

TWO

Statement formats and content

2.1

Presentation of financial statements – IAS 1

Why needed

What should a set of Financial Statements contain? There will be differing views as to what are essential to statements and their layout. This Standard lists the essential elements of a set of financial statements.

Also businesses must have clearly stated accounting policies (rules) if financial statements are to be read or interpreted clearly. Figures are meaningless if not prepared on a defined base. Accounting concepts such as 'going concern' and 'accruals' are considered fundamental or 'bedrock'. These and other concepts are defined and explained. If there were no rules then creative accounting might follow!

Ideas – concepts

Financial statements could contain endless statements, data and explanations. What is required is a practical minimum number of statements and narrative that permit a fair understanding of the financial results, cash flows and state of a business for a defined period.

A complete set of financial statements is considered to comprise:

- a balance sheet
- an income statement (P&L account)
- a cash flow statement

- **accounting policies** and explanatory notes
- **a statement of changes in equity** – all changes in equity or at least the changes that arise from capital transactions other than those with owners, e.g. revaluation gains.

Examples of balance sheets and income statements (and their differing national layouts) can be found in chapter 9. Cash flow statements, their content and layout can be found in IAS 7 and in chapter 2.5.

A statement of changes in equity should show all items that affect total shareholders' equity. That is profit or loss for the period, other gains or losses, adjustments due to changes in accounting policies, capital transactions with the owners, e.g. dividend payments or capital introduced. For many companies this is a very straightforward statement – opening amount, add profit for year less dividends gives closing amount.

Accounting policies define the process whereby transactions and other events are reflected in financial statements. Figures are meaningless if not prepared on a defined base. Accounting concepts such as 'going concern' and 'accruals' are considered fundamental or 'bedrock' and other concepts and desirable qualities and their application, are considered in this Standard or the IASB Framework. Policies are the particular ways in which concepts are applied to separate items in the financial statements.

For example, an accounting policy for a particular type of expenditure may specify whether an asset or an expense is to be recognized; the basis on which it is to be measured; and where in the balance sheet or income statement it is to be presented.

Key terms – The two fundamental or 'bedrock' concepts

GOING CONCERN

The preparer (and auditor) of the accounts should consider and check whether or not the enterprise is likely to continue in operational existence for the foreseeable future. This means, in particular, that there is no intention or necessity to liquidate or curtail significantly the scale of operations, and thus the balance sheet and income statement will not be materially affected.

The concept also requires the preparer (and auditor) to consider and check that the business is likely to have cash/bank resources sufficient to remain in business for the foreseeable future – ‘foreseeable future’ is considered by auditing Standards to be a period of at least twelve months beyond the date of signing the financial statements. When financial statements cannot or are not prepared on a going concern basis, then that fact should be disclosed.

ACCRUALS OR MATCHING CONCEPT

Revenue and costs should be accrued (that is, recognized as they are earned or incurred, not as money is received or paid), matched with one another so far as their relationship can be established or justifiably assumed, and dealt with in the income statement of the period to which they relate.

Other concepts and desirable qualities

CONSISTENCY

Presentation and classification of items in the financial statements should be retained from one period to the next, unless a more appropriate presentation evolves, e.g. due to business changes or because of an IFRS. Any change or inconsistency should be disclosed and quantified.

PRUDENCE

Prudence means being cautious. Prudence is the inclusion of a degree of caution in the exercise of judgment needed in making the estimates required under conditions of uncertainty, such that assets or expenses are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow the creation of hidden reserves.

SUBSTANCE OVER FORM

If financial statements are to represent events fairly then it is necessary that the substance or commercial reality of events is disclosed and not merely the legal form. A good example of abuse of this concept was Enron. Owning directly only a small percentage of ‘subsidiaries’ might keep assets and, more importantly, liabilities off Enron’s balance sheet, but commercial reality was that these assets and liabilities were owned and controlled by Enron.

MATERIALITY AND AGGREGATION

Every material item should be presented separately and conversely immaterial amounts should be aggregated with similar items.

OFF-SETTING OR NETTING OFF

Asset/liabilities and income/expenditure should not be off-set or netted off unless amounts are immaterial or an IFRS permits this action.

