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A Digital Learning Platform for Generation Z:
Passport to IFRS®

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IAS® Standard 1 Presentation of Financial Statements

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IAS® Standard 1 Presentation of Financial Statements

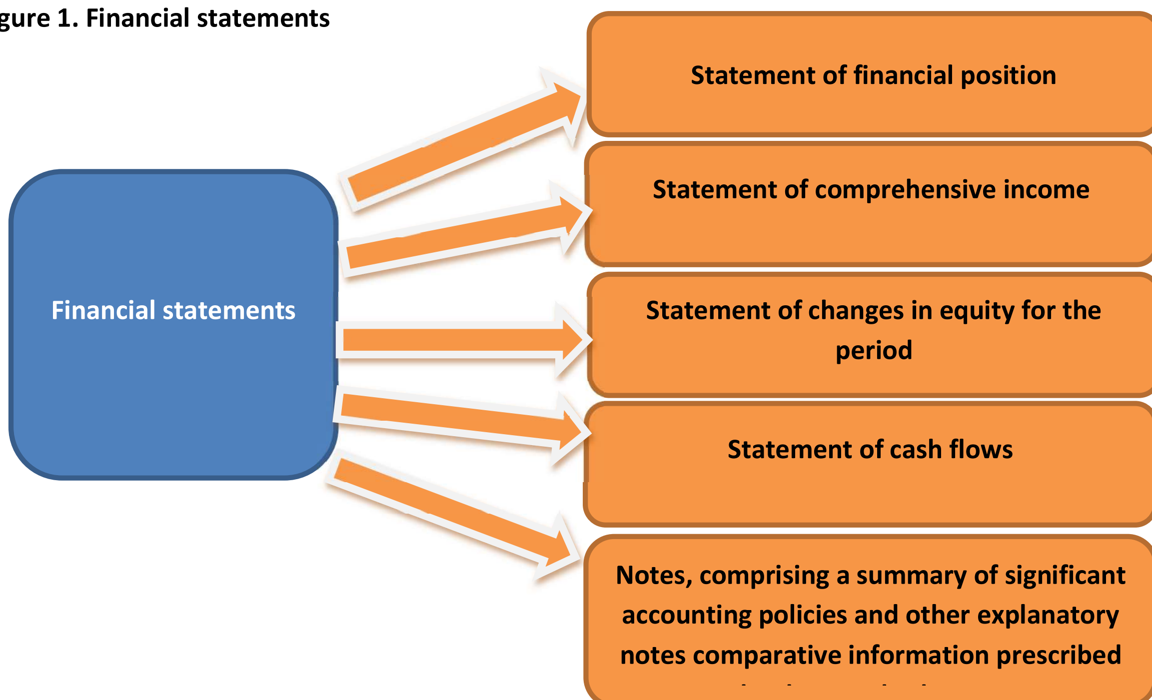
SCOPE

The aim of IAS Standard 1 Presentation of Financial Statements is to prescribe the basis for presentation of general purpose financial statements. The compliance with these requirements ensures a comparability of the financial statements of an entity both to its financial statements from previous reporting periods and to those of other entities. The standard sets out the general provisions for the presentation of financial statements, provides guidance and guidelines on the specific structure and minimum requirements for the content of these financial statements.

The objective of general purpose financial statements is to provide information about an entity's financial position, financial performance, and cash flows that is useful for a wide range of users in making economic decisions. To meet this objective, financial statements provide information about an entity's: [IAS 1.9] assets; liabilities; equity; income and expenses, including gains and losses; contributions by and distributions to owners (in their capacity as owners); cash flows. This information, along with additional information included in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.

