there is now a requirement to show various other information regarding:
* statement of changes in equity
* information relating to dividends.

Example extract from statement of changes in equity

| **Retained Earnings** | | |
| --- | --- | --- |
|  | **31 December 2020**  **$000** | **31 December 2019**  **$000** |
| Balance at start of year | 43 000 | 35 000 |
| Profit for the year | 14 500 | 12 000 |
| Transfers from other reserves | – | – |
|  | 56 500 | 47 000 |
| Dividends paid | (5 000) | (4 000) |
| Transfers to other reserves | – | – |
|  | (3 000) | (2 000) |
| Balance at end of year | 52 500 | 43 000 |

**Notes**:

See Appendix 1 for a comprehensive example of a statement of changes in equity.

|  | | |
| --- | --- | --- |
| **Notes to the financial statements** | **31 December 2020**  **$000** | **31 December 2019**  **$000** |
| Amounts recognised as distributions to equity holders during the year: |  |  |
| Final dividend for last year of $0.075 per share | 3 000 | 2 200 |
| Interim dividend for this year of $0.050 per share | 2 000 | 1 800 |
| Total | 5 500 | 4 000 |
| Proposed final dividend for this year of  $0.095 per share | 3 800 | 3 000 |

Example dividends statement

**Notes**:

* Only dividends paid **during the year** are included in the financial statements. They are shown as deductions in the statement of changes in equity.
* The proposed final dividend is subject to approval by the shareholders at the Annual General Meeting. It is only included by way of a note to the financial statements.
* No liability is included in the financial statements in respect of the proposed final dividend.

The statement of financial position

IAS 1 specifies the minimum information which must be shown on the face of the statement of financial position. It requires entities to separate out:

* **non-current assets** – property, plant, equipment, plant and machinery, motor vehicles, intangible assets, goodwill, etc.
* **current assets** – inventories, trade receivables, cash and cash equivalents
* **current liabilities** – trade payables, bank overdrafts and taxation
* **non-current liabilities** – bank loans and long-term provisions
* **equity** – share capital, share premium, reserves and retained earnings.

An asset is classified as current when:

* the asset is held primarily for the purpose of trading
* the asset is expected to be realised, consumed, or sold within the entity’s normal operating cycle
* when the asset is expected to be realised within twelve months after the reporting period
* cash and cash equivalent (unless restricted), for example, a short-term investment or deposit that can easily be converted into cash.

Any other assets would then be classified as non-current.

A liability is classified as current when:

* it is expected to be settled in the entity’s normal operating cycle
* the liability is held primarily for the purpose of trading
* the liability is due to be settled within twelve months after the reporting period
* the liability for which the entity does not have the right at the end of the reporting period to defer settlement beyond twelve months.

Any other liabilities would then be classified as non-current.

The example on the next page shows the way the information should be presented. Notice that the figure for retained earnings is the closing figure from the statement of changes in equity.

Example statement of financial position

**XYZ Limited**

**Statement of financial position as at 31 December 2020**

|  |  |  |  |
| --- | --- | --- | --- |
|  | **2020**  **$000** |  | **2019**  **$000** |
| **ASSETS** |  |  |  |
| **Non-current assets** |  |  |  |
| Intangible assets Goodwill | 7 700 |  | 8 000 |
| Property, plant & equipment | 100 000 |  | 92 100 |
|  | 107 700 |  | 100 100 |
| **Current assets** |  |  |  |
| Inventories | 1 000 |  | 800 |
| Trade and other receivables | 5 000 |  | 4 000 |
| Cash and cash equivalents | 500 |  | 300 |
|  | 6 500 |  | 5 100 |
|  |  |  |  |
| **Total assets** | **114 200** |  | **105 200** |
|  |  |  |  |
| **EQUITY & LIABILITIES** |  |  |  |
| Equity |  |  |  |
| Issued capital | 40 000 |  | 40 000 |
| Share premium | 2 000 |  | 2 000 |
| General reserve | 10 000 |  | 10 000 |
| Retained earnings | 52 500 |  | 43 000 |
| Total equity | 104 500 |  | 95 000 |
| **Non-current liabilities** |  |  |  |
| Bank loan | 5 000 |  | 5 200 |
|  |  |  |  |
| **Current liabilities** |  |  |  |
| Trade and other payables | 1 200 |  | 1 000 |
| Tax liabilities | 3 500 |  | 4 000 |
|  | 4 700 |  | 5 000 |
| **Total liabilities** | **9 700** |  | **10 200** |
| **Total equity and liabilities** | **114 200** |  | **105 200** |

IAS 2: Inventories

The term inventory refers to the stock of goods which a business holds in a variety of forms:

* raw materials for use in a subsequent manufacturing process
* work in progress, partly manufactured goods
* finished goods, completed goods ready for sale to customers
* finished goods that the business has bought for resale to customers.

The principle of inventory valuation set out in IAS 2 is that inventories should be valued at the lower of cost and net realisable value.

**Note the exact wording**. It is the lower of cost **and** net realisable value, not the lower of cost **or** net realisable value.

**Cost** should include all costs of purchase (including transport and handling), costs of conversion (including manufacturing overheads) and other costs incurred in bringing the inventory to its present location and condition.

**Net realisable value** is the estimated selling price in the normal course of business, less the estimated cost of completion and the estimated costs necessary to make the sale. Any write-down to net realisable value should be recognised as an expense in the period in which the write-down occurs.

Note that inventory is never valued at selling price or net realisable value when that value is greater than the cost.

Example of stock valuation (1)

The ABC Stationery Company bought 20 boxes of photocopier paper at $5 per box. Following a flood in their stockroom 5 of the boxes were damaged. They were offered for sale at $3 per box. All were unsold at the end of the company’s financial year.

At what value will they be included in the financial statements?

15 boxes will be valued at their cost of $5 per box, a total of $75.

5 boxes will be valued at $3 per box, a total of $15. The total inventory value will be $90.

Example of stock valuation (2)

The Good Look Clothing Company carries a variety of inventory. At their year-end they produce the following data:

|  |  |  |  |
| --- | --- | --- | --- |
| Item | **Cost**  **Price**  **$** | **Net Realisable**  **Value**  **$** | **Selling**  **Price (when new)**  **$** |
| New dresses | 1 000 | 1 500 | 2 000 |
| Children’s clothes | 2 000 | 3 000 | 3 000 |
| Bargain fashions | 1 200 | 900 | 2 000 |

What will be the total inventory value for the financial statements?

$

New dresses 1 000

Children’s clothes 2 000

Bargain fashions 900

Total inventory value 3 900

Note that the valuation of the Bargain Fashions is the lowest of the three choices. This means that inventory valuation follows the **prudence** concept.