FAIR PRESENTATION

Financial statements should present fairly the financial position, performance and cash flows of a business. A specific example of the application of the 'fairness' principal is the concept of 'substance over form' as defined in the IASB Framework. If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality, and not merely their legal form. It may be reasonably assumed that complying with all IFRS's will result in fair presentation.

Accounting

The figures reported in financial statements should be compiled and presented as required by the appropriate Accounting Standard (if one exists). In any event figures should be compiled and presented based on the bedrock concepts of going concern and accruals, also taking into account the further issues and concepts set out in the IASB framework.

Disclosure

CONTENT OF FINANCIAL STATEMENTS

A balance sheet, income statement (P&L account)*, cash flow statement, statement of change in equity and accounting policies must be produced. The format of the statements will follow the IFRS recommendations of the layouts or as amended by local legislation, e.g. the EU has standardized layout and terminology for balance sheets and P&L accounts. See chapter 9.1 for examples.)

* **NOTE:** there is a firm proposal to combine the income statement/P&L account with a Statement of Total Recognized Gains and Losses to form a Statement of Financial Performance.

This statement will be divided into three sections:

- 1 Operating**
- 2 Finance and treasury**
- 3 Other gains and losses**

Recycling of gains and losses between different sections of the performance statement is not permitted. Dividends for the period are excluded from the performance statement as they represent transactions with owners as owners rather than expenses. A reconciliation of ownership interests – a statement of changes in equity would still be required to be presented as a primary statement.

ACCOUNTING POLICIES

All significant accounting policies should be disclosed. **Also the judgements made by management in applying the accounting policies that have a (the most) significant effect on the amounts of items recognized in the financial statements.**

Key measurement assumptions

An entity shall disclose in the notes information regarding key assumptions about the future, and other sources of measurement uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

RESPONSIBILITY FOR FINANCIAL STATEMENTS

Acknowledgment of responsibility for Financial Statements is required – they are the responsibility of the board of directors or other governing body.

Problem areas and questions to ask about the accounts

STATEMENT LAYOUTS

Dealing with different layouts of statements – the ordering of lists of assets, liabilities etc., means that some homework often has to be done. Within a multi-national business there should be a standard layout for internal and external reporting.

NON-COMPLIANCE WITH STANDARDS

In the extremely rare situation when compliance with an IAS is considered to be misleading then the departure from the Standard necessary to achieve a fair (in the UK true and fair) presentation is permitted. Disclosures should include:

- that management concluded that the financial statements (with the non-compliance) do fairly present position, cash flows and performance;
- that all other relevant Standards have been complied with;
- the nature of and rationale for departure from a Standard; and
- the financial impact of non-compliance on the profit and net assets of the enterprise.

SIGNIFICANT DIFFERENCES IN GAAP

The only significant key differences are in the layouts and terminology of financial statements in different countries.

Objective and definitions from the Standard

Objective

The objective of this Standard is to prescribe the basis for presentation of general purpose financial statements, in order to ensure comparability both with the enterprise's own financial statements of previous periods, and with the financial statements of other enterprises. To achieve this objective, this Standard sets out overall considerations for the presentation of financial statements, guidelines for their structure and minimum requirements for the content. The recognition, measurement and disclosure of specific transactions and events are dealt with in other Standards.

Definitions

GOING CONCERN

When preparing financial statements, management shall make an assessment of the enterprise's ability to continue as a going concern. Financial statements shall be prepared on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so. When management is aware, in making its assessment, of material uncertainties related to events or conditions which may cast significant doubt upon the enterprise's ability to continue as a going concern, those uncertainties should be disclosed. When the financial statements are not prepared on a going concern basis, that fact should be disclosed, together with the basis on which the financial statements are prepared and the reason why the entity is not considered to be a going concern.

ACCRUAL BASIS OF ACCOUNTING

Under the accrual basis of accounting, transactions and events are recognized when they occur (and not as cash or its equivalent is received or paid), and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Expenses are recognized in the income statement on the basis of a direct association between the costs incurred and the earning of specific items of income (matching). However, the application of the matching concept does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.