In order to fulfil their purpose, the general purpose annual financial statements comprise the components shown in Figure 1:

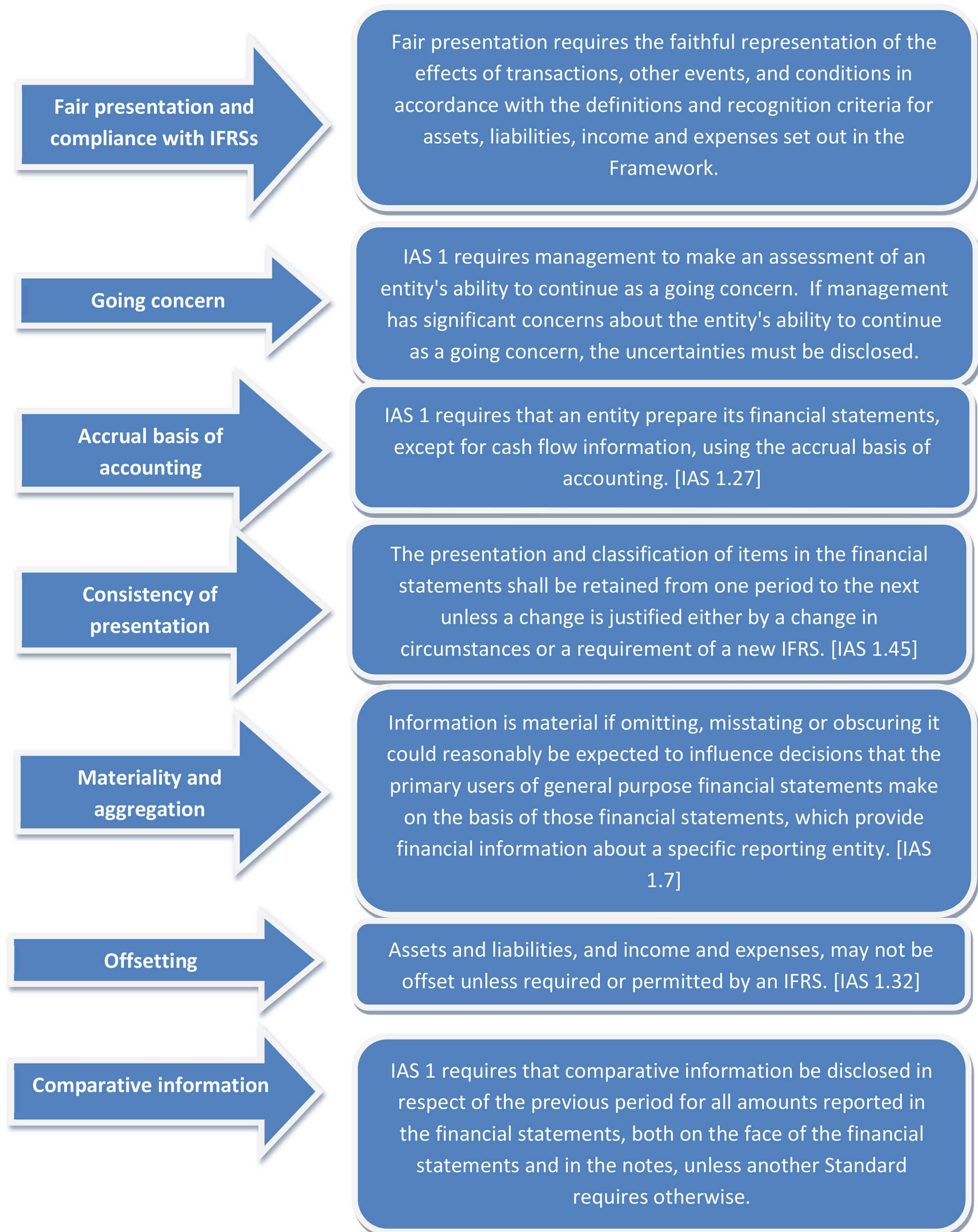
Figure 1. Financial statements

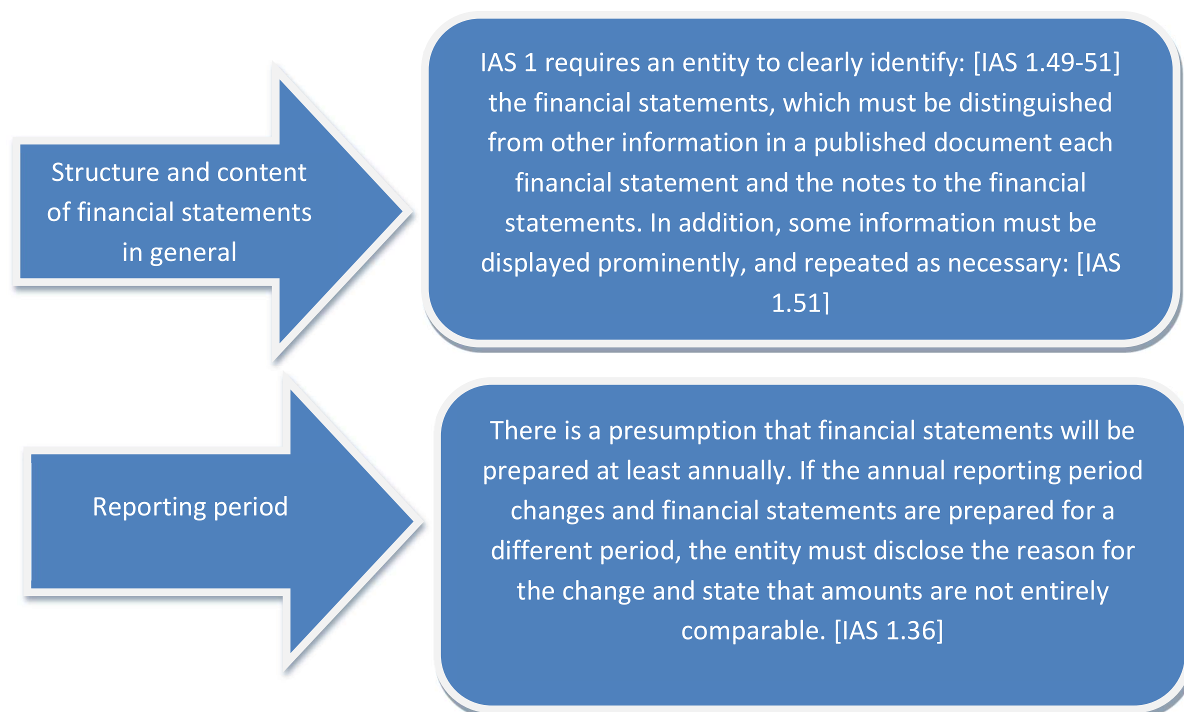


GENERAL ASSUMPTIONS IN THE PREPARATION OF FINANCIAL STATEMENTS

The following definitions are given for the proper understanding and application of IAS 1 (see Figure 2):

Figure 2. General assumptions in the preparation of financial statements





According to the provisions of IFRS, there can be no exemptions from the full set of financial statements although such exemptions are permitted by the European accounting law. Each of the elements of the financial statements has a specific purpose and only in their entirety can they fulfil the purpose for which they are prepared.

STATEMENT OF FINANCIAL POSITION

The minimum content and sample structure are contained in IAS 1, the remainder is a matter of the entity's accounting policies.

Most often, statements of financial position are bilateral, in which the equation Assets = Equity + Liabilities is maintained. The ranking can start from non-current to current (European model) or vice versa (US model). The UK's one-sided statement of financial position model is much less common.

The understanding of current and non-current assets and liabilities is not synonymous with short-term and long-term, as could be understood. Short-term and long-term are inherent physical qualities of assets and liabilities. Whether they will be current or non-current depends on how they will transfer their value when used. For example, cars are long-term assets in their physical characteristics, but if the entity trades in them, they are current. Cash is current assets, but if it is blocked for a period longer than the next reporting year, it cannot be current. IAS 1 applies an approach that defines four possible occurrences of current assets and liabilities (see Figure 3).

Figure 3. Current and non-current classification

Assets	
Assets are current if:	**Non-current assets are:**
(a) The asset is expected to be realised, or sold or consumed within the normal operating cycle. (b) The asset is held primarily for trading purposes. (c) The asset is expected to be realised no later than twelve months after the end of the reporting period. (d) An asset is cash or cash equivalents on which there are no restrictions within twelve months after the end of the reporting period.	All others, except as indicated.
Liabilities	
Liabilities are classified as current liabilities if:	**Non-current liabilities are:**
(a) The liability is expected to be settled within the normal operating cycle. (b) Liabilities are held primarily for trading purposes. (c) The liability is expected to be settled no later than twelve months after the end of the reporting period. (d) An entity shall not have an unconditional right to defer settlement for at least twelve months after the end of the reporting period.	All others, except as indicated.