Inventory valuation methods

IAS 2 allows two different methods to be used for valuing inventory:

* **First in, first out (FIFO).** This assumes that the first items to be bought will be the first to be used, although this may not match the physical distribution of the goods. The valuation of the remaining inventory will therefore always be the value of the most recently purchased items.
* **Average cost (AVCO).** Under this method a new average value (usually the weighted average using the number of items bought) is calculated each time a new delivery of inventory is received.

IAS 2 does not allow for inventory to be valued using the last in, first out (LIFO) method. Inventories which are similar in nature and use to the business will use the same valuation method. Only where inventories are different in nature or use, a different valuation method be used. Once a suitable method of valuation has been adopted by a business then it should continue to use that method unless there are good reasons why a change should be made. This is in line with the **consistency concept**.

Closing inventories for a manufacturing business

A manufacturer may hold three categories of inventory:

* raw materials
* work in progress
* finished goods.

**Valuing raw materials**

Raw (direct) materials will be valued at the lower of cost (applying either FIFO or AVCO) and their realisable value.

**Valuing work in progress and finished goods**

IAS 2 requires that the valuation of these two items includes not only their raw or direct material content, but also includes an element for direct labour, direct expenses and production overheads.

The valuation of work in progress and finished goods therefore consists of:

* direct materials which includes the purchase price, including import duties, transport and handling costs, less trade discounts and rebates
* direct labour
* direct expenses (for example royalties or licence fees)
* production overheads (costs to bring the product to its present location and condition)
* other overheads which may be applicable to bring the product to its present location and condition.

The inventory value of work in progress and finished goods excludes:

* abnormal waste in the production process
* storage costs
* selling costs
* administrative overheads not related to production.

Example valuation of work in progress and finished goods

The XYZ Manufacturing Company manufactures wooden doors for the building trade. For the period under review it manufactured and sold 10,000 doors. At the end of the trading period there were 1,000 completed doors ready for dispatch to customers and 200 doors which were half-completed as regards direct material, direct labour and production overheads.

Costs for the period under review were:

$

Direct material used 20 000

Direct labour 5 000

Production overheads 8 300

Non-production overheads 10 000

Total costs for the period 43 300

Calculate the value of work in progress and finished goods:

Total units sold 10 000

Finished goods units 1 000

Half-completed units (200 x 0.5) 100

Production for the period 11 100

Attributable costs $33 300

Cost per unit 33 300 / 11 100 = $3

**Value of work in progress:**

200 x 0.5 x $3 = $300

**Value of finished goods:**

1,000 x 3 = $3,000

Notes:

* Non-production overheads of $10 000 are excluded from the calculations.
* The value of finished goods ($3 000) will be compared with their net realisable value when preparing the financial statements.

IAS 7: Statement of cash flows

The standard requires the presentation of information about the historical changes in an entity’s cash and cash equivalents by means of a statement of cash flows. Information about the cash flows of an entity is useful in enabling users of financial statements to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to use those cash flows. The statement, required to be produced as part of the entity’s financial statements, classifies cash flows during the period according to operating, investing and financing activities.

* **operating activities** – the main revenue-generating activities of the business, together with cash outflows relating to interest and tax
* **investing activities** – the acquisition and disposal of long-term assets and other investments that are not considered to be cash equivalents, together with interest and dividends received
* **financing activities** – receipts from the issue of new shares, changes in long-term borrowings and payment of dividends.

At the end of the statement, the net increase in cash and cash equivalents is shown, both at the start and end of the period under review. For this purpose:

* Cash is defined as cash on hand and demand deposits.
* Cash equivalents are defined as short-term, highly liquid investments that can easily be converted into cash. This is usually taken to mean money held in a term deposit account that can be withdrawn within three months from the date of deposit.
* Bank overdrafts – usually repayable on demand – are included as part of cash and cash equivalents.

Format of the statement

Operating activities

The cash flow from operating activities is calculated as:

* profit from operations (profit before deduction of tax and interest)
* add: depreciation charge for the year
* add: loss on sale of non-current assets (or deduct gain on sale of non-current assets)
* less: investment income
* add: decrease in inventories, decrease in trade and other receivables and increase in trade payables; or deduct: increase in inventories, increase in trade and other receivables and decrease in trade payables
* less: interest paid
* less: taxes paid on income (usually corporation tax).

Investing activities

This is calculated by including:

* inflows from sale proceeds of property, plant and equipment both tangible and intangible, together with other non-current assets
* outflows from cash used to purchase property, plant and equipment, both tangible and intangible, together with other non-current assets
* interest received
* dividends received.

Financing activities

This is calculated by including:

* inflows from:
* cash received from the issue of share capital (including share premium)
* raising or increasing loans
* outflows from:
* repayment of share capital
* repayment of loans and finance lease liabilities
* equity dividends paid.

Example calculation of cash flow from operating activities

$

Profit/(loss) from operations (before tax and interest) 50 000

Adjustments for:

Depreciation charge for the year 12 000

Increase in inventories (3 000)

Decrease in trade receivables 2 000

Increase in trade payables 4 000

Cash (used in)/from operations 65 000

Interest paid (during the year) (5 000)

Tax paid (during the year) (8 000)

**Net cash (used in)/from operating activities** 52 000

The final figure from the calculation is used in the cash flow statement below.

Example statement of cash flows

**Statement of cash flows for the year ended 31 December 2020**

$ $

Net cash (used in)/from operating activities 52 000

**Cash flows from investing activities:**

Purchase of non-current assets (20 000)

Proceeds from the sale of non-current assets 1 000

Interest received 2 000

Dividends received 500

Net cash (used in)/from investing activities (16 500)

**Cash flows from financing activities:**

Proceeds from issue of share capital (this would 80 000

include both the share and share premium amounts)

Repayment of long-term borrowings (30 000)

Dividends paid (4 000)

Net cash (used in)/from financing activities46 000

**Net increase/(decrease) in cash and cash equivalents** 81 500

**Cash and cash equivalents at the beginning of the year** 10 000

**Cash and cash equivalents at the end of the year** 91 500

Allowable variations:

The standard allows some flexibility in the way in which cash flow statements can be presented:

* Cash flows from interest and dividends received and paid, can be shown as operating or investing or financing activities. Whichever is chosen must be applied consistently from period to period.
* Cash flows arising from taxes on income are always classified as operating activities unless they can be specifically identified with financing and/or investing activities.

IAS 8: Accounting policies, changes in accounting estimates and errors

The standard provides guidance for selecting and applying accounting policies, accounting for changes in estimates and correcting prior period errors.

