Instructor's Manual

International Financial Reporting: A Practical Guide

Fifth Edition

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Preface

As indicated in the preface to *International Financial Reporting*, the main book does not contain solutions for those exercises which are marked with an asterisk. This provides lecturers who have adopted the textbook with a source of problems which may be used for tutorial work and revision. The purpose of this Instructor's Manual is to supply suggested solutions to those exercises and questions.

I should like to remind the reader that, whilst some of the exercises are drawn from the past examination papers of the professional accounting bodies, the answers provided here to those questions are entirely my own responsibility.

Alan Melville
April 2015

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Alan Melville
April 2015

Chapter 1
The regulatory framework

1.8

(a) The objectives of the IASB are:

(i) to develop, in the public interest, a single set of high-quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles; these standards should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, participants in the world's capital markets and other users of financial information to make economic decisions;

(ii) to promote the use and rigorous application of those standards;

(iii) in fulfilling objectives (i) and (ii), to take appropriate account of the needs of a range of sizes and types of entities in diverse economic settings;

(iv) to bring about convergence of national accounting standards and international standards.

(b) The *Preface* states that IFRSs and IASs are designed to apply to the general purpose financial statements and other financial reporting of profit-oriented entities, whether these are organised in corporate form or in other forms.

(c) The main stages in the IASB due process are:

- identification and review of all the issues associated with the topic concerned
- consideration of the way in which the IASB's *Conceptual Framework* applies to these issues
- a study of national accounting requirements in relation to the topic and an exchange of views with national standard-setters
- consultation with the Trustees and the Advisory Council about the advisability of adding this topic to the IASB's agenda
- publication of a discussion document for public comment
- consideration of comments received within the stated comment period
- publication of an exposure draft for public comment
- consideration of comments received within the stated comment period
- approval and publication of the standard.

1.9

(a) The objective of IFRS1 is to ensure that an entity's first financial statements that comply with international standards should contain high-quality information that:

- is transparent for users and comparable for all periods presented
- provides a suitable starting point for accounting under international standards
- can be generated at a cost that does not exceed the benefits to users.

(b) An entity's "first IFRS reporting period" is the reporting period covered by the first IFRS financial statements. The first IFRS financial statements are the first financial statements in which the entity adopts international standards and makes an explicit and unreserved statement of compliance with those standards.

The "date of transition to IFRS" is the date at the beginning of the earliest period for which an entity presents comparative information in its first IFRS financial statements.

(c) The company's first IFRS reporting period is the year to 31 October 2016. The earliest period for which comparative figures are presented in the first IFRS financial statements is the year to 31 October 2011. Therefore the date of transition is 1 November 2010. The company must:

(i) prepare an IFRS statement of financial position as at the start of business on 1 November 2010 (i.e. as at the close of business on 31 October 2010)

(ii) use identical accounting policies in this "opening" IFRS statement of financial position and in the financial statements for the year to 31 October 2016 and in the comparative figures provided for the previous five years; these accounting policies must comply with international standards in force for periods ending on 31 October 2016

(iii) provide a reconciliation of equity as reported under previous GAAP with equity reported under IFRS, for 31 October 2010 and 31 October 2015

(iv) provide a reconciliation of total comprehensive income as reported under previous GAAP with total comprehensive income as it would have been reported under IFRS, for the year to 31 October 2015.

Chapter 2
The IASB conceptual framework

2.8

(a) £1 invested at 7% per annum will become £1 × 1.07 × 1.07 × 1.07 after three years. So the present value on 1 January 2016 of an amount to be received on 1 January 2019 (assuming a discount rate of 7%) is equal to that amount divided by $(1.07)^3$. This is the same as multiplying the amount by a discounting factor (to three decimal places) of 0.816 ($1/1.07^3$).

So the present value of £50,000 to be received on 1 January 2019 is £40,800 (£50,000 × 0.816).

(b) Similarly, the discounting factor over a five-year period is 0.713 ($1/1.07^5$) and so the present value of £100,000 to be received on 1 January 2021 is £71,300 (£100,000 × 0.713).

(c) With a discount rate of 7%, discounting factors for one, two, three and four years are 0.935, 0.873, 0.816 and 0.763 respectively (the calculation of these factors is left to the reader). So the present value of £10,000 to be received on 1 January each year from 2017 to 2020 inclusive is £33,870 (£9,350 + £8,730 + £8,160 + £7,630).