IAS 1 does not prescribe the format of the statement of financial position. Assets can be presented current then non-current, or vice versa, and liabilities and equity can be presented current then non-current then equity, or vice versa. A net asset presentation (assets minus liabilities) is allowed. The long-term financing approach used in the UK and elsewhere, viz. fixed assets + current assets - short term payables = long-term debt plus equity, is also acceptable.

Example 1.

An entity has three long-term financial liabilities on bank loans. As of 31.12.20X2 the book value of the received loans is as follows:

Loan 1: CU100,000
Loan 2: CU150,000
Loan 3: CU200,000

The entity violated the terms of its credit agreements before the date of the financial statements and therefore became due. For loan 1, the entity signed an 18-month grace agreement with the servicing bank

in December 20X2. For loan 2 and loan 3, the grace period agreement was signed after the date of the financial statements.
The grace period of loans 2 and 3 expires twelve months after the date of the financial statements.
How should loans be presented in the financial statements for the year ended 31.12.20X2?

(a) non-current liabilities CU450,000;
(b) non-current liabilities CU100,000, current liabilities CU350,000;
(c) current liabilities CU450,000;
(d) non-current liabilities CU35,000, current liabilities CU100,000.

Solution
According to IAS 1 Presentation of Financial Statements, the classification of financial liabilities (loans received, etc.) as current or non-current liabilities should be made on the basis of compliance with the terms of the contract at the reporting date.
The entity has violated the terms of all three loans before the date of the financial statements, which makes them due. With regard to loan 1, as the entity has signed an agreement for an 18-month grace period (i.e. more than 12 months) with the servicing bank in December 20X2 (i.e. before 31.12.20X2), according to par. 75 of IAS 1, this loan is classified as a non-current liability,
With regard to loans 2 and 3, the grace period agreement was signed after 31.12.20X2, therefore the classification is based on the facts and circumstances that existed at 31.12.20X2, so they are classified as current on the basis of par. 74 and 72. Therefore, the correct answer is B and the statement of financial position prepared on 31.12.20x2 will include non-current liabilities of CU100,000 and current liabilities of CU350,000.

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
The concept of comprehensive income was introduced in IFRS after 2009 in order to consolidate in one component of the financial statements all changes in net assets during the year, other than those resulting from the actions of owners in their capacity as such. Thus, the income statement was supplemented and replaced with a statement of comprehensive income (subsequently its name was changed to profit or loss statement and other comprehensive income). The latter is a profit and loss account which presents the financial result for the period followed by those profits and losses the effect of which does not affect the profit or loss for the period, but directly affects net assets. In IFRS they are called components of other comprehensive income, which in our economic reality could usually arise from:

- Changes in the revaluation, respectively in the revaluation reserve of fixed assets under IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets;
- Actuarial gains and losses under IAS 19 Employee Benefits;
- Exchange differences from restatements of financial statements of foreign operations in foreign currency in accordance with IAS 21 Effects of changes in exchange rates, this item applies only to consolidated financial statements;
- Other, less popular and very rare cases in our practice, mainly from the application of certain financial instruments and hedging.

The components (items) of other comprehensive income should be grouped according to the possibility that they may or may not be reclassified to profit or loss after their initial accrual. For example, changes in revaluation reserves and actuarial gains and losses should not be reclassified to profit or loss on disposal because they do not reflect actual transactions. However, exchange differences on the translation of foreign currency financial statements should be reclassified after disposal as they would result from transactions. In such cases it is necessary to additionally present corrections from the performed reclassifications. These are amounts that are reclassified to profit or loss in the current period but which were previously accrued in other comprehensive income.
The items of other comprehensive income can be represented in one of two ways in terms of the tax effect they would generate:

- net of tax expense;
- before the tax effect and with a separate article about it (gross presentation).

According to the grouping of operating costs, there are two possible options for preparing the income statement.