Accounting policies

These are defined as: ‘the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

In selecting and applying accounting policies, the standard requires that:

* when an accounting standard specifically applies to a transaction or event, then the policy contained in that standard should be applied, **OR**
* when no specific standard applies, then management should use its judgement in developing and applying an accounting policy that provides information to the users of the financial statements that is relevant, reliable, prudent and complete. In doing so, they should refer to any other standards or interpretations or to other standard-setting bodies to assist them. However, they must make sure that their subsequent interpretation or recommended method of treatment for the transaction does not result in conflict with international standards or interpretations.

An entity must apply accounting policies consistently for similar transactions. Changes in accounting policies can only occur:

* if the change is required by an accounting standard or interpretation, or
* if the change results in the financial statements providing more reliable and relevant information that faithfully represents the effect of transactions on the financial statements.

Any changes adopted must be applied retrospectively to financial statements. This means that the previous figure for equity and other figures in the statement of profit or loss and statement of financial position must be altered, subject to the practicalities of calculating the relevant amounts.

Changes in accounting estimates

As a result of the uncertainties in business activities, many items in financial statements can only be estimated. The use of reasonable estimates is an essential part of the preparation of financial statements. For example, estimates may be required for allowance for irrecoverable debts, obsolete inventory, the useful lives of depreciable assets, and warranty obligations.

An estimate may need to be revised if changes occur in the circumstances on which the estimate was originally based or as a result of new information. The revision of an estimate does not relate to prior periods and is, therefore, not the correction of an error. The effect of a change in an accounting estimate should be included in the statement of profit or loss or, where it relates to changes in assets and liabilities, by adjusting the carrying value of the relevant asset, liability or equity item.

The nature and amount of the change in the accounting estimate, which has an effect on the current and is expected to affect future periods, should be disclosed in the financial statements.

Dealing with errors

The standard recognises that errors can arise in respect of the recognition, measurement, presentation or disclosure of items within financial statements. Errors are defined as: ‘omissions from, and misstatements in, the entity’s financial statements for one or more prior periods arising from a failure to use, or misuse, reliable information that:

* was available when those financial statements for those periods were authorised for issue; **and**
* could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Errors in this context could be mathematical mistakes, mistakes in applying accounting policies, oversights, the misinterpretation of facts, or fraud.

The general principle is that the entity must correct material errors from prior periods retrospectively in the first set of financial statements authorised for issue after their discovery. Thus, comparative amounts from prior periods must be restated, subject to the practicalities of calculating the relevant amounts.

In the notes to the financial statements, the entity should disclose the nature of the prior period error and the amount of the correction.

IAS 10: Events after the reporting period

These are events, either favourable or unfavourable, that occur between the end of the reporting period, and the date on which the financial statements are authorised for issue. They may occur as a result of information which becomes available after the end of the period, and therefore need to be disclosed in the financial statements.

The key is the point in time at which changes to the financial statements can be made. Once the financial statements have been approved for issue by the board of directors they cannot be altered. For example, the financial statements are prepared up to 31 December and are approved for issue by the board of directors on 30 April in the following year. Between these two dates, changes resulting from events after 31 December can be disclosed in the financial statements.

The standard distinguishes between two types of events:

**Adjusting events**

An adjusting event is defined as an event after the reporting period that provides further evidence of conditions that existed at the end of the reporting period. If such an event would materially affect the financial statements, the financial statements should be changed to reflect these conditions.

Examples of adjusting events include:

* the settlement after the end of the reporting period of a court case that confirms that a present obligation existed at the year end
* the determination, after the reporting period of the purchase price or sale price of a non-current asset bought or sold before the year end
* inventories where the net realisable value falls below the cost price
* assets where a valuation shows that impairment has occurred
* trade receivables where a customer has become insolvent
* the discovery of fraud or errors which show the financial statements to be incorrect.

**Non-adjusting events**

A non-adjusting event is defined as an event after the reporting period that is indicative of a condition that arose after the end of the reporting period. No adjustment is made to the financial statements for such events. If material, they are disclosed by way of notes to the financial statements.

Examples of non-adjusting events include:

* major purchase of assets
* losses of production capacity caused by fire, floods or strike action by employees
* announcement or commencement of a major reconstruction of the business
* changes in tax rates
* entering into significant commitments or contingent liabilities
* commencing litigation based on events arising after the reporting period
* major share transactions.

**Specific cases**

There are three situations in addition to the above that require consideration:

* Dividends declared or proposed after the reporting period are not recognised as a liability at the end of the reporting period. They are non-adjusting events and are shown in a note to the financial statements.
* An entity shall not prepare its financial statements on a going concern basis if management determines after the end of the reporting period either that it intends to liquidate the entity or to cease trading, or that it has no realistic alternative but to do so.
* Entities must disclose the date when the financial statements were authorised for issue and who gave that authorisation. If anyone had the power to amend the financial statements after issue then this fact must also be disclosed.

**Examples of adjusting and non-adjusting events**

ABC PLC prepared its financial statements for the year ended 30 June 2019. During August 2019, before the financial statements were approved, the following issues arose:

1. The company was informed that a customer had been declared bankrupt owing ABC PLC $38,000. The debt related to sales in January 2019.

2. The directors discovered that an error in preparing the financial statements resulted in revenue being understated by $150,000.

3. A fire at one of the company’s properties in July 2019 resulted in damage estimated at $125,000.

**What action should the directors take in respect of these issues, all of which are material?**

1. As the outstanding debt dated back to January 2019, before the end of the reporting period, the insolvency was evidence of a condition that existed at the date of the financial statements. It is thus an adjusting event and the financial statements should be amended to write off the outstanding $38,000.

2. The error of understating revenue relates to the period ended 30 June 2019. It is thus an adjusting event and revenue should be increased by $150,000.

3. The fire happened after the end of the reporting period and is therefore **not** evidence of a condition that existed at that date. This is a non-adjusting event. No adjustment is to be made in the financial statements, but as the amount is material, the event should be disclosed in the notes to the financial statements.

IAS 16: Property, plant and equipment

The objective of the standard is to prescribe the accounting treatment of property, plant and equipment. The principal issues covered by the standard are:

* the recognition of the assets
* the determination of their carrying amounts
* their depreciation charges
* any impairment losses to be recognised in relation to them.