2.2

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

Why needed

What is the bottom line? Good question! Are one off profits to be included? If a business acquires and disposes of activities how is the underlying core business doing? Results need to be disclosed in their constituent parts.

What is the bottom line? Should all income/expense be included in the calculation of profit? What is **net** profit?

Are income/expenses exceptional or extraordinary?

How should changes in profit due to changes in accounting methods/policies be reported?

This revised Standard now focuses on the last issue – accounting policies and changes in estimates and dealing with errors – and aims to answer these questions.

It should be noted that this Standard along with IAS's 1 – Presentation of Financial Statements and IAS 35 – Discontinuing Operations, will be supplanted with a new Standard that embraces many of the issues that arise in reporting the components of profit or loss.

Ideas – concepts

Businesses make profits or losses from their core, continuing businesses, but also will have profits or losses from exceptional, unusual or extraordinary sources. These have to be distinguished, defined and disclosed separately from the continuing results. Typically in the UK, a layered format is used for the income statement that highlights a number of important components of financial performance:

- a) results from continuing operations (including acquisitions)
- b) results of discontinuing operations

- c) profit or loss on the sale or termination of an operation, costs of a fundamental reorganization or restructuring and profits or losses on the disposal of fixed assets
- d) extraordinary items (which although defined are effectively prohibited!)

ACCOUNTING POLICIES AND ACCOUNTING ESTIMATES

There is a distinction drawn between accounting policies and accounting estimates. An accounting policy is the basis on which a figure is calculated whereas an accounting estimate is the method by which a figure is calculated. For example – a typical (and required) accounting policy is to depreciate tangible fixed assets. The straight-line and reducing balance methods are two alternative methods of arriving at the figure – the estimate of what the depreciation charge should be.

Key terms

ORDINARY ACTIVITIES

Any activities that are undertaken by a reporting entity as part of its business and such related activities in which the reporting entity engages in furtherance of, incidental to, or arising from these activities.

EXCEPTIONAL OR UNUSUAL ITEMS

Material items that derive from events or transactions that fall within the ordinary activities of the reporting entity for which separate disclosure is required to give the user a proper understanding of the performance of the business.

EXTRAORDINARY ITEMS

Material items possessing a high degree of abnormality that arise from events or transactions that fall outside the ordinary activities of the reporting entity, and that are not expected to recur.

PRIOR PERIOD ADJUSTMENTS

Material adjustments applicable to prior periods arising from changes in accounting policies or from correction of fundamental errors. They do not include normal recurring adjustments or corrections of accounting estimates made in prior periods.

Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an enterprise in preparing and presenting financial statements

TOTAL RECOGNIZED GAINS AND LOSSES

The total of all gains and losses of the reporting entity that are recognized in a period and are attributable to shareholders.

Accounting

DISCLOSURE IN THE INCOME STATEMENT (THIS TOPIC HAS IN A RECENT REVISION OF THE STANDARD BEEN MOVED TO IAS 1)

All items of income and expense should be included in the income statement unless the IAS requires or permits otherwise; e.g. revaluation gains are required to be taken directly to reserves. Although defined and required to be separately disclosed it is considered that **extraordinary items are unlikely to occur**.

The Standard does not define exceptional items but any material 'one-off' income or expense items should be separately disclosed; e.g. settlement of a court case, bankruptcy of a major customer-debtor, restructuring costs.

REVISING ACCOUNTING POLICIES

A change in accounting policy should be made only if required by statute, by an Accounting Standard or if the change will result in a more appropriate presentation of transactions in the financial statement.

DEALING WITH A CHANGE TO ACCOUNTING POLICIES

Figures for the current and previous year should be prepared under the new policy, and opening balances of retained earnings adjusted accordingly. The previous year's comparative figures should also normally be altered.

DEALING WITH A FUNDAMENTAL ERROR

Figures for the current or previous year should be corrected and opening balances of retained earnings adjusted accordingly. The previous year's comparative figures should also normally be altered.