1) If the entity chooses to present them on a gross basis (in essence of costs), then the appropriate classification of costs is by economic elements. In this case, the operating costs include the costs of economic elements (depreciation, purchases of materials, transport costs, employee benefits and advertising costs) in terms of turnover, and for the purposes of presentation they are usually grouped in some items, regardless of which account was initially reported. In this model, the items of a corrective nature should be presented separately - Increases and/or decreases in work in progress and/or finished goods, as well as the value of the assets actually created in the balance sheet. Increases in work in progress and/or finished goods should be presented with a plus sign, while reductions should be presented with a minus sign and this should be compensated.
2) If the entity is productive and chooses to present operating costs on a net basis, then the appropriate classification is by cost function. In this classification, the initial economic content of costs is not taken into account, and in the income statement they are grouped according to their purpose in the entity.

There can be no adjustment items in the classification of expenses by functional attribute, as all expenses are recalculated and comparable to the reported sales revenues. IFRS does not give preference to one or the other approach to presenting costs. Each of them has advantages and disadvantages, which makes them selectable under different production conditions. The presentation of costs on a functional basis is understandable to consumers, but is more complex and subjective, as it requires additional redistribution. When adopting this approach, it is required in the explanatory notes to the financial statements to present the costs of the main elements - material, labour, depreciation and others.
The functional presentation method is appropriate and is usually applied to larger manufacturing entities with significant residues of finished goods and work in progress, as well as with various clearly defined production, commercial and administrative departments. The presentation of costs by economic elements is easier to implement and more objective, as no additional estimates are required to redistribute the costs already reported. It is usually applied by smaller manufacturing companies as well as by trade and service companies.

Comprehensive income for the period = Profit or loss + Other comprehensive income

Example 2.

An entity applying IFRS has prepared its income statement and other comprehensive income as at 31 December 20X2 on the basis of the following data:

- revenues from sales of products - CU500,000;
- cost of goods sold - CU240,000;
- sales expenses - CU30,000;
- administrative expenses - CU10,000;
- other expenses - CU20,000.

The entity has chosen to present its properties, machinery and equipment according to the revaluation model. As at 31 December 20X2 the carrying amount of property, plant and equipment is CU500,000 and the fair value of these assets is CU600,000.

The entity has not impaired these assets and has not formed a revaluation reserve in previous periods.

The profit tax is 10%.

Question

Determine the entity's total comprehensive income.

Solution

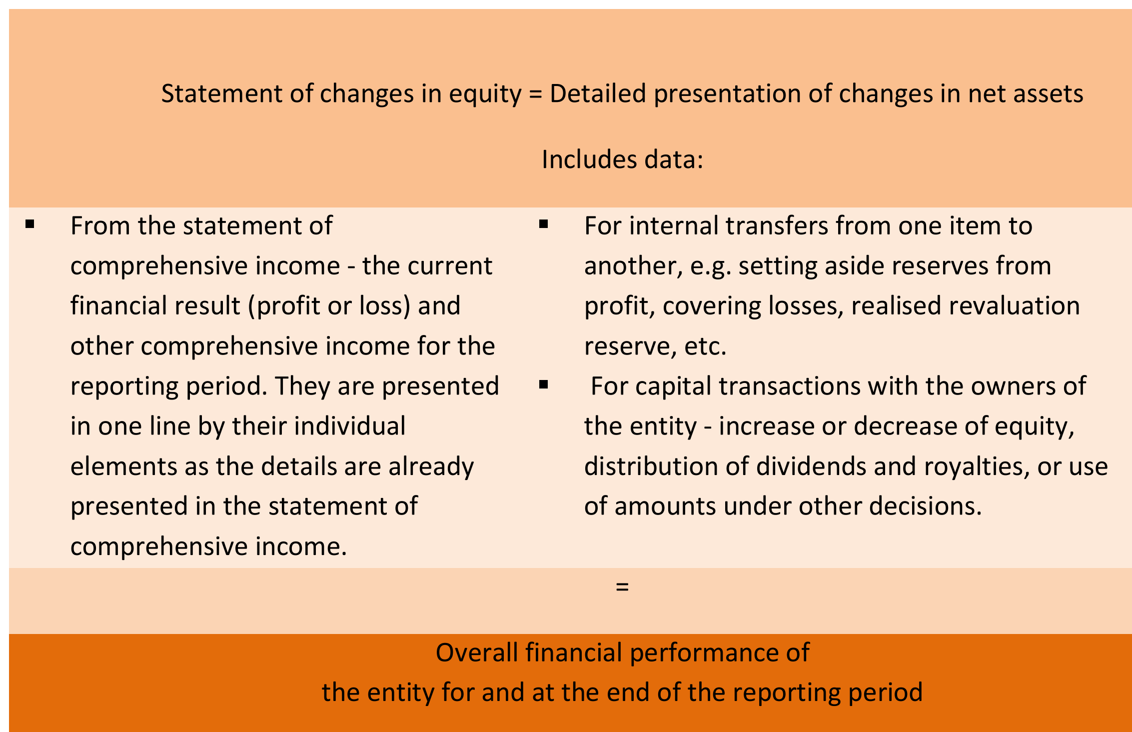
Sales revenue	CU500,000
Cost of sales	(CU240,000)
Gross profit	CU260,000
Sales expenses	(CU30,000)
Administrative costs	(CU10,000)
Other expenses	(CU20,000)
Profit before taxes	CU200,000
Income tax expense	(CU20,000)
Profit for the period	CU180,000
Other comprehensive income	
Changes in the revaluation surplus of property, plant and equipment	CU100,000
Income tax on items of other comprehensive income	(CU10,000)
Total other comprehensive income:	CU90,000
Total comprehensive income for the year	CU270,000