The standard contains a number of key definitions along with definitions from IAS 36-Impairment of assets:

* **Property, plant and equipment** – tangible assets held for use in the production or supply of goods and services, for rental to others and for administrative purposes, which are expected to be used for more than one accounting period. Such assets are classified as non-current assets on the statement of financial position.
* **Depreciation** – the systematic allocation of the depreciable amount (cost less residual value) of a tangible non-current asset over its useful life.
* **Useful life** – the period over which a tangible non-current asset is expected to be available for use, or the number of production units expected to be obtained from the tangible non-current asset.
* **Residual value** – the estimated amount the entity expects to obtain for a tangible non-current asset at the end of its useful life, after deducting the estimated costs of disposal.
* **Fair value** – the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction. The fair value of a tangible non-current asset is normally its open market value.
* **Carrying amount** – the amount at which a tangible non-current asset is recognised in the statement of financial position, after deducting any accumulated depreciation or accumulated impairment losses.
* **Impairment loss** – is the amount by which the carrying amount of an asset exceeds its recoverable amount.
* **Recoverable amount** – is the amount which is higher of an asset’s fair value less costs to sell, and its value in use.
* **Value in use** – is the present value of the future cash flows expected to be derived from an asset.

Recognition of the tangible non-current asset in the financial statements

The standard states that an item of property, plant and equipment is to be recognised in the financial statements when:

* it is probable that future economic benefits associated with the asset will flow to the entity, and
* the cost of the asset can be measured reliably.

Initial costs associated with the tangible non-current asset

The standard provides that the following can be **included** as part of the initial cost of the tangible non-current asset in the statement of financial position:

* the initial purchase price after deducting discounts or rebates
* any import duties, taxes directly attributable to bring the asset to its present location and condition
* the costs of site preparation
* initial delivery and handling costs
* installation and assembly costs
* cost of testing the asset
* professional fees (e.g. architects or legal fees).

The standard also provides guidance on which costs must be excluded as part of the cost in the statement of financial position:

* any general overhead costs
* the start-up costs of a new business or section of the business
* the costs of introducing a new product or service (e.g. advertising).

Additional costs associated with the tangible non-current asset

The standard recognises that, in addition to the initial purchase price of the asset, other amounts wil also be spent on it. The standard provides the following guidelines to assist with the treatment of such expenditure:

* Day-to-day costs of servicing or repairing the asset should be charged as expenditure in the statement of profit or loss.
* Where parts (e.g. the seats in an aeroplane) require replacement at regular intervals, these costs can be recognised as part of the carrying amount of the asset – subject to the rules of asset recognition above.
* Where the asset requires regular inspections in order for the asset to continue operating, the costs of such inspections can also be recognised in the carrying amount, again subject to the rules of recognition above.

Valuation of the tangible non-current asset

An entity must adopt one of two models as its accounting policy for its valuation of each class of tangible non-current assets:

* **Cost model** – the asset is carried at cost less accumulated depreciation and any accumulated impairment losses.
* **Revaluation model** – the asset is included (carried) at a revalued amount. This is taken as its fair value less any subsequent depreciation and impairment losses. Revaluations are to be made regularly to make sure that the carrying amount does not differ materially from the fair value of the asset at the date of the statement of financial position.

Guidance is also given on the frequency of the revaluations:

* if changes are frequent, annual revaluations must be made
* where changes are insignificant, revaluations can be made every three to five years.

If a tangible non-current asset is revalued, then every asset in that class must be revalued. Thus, if one parcel of land and buildings is revalued then all land and buildings must be revalued. Any surplus on revaluation is transferred to the equity section of the statement of financial position as part of the revaluation reserve. Any loss on revaluation is recognised as an expense in the statement of profit or loss. A decrease arising as a result of revaluation should be recognised as an expense to the extent that it exceeds any amount previously credited to the revaluation reserve relating to the same tangible non-current asset.

Depreciation

Depreciation should be allocated on a systematic basis over the tangible non-current asset’s useful life. The depreciation method should reflect the pattern in which asset’s future economic benefits are expected to be consumed by the entity.

The expected useful life and residual value of the tangible non-current asset should be reviewed at least at each financial year-end. If there is a difference from previous estimates this must be recognised as a change in an estimate under IAS 8 (Accounting policies, changes in accounting estimates and errors).

* Depreciation must continue to be charged even if the fair value of a tangible non-current asset exceeds its carrying amount.
* Depreciation need not be charged when the residual value is greater than the carrying amount.
* Depreciation is to be included as an expense in the statement of profit and loss.

When considering the useful life of a tangible non-current asset the following should be considered:

* expected usage of the tangible non-current asset, its capacity or output
* expected physical wear and tear
* technical or commercial obsolescence
* legal or other limits imposed on the use of the tangible non-current asset.

Land and buildings are separable assets. Land has an unlimited useful life, other than in the case of a mine or quarry, and land is not depreciated. It is carried in the statement of financial position at cost. Buildings have a limited useful life and should therefore be depreciated.

Allowable methods of depreciation are:

* straight line
* diminishing or reducing balance
* revaluation model.

A depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate. The entity must choose a method of depreciation which reflects the pattern of its usage over its useful economic life. The method should be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of future economic benefits, the method should be changed to reflect the changed pattern. This must be recognised as a change in an estimate under IAS 8 (Accounting policies, changes in accounting estimates and errors).

Derecognition

This occurs when the tangible non-current asset is sold or no further future economic benefits are expected from its use. Any profit or loss on disposal is shown in the statement of profit or loss.

Disclosure in the financial statements

For each class of property, plant and equipment the financial statements must show:

* the basis for determining the carrying amount
* the depreciation methods used
* the useful life or the depreciation rates used
* the gross carrying amount at the beginning and end of the accounting period
* the accumulated depreciation and impairment losses at the beginning and end of the accounting period
* revaluation increases or decreases
* additions during the period
* disposals during the period
* depreciation for the period.

These are likely to be shown as a non-current assets schedule and included as a note to the financial statements.

**Example schedule of non-current assets**

**DEF plc**

**Schedule of non-current assets as at 31 December 2020**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Land and building** | **Plant and machinery** | **Motor vehicles** | **Total** |
|  | $000 | $000 | $000 | $000 |
| **Cost or valuation** |  |  |  |  |
| At 1 January 2020 | 600 | 320 | 250 | 1170 |
| Revaluation | 300 | - | - | 300 |
| Additions | - | 115 | 120 | 235 |
| Disposals | - | (85) | (90) | (175) |
| At 31 December 2020 | 900 | 350 | 280 | 1530 |
|  |  |  |  |  |
| **Accumulated depreciation** |  |  |  |  |
| At 1 January 2020 | 60 | 145 | 115 | 320 |
| Revaluation | (60) | - | - | (60) |
| Charge for the year | - | 35 | 90 | 125 |
| Disposals | - | (15) | (30) | (45) |
| At 31 December 2020 | - | 165 | 175 | 340 |
|  |  |  |  |  |
| **Carrying amount** |  |  |  |  |
| At 31 December 2020 | 900 | 185 | 105 | 1190 |
| At 1 January 2020 | 540 | 175 | 135 | 850 |

IAS 36: Impairment of assets

The objective of the standard is to ensure that assets are carried at no more than their recoverable amount, and to define how the recoverable amount is determined.