2.9

(a) The *Conceptual Framework* sets out the concepts that underlie the preparation and presentation of general purpose financial statements prepared for the benefit of external users. The main purposes of the *Conceptual Framework* are:

- to assist in the development of future international standards and review of existing standards
- to provide a basis for reducing the number of alternative accounting treatments permitted by international standards
- to assist national standard-setters in developing national standards
- to assist preparers of financial statements in applying international standards and in dealing with topics which are not yet covered by international standards
- to assist auditors in forming an opinion as to whether financial statements conform with international standards
- to assist the users of financial statements in interpreting the information contained in financial statements prepared in accordance with international standards
- to provide information about the IASB approach to the formulation of international standards.

(b) The *Conceptual Framework* states that the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

(c) The primary users of general purpose financial reports are existing and potential investors, lenders and other creditors. Further user groups include employees, customers, governments (and their agencies) and the public. Examples of the types of information that each user group would be seeking from financial reports are given in Chapter 2 of the textbook.

(d) Financial statements are normally prepared on the "going concern" basis. It is assumed that the reporting entity will continue to operate for the foreseeable future and has neither the intention nor the need either to close down or materially reduce the scale of its operations. But if an entity is not a going concern, the financial statements will have to be prepared on a different basis and that basis should be disclosed.

(e) The fundamental qualitative characteristics are relevance and faithful representation. The enhancing characteristics are comparability, verifiability, timeliness and understandability. A full explanation of each characteristic is given in Chapter 2 of the textbook.

(f) Reporting financial information imposes costs and these costs should be justified by the benefits which users obtain from this information. This means that there is a cost constraint on the extent to which financial statements can attain all of the qualitative characteristics that are listed in the *Conceptual Framework*.

Chapter 3
Presentation of financial statements

3.7

(a)

Chilwell Ltd
Statement of comprehensive income for the year to 31 October 2015

		£
Sales revenue (£1,025,420 - £27,110)		998,310
Cost of sales (W1)		465,900
Gross profit		532,410
Distribution costs (W2)	173,610	
Administrative expenses (W3)	259,250	432,860
		99,550
Other income		10,270
		109,820
Finance costs (£6,220 + £3,600)		9,820
Profit before taxation		100,000
Taxation (£20,000 + £8,400)		28,400
Profit for the year		71,600
Other comprehensive income for the year:		
Items that will not be reclassified to profit or loss:		
Gain on revaluation of land		30,000
Total comprehensive income for the year		101,600

(b)

Chilwell Ltd
Statement of changes in equity for the year to 31 October 2015

	Share capital	*Revaluation reserve*	*Retained earnings*	*Total equity*
	£	£	£	£
Balance at 31 October 2014	80,000	75,000	247,060	402,060
Total comprehensive income		30,000	71,600	101,600
Dividend paid			(35,000)	(35,000)
Bonus issue	40,000		(40,000)	
Balance at 31 October 2015	120,000	105,000	243,660	468,660

(c)

Chilwell Ltd
Statement of financial position as at 31 October 2015

	£	£
Assets		
Non-current assets		
Property, plant and equipment (W4)		565,550
Current assets		
Inventories	92,280	
Trade receivables (£69,500 × 98%)	68,110	160,390
Total assets		725,940
Equity		
Share capital	120,000	
Other reserves	105,000	
Retained earnings	243,660	468,660
Liabilities		
Non-current liabilities		
Long-term borrowings		120,000
Current liabilities		
Trade and other payables (£103,290 + £3,600)	106,890	
Bank overdraft	10,390	
Current tax payable	20,000	137,280
Total equity and liabilities		725,940

Workings

W1 Cost of sales	£
Opening inventory	87,520
Purchases	483,230
Returns outwards	(12,570)
Closing inventory	(92,280)
	465,900

W2 Distribution costs	£
Per trial balance	107,050
Wages and salaries (50%)	51,200
Buildings depreciation (W4) (30%)	2,400
Equip't depreciation (W4) (60%)	10,710
Loss on disposal (W4)	2,250
	173,610

W3 Administrative expenses	£
Per trial balance	143,440
Directors' fees	50,000
Wages and salaries (50%)	51,200
Buildings depreciation (W4) (70%)	5,600
Equip't depreciation (W4) (40%)	7,140
Bad debts	2,000
Reduction in allowance for receivables:	
(2% × £69,500) - £1,520	(130)
	259,250