Disclosure

CHANGES TO ACCOUNTING POLICIES AND DEALING WITH FUNDAMENTAL ERRORS

Changes in accounting policies should be disclosed, as should details of any fundamental errors that come to light.

CHANGES IN ACCOUNTING ESTIMATE

If a change in the method of arriving at an accounting estimate currently or in future statements is material then the nature of the change and the amounts involved should be disclosed.

Problem areas and questions to ask about the accounts

REVIEW OF FINAL ACCOUNTS

Questions to ask:

- Is there a full and proper analysis of the components of net profit or loss?
- Are appropriate accounting policies and basis being used?
- Have all material items been disclosed?
- If there are any extraordinary items in the accounts – are they really extraordinary?

NATURE OF THE EVENT AND MATERIALITY OF AMOUNTS

Some events such as disposal of plant and equipment on cessation of one production line may be considered a normal part of business life. Profits or losses on disposals could also be considered merely adjustments to the depreciation charge. Unless truly immaterial, at least less than 10% in amount of net profit or loss, such items should be separately disclosed.

Key differences

Differences between countries tend to be in the 'look' of, and the terminology used, e.g. P&L account (UK) v Income or Revenue statement (US).

As noted above there is a move to introduce a more Standardized and comprehensive statement of total recognized gains and losses.

Objective and definitions from the Standard

Objective

The objective of this Standard is to prescribe the criteria for selecting accounting policies, and the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and errors, so that entities prepare and present their financial statements on a consistent basis. This enhances comparability with the entity's financial statements of previous periods and with financial statements of other entities.

Definitions

Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an enterprise in preparing and presenting financial statements.

Errors are omissions from, and other misstatements of, the entity's financial statements for one or more prior periods that are discovered in the current period and relate to reliable information that:

- a) was available when those prior period financial statements were prepared; and
- b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements

Errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misrepresentations of facts, and fraud.

Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly.

Ordinary activities are any activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from, these activities.

2.3

Discontinuing operations – IAS 35

Why needed

The income statement or P&L account reveals the profit or loss that a business makes, but what is the bottom line? Good question!

Should one off profits be combined with normal trading profits? Specifically if a business disposes of activities how is the underlying core business doing? Without the discontinuing business what might future profits be?

Ideas – concepts

The components of a businesses total profit or loss should be disclosed. That is continuing profits or losses should be distinguished from profits or losses from discontinuing transactions (also from one-off profits or losses – IAS 1).

Key terms

ORDINARY ACTIVITIES

Any activities that are undertaken by a reporting entity as part of its business and such related activities in which the reporting entity engages in furtherance of, incidental to, or arising from these activities.

DISCONTINUING OPERATIONS

Operations of a reporting entity that are sold or terminated either as a whole, piecemeal or are abandoned and can be distinguished both operationally and for accounting purposes.

Accounting

The calculation of figures relating to a discontinuing operation should be done in compliance with other Standards where applicable.

Disclosures outlined below can be shown on the face of the income statement or in the notes to the financial statements. Any pre-tax gain or loss on disposal of assets or settlement of liabilities must be shown in the income statement.

A discontinuing operation should NOT be shown as an extraordinary item.

A restructuring or other event that does not meet the Standard's definition of a discontinuing operation should NOT be called a discontinuing operation.

Disclosure

In respect of the discontinuing operations the following information should be disclosed:

- The date and nature of the initial disclosure event, a description of the discontinuing operation and when the discontinuance is expected to be completed (if known).
- The amounts of the total assets and liabilities to be disposed of as at the balance sheet date.
- The amounts of revenue, expenses, pre tax profit or loss and income tax expense (if any) from ordinary activities.
- The amounts of net cash flows relating to the operating, investing and financing activities.
- The business or geographical segment(s) in which it is reported in accordance with IAS 14 – Segment Reporting.

Any gain or loss in respect of disposal of assets or settlement of liabilities should be disclosed in the financial statements when the event occurs.

The details (amounts and timing) of selling prices for any binding agreement to sell assets should also be disclosed along with the balance sheet amounts for the assets being sold.

Problem areas and questions to ask about the accounts

WHEN ARE OPERATIONS DISCONTINUED?