The standard identifies several classes of assets that it does not apply to. These are either outside the scope of the syllabus or are covered by other accounting standards, for example inventories (IAS 2). For the purposes of the syllabus, IAS 36 typically applies to:

* land
* buildings
* machinery and equipment
* intangible assets and goodwill
* assets carried at revalued amounts under IAS 16 and IAS 38.

The standard contains certain key definitions:

* **Impairment loss** – the amount by which the carrying amount of an asset or cash generating unit exceeds its recoverable amount.
* **Carrying amount** – the amount at which the asset is recognised in the statement of financial position, after deducting accumulated depreciation and accumulated impairment losses.
* **Recoverable amount** – the higher of the asset’s fair value less costs of disposal (net selling price) and its value in use.
* **Fair value** – the price that would be received to sell an asset, or paid to settle a liability between knowledgeable, willing parties in an arm’s length transaction. The standard provides guidance:
  + - The best evidence of fair value is a binding sale agreement less disposal costs.
    - If there is an active market as evidenced by buyers, sellers and readily available prices, it is permissible to use the market price less disposal costs.
    - Where there is no active market, the entity can use an estimate based on the best information available of the selling price less the disposal costs.
    - Costs of disposal are direct costs only, for example legal or removal expenses.
* **Value in use –** the present value of the estimated future cash flows expected to be derived from an asset or cash generating unit. This is usually calculated using discounted cash flow techniques. The entity should consider the following:
  + - estimated future cash flows from the asset
    - expectations of possible variations, either in amount or timing of the future cash flows
    - current interest rates
    - the effect of uncertainty inherent in the asset.

Identifying an asset that may be impaired

At the end of each reporting period, an entity is required to assess whether there is any indication that an asset may be impaired (i.e. its carrying amount may be higher than its recoverable amount). If there is an indication that an asset may be impaired, then the asset’s recoverable amount should be calculated. Goodwill acquired in a business combination should be tested for impairment annually.

Indications of impairment

External sources:

* market value declines
* negative changes in technology, markets, economy or laws
* increases in interest rates
* net assets of the company higher than market capitalisation.

Internal sources:

* obsolescence or physical damage
* asset is idle or is being held for disposal
* worse economic performance than expected.

An indication of impairment indicates that the asset’s useful life, depreciation method, or residual value may need to be reviewed and adjusted.

Recognition of an impairment loss

* An impairment loss is recognised whenever the recoverable amount is below the carrying amount.
* The impairment loss is recognised as an expense in the statement of profit or loss, unless it relates to a revalued asset. For revalued assets, the impairment loss is treated as a revaluation decrease.
* Depreciation for future periods must be adjusted.

Disclosure

Impairment losses either recognised or reversed should be disclosed by class of asset.

If an individual impairment loss is material, the following must be disclosed:

* the events and circumstances resulting in the impairment loss
* the amount of the loss or reversal
* details of the individual asset and the class to which it relates.

If impairment losses recognised or reversed are material in total to the financial statements as a whole, disclose:

* the main classes of assets affected
* the main events and circumstances involved.

Example asset values in statement of financial position

An entity has three non-current assets in use at the date of its statement of financial position.  
Details of their carrying values and recoverable amounts are set out below:

|  |  |  |  |
| --- | --- | --- | --- |
| Asset | Carrying amount  $ | Fair value less costs to sell  $ | Value in use  $ |
| 1 | 30 000 | 10 000 | 50 000 |
| 2 | 15 000 | 12 000 | 14 000 |
| 3 | 20 000 | 15 000 | 9 000 |

In the statement of financial position, they should be shown at the following values:

|  |  |  |
| --- | --- | --- |
| Asset | Value in statement of financial position  $ | Reason |
| 1 | 30 000 | The carrying amount is less than the recoverable amount, which is higher of fair value less costs to sell and its value in use and here it is value in use. |
| 2 | 14 000 | The carrying amount is greater than the recoverable amount, which is higher of fair value less costs to sell and its value in use and here it is value in use. |
| 3 | 15 000 | The carrying amount is greater than the recoverable amount, which is higher of fair value less costs to sell and its value in use and here it is fair value less costs to sell. |

IAS 37: Provisions, contingent liabilities and contingent assets

The objective of the standard is to make sure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets. Sufficient information must be disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount. The key principle established by the standard is that a **provision** should be recognised only when there is a liability i.e. there is a present obligation resulting from past events.

There are a series of key definitions:

* **Provision** – a liability of uncertain timing or amount.
* **Liability** – a present obligation arising from past events, where settlement is expected to result in an outflow of resources (payment). A past event that leads to a present obligation is an obligating event. For an event to be obligating, it is necessary that there is no realistic alternative to settling the obligation created by the event.
* **Contingent liability** – either a possible obligation that arises from past events but which depends on some uncertain future event occurring not wholly within the control of the entity, or a present obligation where payment is not probable or the amount cannot be reliably measured.
* **Contingent asset** – a possible asset that 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.

Recognition of a provision

A provision must be recognised if, and only if:

* a present obligation exists as a result of a past event (the obligating event)
* payment is **probable** (more than 50% likelihood of occurrence)
* the amount can be estimated reliably.

The obligating event creates a legal or constructive obligation. A legal obligation derives from a contract or legislation. A constructive obligation derives from past actions or policies that imply that an entity will accept certain responsibilities, for example, warranties or refunds.

The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the date of the statement of financial position. The provision should be reviewed at each subsequent reporting period end date and, if an outflow is no longer probable, the provision should be reversed.

Contingent liabilities

A **possible** obligation (a contingent liability) is disclosed in the notes to the financial statements, but not recognised. However, where the possibility of payment is remote, no recognition or disclosure is required.

Contingent assets

These should not be recognised in the financial statements, but should be disclosed in the notes to the financial statements where an inflow of economic benefits is probable and the amount is material. Where the inflow of economic benefits is possible or remote, there should be no recognition and no disclosure.

**Example of recognition of provision or contingent liability**

A company manufactures shampoo. A customer is suing the company claiming that the shampoo has caused burns to her head. The customer is claiming damages of $100 000. Lawyers have advised the company that it is possible that the customer may win the legal case.

As the outcome of the case is uncertain (i.e. a **possible** successful claim for damages), the company is not certain to be liable, i.e. this is a contingent liability. In these circumstances, the company should not make a provision, but should disclose details of the case in its notes to the financial statements.

If the lawyer was of the opinion that it was **probable** that they would lose the legal case, a provision for the damages should be made in the financial statements.