Tax base of revalued properties, machinery and equipment	CU500,000
Book value after revaluation at fair value	CU600,000

A taxable temporary difference arises under of IAS 12.20 in the amount of CU100,000 (600,000 – 500,000), for which a deferred tax liability in the amount of CU10,000 (CU100,000×10%) is recognised.

STATEMENT OF CHANGES IN EQUITY

The purpose of the statement of changes in equity is to present the financial position, as well as the overall performance of the entity at the end and during the reporting period regardless of whether it is the result of its operations or actions of its owners. It is a summary of the changes that occur in the individual elements of the net assets owned by the owners of the entity. This component of the financial statements is required to contain the following information to balance the opening and closing statements of financial position for the current and previous year:



This is the only component of the financial statement that is presented in a checkerboard table. It includes all possible items of changes in net assets for and towards the end of the period. The opening and closing statements of financial position must be reconciled in order to see the continuity and correlation with the values in the statement of financial position and the statement of comprehensive income.

NOTES TO THE FINANCIAL STATEMENTS

They aim to:

a) Provide systematic textual information on:
- the main corporate issues of the registration, activity, structure and management of the entity;
- the adopted accounting base for the preparation of the financial statements and the statement of the management for compliance with it;
- the defined accounting policy that is applied to significant transactions and events through its clear description.

b) Provide additional numerical and textual information that is considered necessary and appropriate so that users can properly understand the individual items in the elements of the financial statements.

A financial statement cannot be properly understood without reading the notes to it. The explanatory notes justify the amounts set out in the four front pages of the financial statements.

The way in which the explanatory appendices are prepared is a combination of the following possibilities:

(a) Individual comments and explanations should be presented systematically with a combination of texts and numerical disclosures.
(b) Each significant item of the statement of financial position and the statement of comprehensive income should be referred to in separate notes and explanations.
(c) Where possible, any numerical information should not simply be described but logically arranged in tabular form.

Example 3.

Entity X, applying IFRS, has granted an investment loan in 20X1 from the European Investment Bank (EIB) in the amount of CU5,000,000, which it has fully utilised by 31.12.20X2. The entity is obliged to comply with a number of conditions under of the contract, including the maintenance of specific financial indicators. According to the terms of the contract, if the entity fails to maintain these financial indicators, the loan becomes due and payable on demand.

According to the annual financial statements for 20X2, ready for approval by the board of directors at a meeting scheduled for 28.02.20X3, the indicators were not met as at 31.12.20X2. On 20.02.20X3, the EIB sent a letter to entity X ", in which it stated in writing its decision not to require early repayment of the loan within 20X3.