The Standard makes much of the identification of the ‘initial disclosure event’, presumably to prevent results and assets from discontinuing operations going undisclosed, as such. If a discontinuance of business has been agreed, or a plan publicly announced, then the figures for discontinuing operations must be separately disclosed.

INCOME STATEMENT DISCLOSURES

Discontinuing operations are one example of information that has to be disclosed separately. IAS 1 – Presentation of financial statements considers such matters as: ordinary activities, exceptional items and extraordinary items.

REVISION OF STANDARD

Exposure drafts (IFRS – ED4, UK – FRED 32), disposal of non-current assets and presentation of discontinued operations has been issued. This broadens the definition of discontinued operations and eliminates differences with US GAAP.

Objective and definitions from the Standard

Objective

The objective of this Standard is to establish principles for reporting information about discontinuing operations, thereby enhancing the ability of users of financial statements to make projections of an enterprise’s cash flows, earnings-generating capacity and financial position, by segregating information about discontinuing operations from information about continuing operations.

Definitions

A **discontinuing operation** is a component of an enterprise:

- a) that the enterprise, pursuant to a single plan, is:
 - i) disposing of substantially or in its entirety, such as by selling the component in a single transaction, by demerger or spin-off of ownership of the component to the enterprise’s shareholders;

- ii) disposing of piecemeal, such as by selling off the component's assets and settling its liabilities individually;
 - iii) terminating through abandonment;
- b) that represents a separate major line of business or geographical area of operations; and
 - c) that can be distinguished operationally and for financial reporting purposes.

Initial disclosure event is the occurrence of one of the following, whichever occurs earlier:

- a) the enterprise has entered into a binding sale agreement for substantially all of the assets attributable to the discontinuing operation; or
- b) the enterprise's board of directors or similar governing body has (i) approved a detailed formal plan for the discontinuance and (ii) made an announcement of the plan.

2.4

First time adoption of international accounting standards – IFRS 1

Why needed

International Accounting Standards are different from the UK Standards. Some industry results will be much more affected than others. The main thrust of this first IFRS is that adoption should not be impossible because of the time or cost required in dealing with every nuance of the Standards.

Ideas – concepts

Standards should be complied with – but the introduction should not be hindered by undue expense or time required for compliance.

Accounting

The starting point for accounting under IFRS's is an opening IFRS balance sheet at the date of transition to IFRS's.

An entity shall use the same accounting policies in its opening IFRS balance sheet and throughout all periods presented in its first IFRS financial statements. Those accounting policies shall comply with each IFRS effective at the reporting date for its first IFRS financial statements.

An entity may use one or more of the exemptions listed and explained in the IFRS:

- business combinations
- fair value or revaluation as deemed cost
- employee benefits
- cumulative translation differences
- compound financial instruments
- assets and liabilities of subsidiaries, associates and joint ventures.

There are exceptions to retrospective application of some IFRS's:

- de-recognition of financial assets and financial liabilities
- hedge accounting
- estimates

Disclosure

To comply with IAS 1 Presentation of Financial Statements, an entity's first IFRS financial statements shall include at least one year of comparative information under IFRS's.

An entity shall explain how the transition, from previous GAAP to IFRS's affects its financial position, financial performance and cash flows.

Problem areas and questions to ask about the accounts

THE TIME NEEDED

Even for a straightforward business there is a lot of work to do. The first year is not 2005 for relevant EU companies but 2004 or even earlier if reliable comparatives are to be given.

Objective and definitions from the Standard

Objective

An entity shall apply this IFRS in:

- a) its first IFRS financial statements; and
- b) each interim financial report, if any, that it presents under IAS 34 Interim Financial Reporting for part of the period covered by its first IFRS financial statements.

Definitions

Date of transition to IFRS's is the beginning of the earliest period for which an entity presents full comparative information under IFRS's in its first full IFRS statements.

First IFRS financial statements are the first annual financial statements in which an entity adopts IFRS's, by an explicit and unreserved statement of compliance with IFRS's.

A **first time adopter** is an entity that presents its first IFRS financial statements.