IAS 38: Intangible assets

This standard covers the accounting treatment for intangible assets.

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

The three critical attributes of an intangible asset are:

* it must be identifiable (the asset is either separate from the entity and can be sold or transferred or arises due to contractual or other legal rights)
* it must be controlled by the entity ( power to obtain benefits from the asset)
* the entity must be able to obtain future economic benefits from the asset such as revenue or reduced costs.

Intangible assets can be acquired:

* by separate purchase
* as part of a business combination
* by the exchange of assets
* by internal generation (self-produced).

Examples of intangible assets

The following is not an exhaustive list, but gives some examples of intangible assets:

* patented technology, computer software, databases and trade secrets
* trademarks and internet domains
* customer lists
* licensing and royalty agreements
* marketing rights
* franchise agreements.

Recognition

The standard requires an entity to recognise an intangible asset, whether purchased or self-created (at cost), if:

* it is probable that the future economic benefits attributable to the asset will flow to the entity; **and** the cost of the asset can be measured reliably.
* The probability of future economic benefits must be based on reasonable and supportable assumptions about conditions that will exist over the life of the asset.

If an intangible asset does not meet both the definition of, **and** the criteria for, recognition, IAS 38 requires the expenditure to be recognised as an expense when it is incurred.

Specific cases

The standard details initial recognition criteria and accounting treatment for specific cases as follows.

Research and development costs

* Research costs – charge all costs to the statement of profit or loss.
* Development costs may be capitalised as an intangible asset only after the technical and commercial feasibility of the asset for sale or use have been established. The entity must demonstrate how the asset will generate future economic benefits.

Internally generated brands, customer lists, etc.

These should not be recognised as assets.

Computer software

If purchased, this may be capitalised. If internally generated, whether for sale or for use, it should be charged as an expense until technical and commercial feasibility has been established.

Other types of cost

The following items must be charged to expenses in the when incurred, not classed as intangible assets:

* internally generated goodwill
* start-up costs
* training costs
* advertising and promotional costs
* relocation costs.

**Initial measurement**

Intangible assets are initially measured at cost.

Measurement subsequent to acquisition

Similarly, to tangible non-current assets, an entity must choose either the cost model or the revaluation model for each class of intangible asset.

**Cost model**

After initial recognition, intangible assets should be carried at cost less accumulated amortisation (depreciation) and impairment losses.

**Revaluation model**

Intangible assets may be carried at a revalued amount (based on fair value) less any subsequent amortisation and impairment losses, only if fair value can be determined by reference to an active market. In the case of intangible assets, it is unlikely that such markets will exist.

Classification based on useful life

Intangible assets are classified as having either an indefinite life or a finite life.

**Indefinite life**

This is where there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity. An intangible asset with an indefinite useful life should not be amortised.

**Finite life**

This is where there is a limited period of benefit to the entity. In these circumstances, the cost less residual value should be amortised on a systematic basis over that life, reflecting the expected pattern of benefits.

Disclosure

For each class of intangible asset, the following should be disclosed:

* useful life or amortisation rate
* amortisation method
* gross carrying amount
* accumulated amortisation and impairment losses
* reconciliation of the carrying amount at the beginning and end of the reporting period
* the basis for determining that an intangible asset has an indefinite life
* description and carrying amount of individually material intangible assets.

Appendix 1: Statement of changes in equity

**XYZ Limited company**

**Statement of changes in equity for the year ended 31 December 2020**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **Share capital**  **$** | **Share premium**  **$** | **Revaluation reserve**  **$** | **Retained earnings**  **$** | **Total**  **$** |
| **Balance at 1 January 2020** | 150 000 | 5 000 | 20 000 | 108 000 | 283 000 |
| **Share issue** | 30 000 | 3 000 |  |  | 33 000 |
| **Profit for the year** |  |  |  | 58 000 | 58 000 |
| **Revaluation** |  |  | 30 000 |  | 30 000 |
| **Dividends paid** |  |  |  | (12 000) | (12 000) |
| **Balance at 31 December 2020** | **180 000** | **8 000** | **50 000** | **154 000** | **392 000** |

Appendix 2: Financial statements for other forms of business (AS Level)

**(a) Financial statements of a sole trader – trading business**

Statement of profit or loss

**Sole Trader (Name)**

**Statement of profit or loss for the year ended 31 December 2020**

$000 $000 $000

Revenue (sales) 520

Less Sales returns (3)

517

Less Cost of sales

Opening inventory 46

Purchases 196

Less Purchase returns (4)

192

Less Goods for own use (2)

190

Carriage inwards 5 195

241

Less closing inventory (56) 185

Gross profit 332

Discount received 2

Rent received 14

Commission received 4

\* Profit on disposal of non-current assets -

\*\* Reduction in allowance for irrecoverable debts -

352

Less Expenses

Wages and salaries 84

Office expenses 52

Rent and rates 26

Insurance 19

Motor vehicle expenses 28

Selling expenses 22

Loan interest 2

\* Loss on disposal of non-current assets 7

\*\* Provision for doubtful debts 3

Depreciation of fixtures and fittings 9

Depreciation of office equipment 6

Depreciation of motor vehicles 8 (266)

\*\*\* Profit for the year 86

Notes:

\* If only one asset was sold during the year only one of these items will appear.

\*\* If the allowance reduces, the decrease is added to the gross profit: if the allowance increases, the increase is included in the expenses.

\*\*\* If the expenses exceed the gross profit plus other income, the resulting figure is described as a loss for the year.

Statement of financial position

**Sole Trader (Name)**

**Statement of financial position at 31 December 2020**

$000 $000 $000

**ASSETS**

**Non-current assets Cost Accumulated Carrying**

**depreciation amount**

Land and buildings 50 - 50

Fixtures and fittings 49 39 10

Office equipment 36 26 10

Motor vehicles 85 32 53

220 97 123

**Current assets**

Inventory 48

Trade receivables 53

Less allowance for irrecoverable debts (6) 47

Other receivables 6

Cash in hand 2 103

**Total assets**  **226**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **EQUITY & LIABILITIES** |  |  |  |  |  |
| **Capital** |  |  |  |  |  |
| Opening balance |  |  |  |  | 152 |
| Add Profit for the year \* |  |  |  |  | 86 |
|  |  |  |  |  | 238 |
| Less drawings |  |  |  |  | (62) |
| Total equity |  |  |  |  | 176 |
| **Non-current liabilities** |  |  |  |  |  |
| Bank loan |  |  |  |  | 20 |
|  |  |  |  |  |  |
| **Current liabilities** |  |  |  |  |  |
| Trade payables |  |  | 21 |  |  |
| Other payables |  |  | 6 |  |  |
| Bank overdraft |  |  | 3 |  | 30 |
| **Total liabilities** |  |  |  |  | 50 |
| **Total equity and liabilities** |  |  |  |  | 226 |
|  |  |  |  |  |  |

Note:

\* If there is a loss for the year, this will be deducted rather than added.