Question

How should the debt to the EIB on the investment loan be presented in the statement of financial position of entity "X" and the explanatory notes for the year ending 31.12.20X2?

Solution

According to IAS 1 Presentation of Financial Statements, the classification of financial liabilities (loans received, etc.) as current or non-current liabilities should be made on the basis of compliance with the terms of the contract at the reporting date.

As the investment loan has become due because of non-compliance with the financial conditions of the creditor bank as of 31.12.20X2, the loan becomes due on demand and is therefore classified as current liabilities. This classification does not change, although in the period after the end of the reporting period within the meaning of IAS 10 Events after the end of the reporting period the bank has agreed not to require early repayment of the loan within one year (IAS 1.74).

Example 4.

The total comprehensive income of Gamma AD in the income statement and other comprehensive income for 20X2 amounts to CU183,000. In 20X2 the following operations were performed:

(a) distributed dividends - CU18,000;

(b) capitalised development expenses in the amount of CU45,000 are written off directly in retained earnings as a result of a change in market conditions;

(c) equipment with a carrying amount of CU60,000 is revalued to CU135,000, which leads to an additional depreciation expense of CU8,000.

The total amount of equity on 01.01.20X2 in the statement of changes in equity is CU2,123,000.

Question

What is the total amount of equity in the statement of changes in equity as of 31.12.20X2 in accordance with the requirements of IAS 1 Presentation of Financial Statements?

Solution

Reduction of retained earnings: CU45,000 + CU18,000 = CU53,000

Equity as of 31.12.20X2: CU2,123,000 - CU53,000 + CU183,000 = CU2,253,000.

Example 5.

An IFRS entity received a long-term bank loan in September 20X1, which is subject to certain financial conditions. According to one of them, during the term of the loan, the borrower must maintain a debt ratio (liabilities/equity) of 65:35 at all times. In the event that this ratio is violated by the end of each quarter, the loan becomes immediately due. Compliance with the terms of the loan is assessed at the end of each quarter and reported to the bank by the end of the month following the end of the quarter.

Question

How should the loan be classified as of 31.12.20X2 if:

(a) The entity determines that it has not breached any of the financial terms of the loan agreement.

(b) In the third quarter of 20X2 the debt ratio was 75:25, which is a breach of contract, but the bank still provides a discount, according to which if the entity eliminates the breach within 12 months after the end of the reporting period, the bank will not require immediate repayment of the loan during this period. The entity expects to remedy the breach by raising additional share capital by issuing rights to existing shareholders and expects this to lead to the issuance of shares.

(c) Given the same facts as in condition (b), except for a discount from the bank, what will be the answer in such a case?

Solution

According to IAS 1.74, when there is a breach of a material condition of a long-term loan agreement on or before the end of the reporting period with such effect that the liability becomes receivable at the reporting date, the entity does not classify the loan as current if the lender has agreed after at the end of the reporting period and before the financial statement is approved for issue, does not require repayment as a result of the violation.

Also, an entity classifies a liability as non-current if the lender has agreed at the end of the reporting period to provide a grace period ending at least 12 months after the end of the reporting period during which the entity can remedy the breach and during which the lender cannot to require immediate repayment.

(a) The entity received a long-term loan in September 20X1. Since the repayment period of the loan is not mentioned in the issue, it is assumed that on 31.12.20X2 the repayment period is more than 12 months. In addition, the entity did not breach the financial terms of the contract. Therefore, as of 31.12.20X2, the loan should be classified as a non-current liability.

(b) In the second case, however, there is a violation of a clause as of 30.06.20X2, i.e. before the reporting date 31.12.20X2, the bank has agreed to provide a grace period of 12 months after the reporting date, during which the entity can eliminate the violation and during this period the bank cannot require immediate repayment of the loan. The entity also intends to remedy the violation. Therefore, it classifies the loan as a non-current liability as of 31.12.20X2.

(c) After the financial condition of the loan agreement has been breached in the third quarter of 20X2 and is reported to the bank within one month after the end of the quarter, i.e. as of 31.10.20X2 the bank loan becomes due immediately. Therefore, it should be classified as a current liability as of 31.12.20X2.