IFRS's are Standards and Interpretations adopted by the International Accounting Standards Board (IASB). They comprise:

- a) International Financial reporting Standards
- b) International Accounting Standards
- c) Interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC) or former Standing Interpretations Committee (SIC), and adopted by the IASB

An **opening IFRS balance sheet** is an entity's balance sheet (published or unpublished) at the date of transition to IFRS's.

Previous GAAP is the basis of accounting that a first-time adopter used immediately before adopting IFRS's.

The reporting date is the end of the latest period covered by financial statements or by an interim financial report.

2.5

Cash flow statements – IAS 7

Why needed

Positive cash flow is essential for the survival and growth of any business.

The balance sheet can tell you where you are, the income statement can tell you what income and expenditure there was (these include accrued amounts), but only a cash flow statement can tell you what, if any, cash is being generated, how it is being sourced and how it's used.

Identifying how cash has flown through a business is very useful in verifying a businesses performance for a period and movement in net asset position over a period.

After the debacle of Worldcom, Enron etc. credit analysts woke up to the fact that maybe they had not been doing their job. On quizzing the CEO of a reputable company about whether reported profits were real he replied 'lift the hatch and the dollars are there' – a good retort!

Ideas – concepts

The majority of business transactions are cash based, that is cash, or more likely bank account, receipts and payments are involved. Thus a statement could be prepared listing cash in and cash out, grouped into:

- Cash in and out from trading, from **operating activities**.
- Cash out into investments or fixed assets, or in from the sale of the same – **investing activities**.
- Cash in from raising new equity or loans, or out from the reduction in loans or equity – **financing activities**.

These headings cover all the activities that a business can get involved in and the net cash in or out will be the change in the net cash position* over the period.

*(Cash on hand, deposited at a bank or overdraft.)

A cash flow statement simply groups cash flows as follows:

- **Cash flows from operating activities.**
- **Cash flows from investing activities.**
- **Cash flows from financing activities.**
- **Net increase (/decrease) in cash and cash equivalents.**

The cash flow statement could be prepared from the cash book and bank accounts. This would show gross receipts from customers, payments to suppliers and employees, payments for the purchase of fixed assets and proceeds of long-term borrowings etc. This would reveal the basic cash flows by type and is called the **direct method**. This is the method preferred by the Standard, but rarely followed. The drawbacks are that there is no clear reconciliation with operating profit and detailed cash and bank analysis has to be done.

The **indirect method** arrives at the cash flow headings above by starting with operating profit which has non-cash figures (e.g. accruals and depreciation) along with movements in working capital (e.g. money tied up in stock) added back to give the operating cash flow. There is thus reconciliation between operating profit reported in the income statement and operating cash flow. This can be shown on the face of the cash flow statement or as a note.

The investing and financing cash flows can be identified by analyzing the movement in balance sheet figures, e.g. fixed assets additions are an investing cash out flow.

Cash flow statements are in essence simple to prepare using the indirect method. For a successful company this would mean the movement in cash and bank balances can be explained by cash inflows from operation of the business, less outflows on investment plus inflows from funding through loans or equity.

There is an example of the layout and preparation of a cash flow statement in chapter 1.1.

Key terms

Cash comprises cash on hand and demand deposits less overdrafts.

Cash equivalents are short-term, highly liquid investments that are readily convertible into cash.

Operating activities are the principal trading revenue producing activities of the enterprise.

Investing activities are the acquisition and disposal of long-term assets (tangible and intangible fixed assets and investments).

Financing activities are activities that result in changes in shareholders' equity and funding (increases in share capital, increases or decreases in loans).

Accounting

An enterprise should report cash flows from operating activities using either:

- a) the direct method where major classes of gross cash receipts and payments are disclosed; or
- b) the indirect method where the net profit or loss for the period is adjusted for the effect of non-cash transactions (items are 'un' or 'dis' accrued and depreciation, never a cash cost, is added back).

Disclosure

The cash flow statement should report cash flows during the period classified by operating, investing and financing activities.

A breakdown of individual types of items should be given under the above headings. In particular, cash flows related to taxation should be separately disclosed under one or more of the three headings.