**(b) Financial statements (final accounts) of a partnership business**

Statement of profit or loss

The statement of profit or loss of a partnership is the same as the statement of profit or loss of a sole trader. The profit for the year is then appropriated to the partners as follows. Assume that the partners share profits in the ratio 2:1.

**(Partnership Name)**

**Profit and Loss Appropriation Account for the year ended 31 December 2020**

$ $ $

Profit for the year 45 000

Add Interest on drawings – Partner A 2 200

Partner B 3 800 6 000

51 000

Less Interest on capital – Partner A 2 000

Partner B 1 000 3 000

Partner’s salary – Partner B 18 000 21 000

30 000

Profit shares Partner A 20 000

Partner B 10 000 30 000

Statement of financial position

The first section of the statement of financial position showing assets and second section showing the liabilities of a partnership is similar to that of a sole trader, the only difference is in the equity shown in the second section of the statement of financial position compared to a sole trader. The equity is shown as the capital and current account of each partner. Where the full details of the partners’ current accounts are not required, this section could be presented as follows.

**(Partnership Name)**

**Statement of financial position (extract) at 31 December 2020**

**Partner A Partner B Total**

**Capital accounts** 40 000 20 000 60 000

\* **Current accounts** 28 200 16 800 45 000 **Total equity** 68 200 36 800 105 000

Note:

\* Where the balance of a partner’s current account is a debit balance it is shown in brackets and deducted rather than added.

Where full details of the current accounts are required the ‘Financed by’ section of a partnership statement of financial position could be presented as follows.

**Partnership (Name)**

**Statement of financial position (extract) at 31 December 2020**

$ $ $

**Partner A Partner B Total**

**Capital accounts** 40 000 20 000 60 000

**Current accounts**

**\***Opening balance 29 400 21 100 50 500

Interest on capital 2 000 1 000 3 000

Partner’s salary - 18 000 18 000

\*\*Profit shares 20 000 10 000 30 000

51 400 50 100 101 500

Less Drawings (21 000) (29 500) (50 500)

Less interest on drawings (2 200) (3 800) (6 000)

28 200 16 800 45 000

Total equity 68 200 36 800 105 000

Notes:

\* Where a balance is a debit balance it is shown in brackets and deducted rather than added.

\*\* Where there is a loss to share out it is shown in brackets and deducted rather than added.

Appendix 3: Financial statements for other forms of business (A Level)

**(a) Financial statements (final accounts) of a manufacturing business**

Manufacturing account

A business that manufactures goods must prepare a manufacturing account to show the calculation of the cost of manufacture, whatever the ownership of the business. The manufacturing business could be a sole trader or a partnership.

**Name of manufacturing business**

**Manufacturing Account for the year ended 31 December 2020**

$ $

Inventory of raw material 38 000

Purchases of raw material 76 000

Carriage on raw material 2 000

116 000

Less closing inventory of raw material (35 000)

Cost of raw material consumed 81 000

Direct wages 43 000

Direct expenses 14 000

Prime cost 138 000

Add Factory overheads

Indirect wages 26 000

Factory rent and rates 18 000

Factory insurance 11 000

Factory fuel and power 15 000

Factory general expenses 23 000

Depreciation of factory machinery 9 000 102 000

240 000

Add opening inventory of work in progress 15 000

255 000

Less closing inventory of work in progress (12 000)

Production costs of goods completed 243 000

Statement of profit or loss

The statement of financial position of a manufacturing business follows the same format as that of any other business but the trading section included the production cost of the goods completed.

The expenses section will include only office, selling and financial expenses.

**Name of manufacturing business**

**Statement of profit or loss for the year ended 31 December 2020**

$ $

Revenue (sales) 365 000

Less cost of sales

Opening inventory of finished goods 23 000

Production cost of goods completed 243 000

Purchases of finished goods 17 000

283 000

Less Closing inventory of finished goods 22 000 261 000

Gross profit 104 000

Statement of financial position

The statement of financial position of a manufacturing business follows the same format as that of any other business; however, there may be three inventories rather than one such as raw materials, work in progress and finished goods.

**(b) Financial statements (final accounts) of a non-trading organisation**

Receipts and payments account

A summary of the cash book, known as a receipts and payments account, is prepared by the treasurer of a non-trading organisation, such as a club or society. All money received is debited to the account and all money paid out is credited to the account. It is balanced in the same way as a cash account. A **statement of profit or loss** may be prepared if a shop or café, for example, is operated by the organisation.

Non-trading Organisation (Name)

Shop statement of profit or loss for the year ended 31 December 2020

$ $

Revenue (sales) 22 500

Less cost of sales

Opening inventory 2 300

Purchases 7 400

9 700

Less closing inventory (1 800)

Cost of goods sold (7 900)

Gross profit 14 600

Add Shop expenses

Wages of shop assistant 4 200

Shop rent and rates 3 600

Depreciation of shop fittings 1 100 (8 900)

Profit for the year 5 700

Income and expenditure account

An income and expenditure account is also prepared – the equivalent of the statement of profit or loss of a business. The expenses of the organisation are deducted from the revenue and the resulting figure is a surplus or deficit, rather than a profit or loss.

**Non-trading Organisation (Name)**

**Income and Expenditure Account for the year ended 31 December 2020**

$ $

**Income**

Subscriptions 45 000

Profit on shop 5 700

Competition – entrance fees 1 600

less expenses (400) 1 200

Interest received 1 400

\* Profit on disposal of non-current assets -

53 300

**Expenditure**

General expenses 16 300

Rates and insurance 12 000

Repairs and maintenance 2 400

Loan interest 600

\* Loss on disposal of non-current assets 300

Depreciation of equipment 1 500 (33 100)

\*\* Surplus for the year 20 200

Notes:

\* If only one asset was sold during the year only one of these items will appear.

\*\* If the expenditure exceeds the income the resulting figure is described as a deficit.

Statement of financial position

The first section of the statement of financial position that shows the assets and the second section that shows the liabilities of a non-trading organisation follows the same format as that of any other business, the only difference is in the accumulated fund shown in the second section of the statement of financial position compared to other business which is shown as equity. The second section of the statement of financial position has to be modified so that it shows the accumulated fund and the surplus or deficit.