W4 Property, plant and equipment	£	£	£
Land at valuation			280,000
Buildings at cost		300,000	
Depreciation to 31/10/2014	60,000		
Depreciation for year (£240,000 ÷ 30)	8,000	68,000	232,000
Equipment at cost (£197,400 - £64,000)		133,400	
Depreciation to 31/10/2014 (£105,750 - £43,750)	62,000		
Depreciation for year (25% × £71,400)	17,850	79,850	53,550
			565,550

Notes re sold vehicle:

(i) WDV of sold vehicle was £64,000 × 75% × 75% × 75% × 75% = £20,250.
(ii) Accumulated depreciation was £43,750 (£64,000 - £20,250).
(iii) The loss on disposal was £2,250 (£20,250 - £18,000).

Chapter 4
Accounting policies, accounting estimates and errors

4.7

(a) IAS8 permits a change of accounting policy only if the change is required by an international standard (or interpretation) or if the change results in reliable and more relevant information being provided to the users of the financial statements.

A change in accounting policy which arises from the initial application of an international standard or interpretation should be accounted for in accordance with the transitional provisions of that standard or interpretation.

A change in accounting policy which has been made voluntarily so as to improve the relevance of the financial statements should be accounted for retrospectively. Comparative figures for the previous period(s) must be adjusted and presented as if the new policy had always been applied.

(b)

		(restated)
	2016	**2015**
	£000	£000
Revenue	5,200	5,400
Operating expenses	4,100	3,900
Profit before taxation	1,100	1,500
Taxation	220	300
Profit after taxation	880	1,200

(c)

	Retained earnings
	£000
Balance b/f as previously reported	1,605
Change in accounting policy (950 × 80%)	760
Restated balance	2,365
Profit for the year to 31 March 2016	880
Balance c/f	3,245

(d) The draft statement of comprehensive income suggests that revenue and profits both increased in the year to 31 March 2016. The revised statement improves comparability between 2015 and 2016 and makes it clear that revenue and profits actually fell in the year to 31 March 2016. The provision of more comparable information is the main aim of IAS8 in relation to changes in accounting policy and is, of course, one of the qualitative characteristics identified by the *Conceptual Framework*.

Chapter 5
Property, plant and equipment

5.7

(a) **Non-current assets**

Broadly, a non-current asset is an asset which is acquired for long-term use within a business. Such an asset is not acquired for sale to a customer (though it may be sold at the end of its useful life) but for use in the business over a number of accounting periods.

Strictly speaking, a non-current asset is any asset which does not qualify as a current asset. The full definition of a current asset is given below.

Typical examples of non-current assets are property, plant and equipment, intangible assets (such as patents and trademarks) and long-term investments.

Current assets

Broadly, current assets comprise short-term assets which continually flow through the business and are constantly being realised. IAS1 defines a current asset as an asset which satisfies any of the following criteria:

(i) it is expected to be realised, or is intended for sale or consumption, within the entity's normal operating cycle

(ii) it is held primarily for the purpose of being traded

(iii) it is expected to be realised within twelve months after the reporting period

(iv) it is cash or a cash equivalent as defined by international standard IAS7, unless it is restricted from being exchanged or from being used to settle a liability for at least twelve months after the reporting period.

Typical examples of current assets are inventories, trade receivables and cash.

(b) Capital expenditure is expenditure which results in the acquisition of a non-current asset or in an improvement to the earning capacity of an existing non-current asset. For example, expenditure on acquiring business premises (or building an extension to existing premises) would be classed as capital expenditure.

Revenue expenditure is expenditure which results in the acquisition of a current asset (e.g. inventory) or expenditure on items such as selling and distribution expenses, administrative expenses and finance charges. The cost of repairs or maintenance to a non-current asset (but not the cost of improvements) would be classed as revenue expenditure.

(c) In general, capital expenditure is shown initially in the statement of financial position and is then transferred to the statement of comprehensive income over a period of years by means of depreciation charges. In contrast, revenue expenditure is wholly written off to the statement of comprehensive income in the year to which it relates.

Therefore, if an item of capital expenditure is incorrectly classified as revenue expenditure, this will reduce the reported profit of the company for the year in which the expenditure is incurred and will also reduce the non-current assets figure shown in the statement of financial position. However, assuming that the asset is depreciable, the absence of depreciation charges in future years will increase the reported profit of those years so that the company's total profits over the entire useful life of the asset will in fact be unaffected by the error.