Problem areas and questions to ask about the accounts

RECONCILING INCOME STATEMENT AND BALANCE SHEET FIGURES - EXPLAINING THE CASH AND DEBT MOVEMENTS

It is in the area of reconciling and explaining movements in cash, bank deposits and overdrafts that both the Standard and practice are often far from clear. The information will be given but the reader of the accounts has to study the statements and, particularly, the notes very carefully.

SIGNIFICANT DIFFERENCES IN GAAP

The existing UK Standard (FRS1) requires up to 9 headings (management of liquid resources and financing may be combined).

These are cash flows related to:

- operating activities
- dividends from joint ventures and associates
- returns on investments and servicing of finance
- taxation
- capital expenditure and financial investment
- acquisitions and disposals
- equity dividends paid
- management of liquid resources
- financing

The final figure on the cash flow statement is then reconciled to movement in net debt – a note on analysis of changes in net debt may also be needed. These are not part of the cash flow statement! This supports the point made under explaining cash and debt movement, that identifying just where the cash came from, or went to, can be difficult. Many companies reporting is poor in this respect.

WHAT IS CASH?

The definition of cash in the UK Standard is particularly tight, less so in the IAS.

Objective and definitions from the Standard

Objective

Information about cash flows of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and cash equivalents, and the needs of the enterprise to utilize those cash flows. The economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents, and the timing and certainty of their generation.

The objective of this Standard is to require the provision of information about historical changes in cash and cash equivalents of an enterprise by means of a cash flow statement which classifies cash flows during the period from operating, investing and financing activities.

Definitions

Cash comprises cash on hand and demand deposits.

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

Cash flows are inflows and out flows of cash and cash equivalents.

Operating activities are the principal revenue producing activities of the enterprise and other activities that are not investing or financing activities.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Financing activities are activities that result in changes in the size and composition of the equity capital and borrowings of the enterprise.

2.6

Interim financial reporting – IAS 34

Why needed

Listed companies, as a matter of good governance and because of stock market listing requirements will report half yearly and even quarterly. This Standard is another where the other demands for reporting and disclosure would seem to make the need for a Standard superfluous.

Ideas – concepts

Interim financial statements should contain the same individual reports and use the same accounting policies as the annual statutory accounts. It may be acceptable and practical to demand less detail in some of the disclosures and notes.

Key terms

Interim financial report means a financial report containing either a complete set of financial statements (as described in IAS1 – Presentation of Financial Statements) or a set of condensed financial statements (as described in this Standard) for an interim period.

Accounting

The only accounting issue is that more figures may be based on estimates.

Disclosure

MINIMUM REQUIREMENTS

- a) a condensed balance sheet
- b) a condensed income statement
- c) a condensed cash flow statement
- d) a condensed statement of changes in equity
- e) selected explanatory notes

The Standard does give examples of what might be in condensed financial statements, but it is far more likely that relevant company law or stock market listing rules will dictate what is disclosed. This is likely to be more than the Standard demands.

Problem areas and questions to ask about the accounts

THE USE OF ESTIMATES

Estimates have to be made when preparing financial statements. For some types of business this can involve much work both for the statement preparers and auditors. When producing interim accounts (possibly to tight deadlines) the level of effort, and thus accuracy of estimates, may be (acceptably) less.

If an estimate used at the interim stage has to be changed significantly when the full annual statements are produced, that fact should be disclosed.

MATERIALITY

The level of 'what is material' should be reviewed. Whilst there may be more estimates used materiality still has to be considered in relation to level of profits etc.

Objective and definitions from the Standard

Objective

The objective of this Standard is to prescribe the minimum content of an interim financial report, and to prescribe the principles for recognition and measurement in complete or condensed statements, for an interim period. Timely and reliable interim financial reporting improves the ability of investors, creditors and others to understand an enterprises' capacity to generate earnings and cash flows and its financial condition and liquidity.

Definitions

An interim period is a financial reporting period shorter than a full financial year.

An interim financial report means a financial report containing either a complete set of financial statements (as described in IAS1 – Presentation of Financial Statements) or a set of condensed financial statements (as described in this Standard) for an interim period.