**Non-trading Organisation (Name)**

**Extract from statement of financial position at 31 December 2020**

$

**Accumulated fund**

Opening balance 67 500

Add: surplus for the year 20 200

Total accumulated fund 87 700

Appendix 4: Resources for photocopying

1. Statement of profit or loss of a sole trader/partnership
2. Statement of financial position of a sole trader
3. Partnership appropriation account
4. Statement of financial position of a partnership
5. Statement of profit or loss of a limited company
6. Statement of changes in equity of a limited company
7. Statement of financial position of a limited company
8. Statement of cash flows of a limited company
9. Schedule of non-current assets of a limited company
10. Manufacturing account
11. Statement of profit or loss of a sole trader/partnership

……………………………………………………

**Statement of profit or loss for the year ended** ………………

|  |  |  |
| --- | --- | --- |
|  | $ | $ |
| **Revenue** |  |  |
|  |  |  |
|  |  |  |
| **Cost of sales** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Gross profit** |  |  |
| **Add: other income** |  |  |
|  |  |  |
| **Less: expenses** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Profit/(loss) for the year** |  |  |

1. Statement of financial position of a sole trader

……………………………………………………

**Statement of financial position as at** ………………

|  |  |  |
| --- | --- | --- |
| **Assets** | **$** | **$** |
| **Non-current assets** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Current assets** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Total assets** |  | **$** |
| **Equity and liabilities** |  |  |
| **Equity** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Total equity** |  |  |
| **Non-current liabilities** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Current liabilities** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Total liabilities** |  |  |
| **Total equity and liabilities** |  | **$** |

1. Partnership appropriation account

……………………………………………………

**Partnership appropriation account for the year ended** ………………

|  |  |  |
| --- | --- | --- |
|  | **$** | **$** |
| **Profit for the year** |  |  |
| **Add: Interest on drawings** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Less: Interest on capital** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Less: Partners’ salaries** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Profit before appropriation** |  |  |
|  |  |  |
| **Profit shared** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |

1. Statement of financial position of a partnership

……………………………………………………

**Statement of financial position as at** ………………

|  |  |  |
| --- | --- | --- |
| **Assets** | **$** | **$** |
| **Non-current assets** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Current assets** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Total assets** |  | **$** |
| **Equity and liabilities** |  |  |
| **Equity** |  |  |
| **Capital accounts** |  |  |
|  |  |  |
|  |  |  |
| **Current accounts** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Total equity** |  |  |
| **Non-current liabilities** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Current liabilities** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Total liabilities** |  |  |
| **Total equity and liabilities** |  | **$** |

1. Statement of profit or loss of a limited company

……………………………………………………

**Statement of profit or loss for the year ended** ………………

|  |  |
| --- | --- |
|  | **$** |
| Revenue |  |
| Cost of sales |  |
| Gross profit |  |
| Distribution costs |  |
| Administrative expenses |  |
| Profit/(loss) from operations |  |
| Finance costs |  |
| Profit/(loss) before tax |  |
| Tax |  |
| Profit/(loss) for the year |  |

1. Statement of changes in equity of a limited company

……………………………………………………

**Statement of changes in equity for the year ended** ………………

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Share capital**  **$** | **General reserve**  **$** | **Revaluation reserve**  **$** | **General reserve**  **$** | **Retained earnings**  **$** | **Total**  **$** |
| **Balance at start of the year** |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |
| **Balance at start of the year** |  |  |  |  |  |  |

1. Statement of financial position of a limited company

……………………………………………………

**Statement of financial position as at** ………………

|  |  |
| --- | --- |
|  | **$000** |
| **ASSETS** |  |
| **Non-current assets** |  |
|  |  |
|  |  |
|  |  |
|  |  |
| **Current assets** |  |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |
|  |  |
| **Total assets** |  |
|  |  |
|  |  |
| **EQUITY & LIABILITIES** |  |
| **Equity** |  |
|  |  |
|  |  |
|  |  |
|  |  |
| **TOTAL EQUITY** |  |
| **Non-current liabilities** |  |
|  |  |
|  |  |
| **Current liabilities** |  |
|  |  |
|  |  |
|  |  |
|  |  |
| **TOTAL LIABILITIES** |  |
| **Total equity and liabilities** |  |

1. Statement of cash flows of a limited company

……………………………………………………

**Statement of cash flow for the year ended** ………………

|  |  |  |
| --- | --- | --- |
|  | **$** | **$** |
| **Net cash (used in)/from operating activities** |  |  |
| **Cash flows from investing activities** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Net cash (used in)/from investing activities** |  |  |
| **Cash flows from financing activities** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Net cash (used in)/from financing activities** |  |  |
|  |  |  |
| **Net increase/(decrease) in cash and cash equivalents** |  |  |
| **Cash and cash equivalents at start of the year** |  |  |
| **Cash and cash equivalents at end of the year** |  |  |

1. Schedule of non-current assets of a limited company

……………………………………………………

**Schedule of non-current assets at** ………………

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **Total** |
|  | $ | $ | $ | $ | $ |
| **Cost or valuation** |  |  |  |  |  |
| At |  |  |  |  |  |
| Revaluation |  |  |  |  |  |
| Additions |  |  |  |  |  |
| Disposals |  |  |  |  |  |
| At |  |  |  |  |  |
|  |  |  |  |  |  |
| **Accumulated depreciation** |  |  |  |  |  |
| At |  |  |  |  |  |
| Revaluation |  |  |  |  |  |
| Charge for the year |  |  |  |  |  |
| Disposals |  |  |  |  |  |
| At |  |  |  |  |  |
|  |  |  |  |  |  |
| **Carrying amount** |  |  |  |  |  |
| At |  |  |  |  |  |
| At |  |  |  |  |  |

1. Manufacturing account

……………………………………………………

**Manufacturing account for the year ended** ………………

|  |  |  |
| --- | --- | --- |
|  | **$** | **$** |
|  |  |  |
| **Opening inventory of raw materials**  **Purchases**  **Carriage inwards**  **Less: returns outwards**  **Net purchases**  **Less: closing inventory of raw materials** |  |  |
|  |  |  |
| **Cost of raw materials consumed** |  |  |
| **Direct wages** |  |  |
| **Direct expenses** |  |  |
| **Prime cost** |  |  |
| **Add: Factory expenses** |  |  |
| **Other factory overheads** |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |
| **Add: Opening inventory of work in progress** |  |  |
|  |  |  |
| **Less: Closing inventory of work in progress** |  |  |
| **Production cost of goods completed** |  |  |

Cambridge Assessment International Education  
The Triangle Building, Shaftesbury Road, Cambridge, CB2 8EA, United Kingdom  
t: +44 1223 553554     
e: [info@cambridgeinternational.org](mailto:info@cambridgeinternational.org)    [www.cambridgeinternational.org](http://www.cambridgeinternational.org)

Copyright © UCLES 2020 (updated October 2023)