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Presentation of Financial Statements

(LKAS 1)

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LKAS 1

Presentation of Financial Statements

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LKAS 1: Overview

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LKAS 1: Objective

- **Prescribe the basis of presentation of general purpose financial statements to ensure comparability**
  - With the entity's financial statements of previous periods
  - With the financial statements of other entities

Scope

- **Applied to all general purpose financial statements prepared and presented in accordance with Sri Lanka Accounting Standards (SLFRSs)**
  - Meet the needs of users who are not in a position to demand reports tailored to meet their particular information needs
  - Financial statements include those:
    - Presented separately
    - Presented within another public document (annual report or prospectus)

Purpose of 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**
- **Show the results of management's stewardship of the resources entrusted to it**
- **Provide information about**
  - Assets
  - Liabilities
  - Equity
  - Income and expenses
  - Other changes in equity
  - Cash flows

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Components of Financial Statements

- **Statement of financial position**
- **Statement of comprehensive income**
  - As a single statement of comprehensive income, or
  - In two statements (a separate income statement and a statement of comprehensive income)
- **Statement of changes in equity**
- **Statement of cash flows (LKAS 7)**
- **Notes, comprising a summary of significant accounting policies and other explanatory notes**

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Overall Considerations

- **SLFRS financial statements should:**
  1. **Present fairly**
  2. **Observe true and fair override provisions**
  3. **State compliance with SLFRS explicitly and unreservedly**
  4. **Use going concern basis, unless management intends to liquidate or cease trading**
  5. **Use accrual basis of accounting**
  6. **Classify and present items consistently except for:**
     - Changes in nature of operations or a review of the entity's financial statements indicates another presentation or classification is more appropriate
     - Changes required by an SLFRS

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Overall Considerations continued

- **SLFRS financial statements should:**
  7. **Present separately each material class of similar items**
  8. **Not offset assets and liabilities, income and expenses unless required or permitted by an SLFRS – except where**
     - Reflects the substance of the transaction, or
     - Increases the ability of users to understand the transactions, or
     - Allows better assessment of entity's future cash flows

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Offsetting

- **Note that measuring assets net of valuation allowances is not offsetting**
  - Obsolescence allowances on inventories
  - Doubtful debts allowances on receivables
- **Examples of acceptable offsetting ('netting' of accounts):**
  - Revenue measured net of trade discounts and volume rebates
  - Gains and losses on the disposal of non-current assets reported net of carrying amount and selling expenses
  - Gains and losses arising from a group of similar transactions

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Overall Considerations

- **SLFRS financial statements should:**
  - Disclose comparative information for previous period
    - If presentation or classification is amended, comparative amounts should be reclassified, unless impracticable
    - Nature, amount, and reasons for the change should be disclosed
- **Present an additional statement of financial position at the beginning of the preceding period when:**
  - Entity applies an accounting policy retrospectively, or
  - Makes a retrospective restatement (e.g. error correction), or
  - Reclassifies items in its financial statements

* *In each case, the additional statement of financial position is only required where adjustment(s) have a material effect on information*

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Structure and Content

- **Identification of the financial statements**
  - Should be clearly identified
  - Distinguished from other information in same document
  - Required information:
    - Name of reporting entity
    - Individual entity or group of entities
    - Date or period covered
    - Currency
    - Level of rounding
- **Reporting period**
  - At least annually
  - Where reporting period is adjusted, note reason and lack of comparability

Statement of Financial Position

- **Formerly known as the balance sheet**
  - Statement of financial position is preferred, but can still use term ‘balance sheet’
- **Current/non-current classification**
  - In exceptional cases present in order of liquidity
    - Where this provides reliable and more relevant information
- **Current assets and liabilities are defined; non-current is the default category**

Current Assets

- **Classified as current assets if any one of the following criteria is met**
  - Expected to be realised or intended for sale or consumption in the normal operating cycle
  - Held primarily for trading purposes
  - Expected to be realised within 12 months after the reporting period
  - Cash or cash equivalent unless restricted in its use for at least 12 months after the reporting period
- **All other assets are classified as non-current assets**
  - Deferred tax assets must be classified as non-current

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Current Liabilities

- **Classified as current liabilities if any one of the following criteria is met:**
  - Expected to be settled in the normal operating cycle
  - Held primarily for trading purposes
  - Due to be settled within 12 months after the reporting period
  - Does not have a right at the reporting date to defer settlement of the liability by the transfer of cash or other assets for at least twelve months after the reporting period"(Amendment to LKAS 1 in 2015)
- **All other liabilities are classified as non-current liabilities**
  - Deferred tax liabilities must be classified as non-current

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Statement of Financial Position Minimum Line Items

- Property, plant & equipment
- Investment property
- Intangible assets
- Financial assets
- Investments (equity method)
- Biological assets
- Inventories
- Trade and other receivables
- Cash and equivalents
- Non-current assets held for sale and assets of disposal group
- Trade and other payables
- Provisions
- Financial liabilities
- Current tax liabilities/assets
- Deferred tax liabilities/assets
- Non-controlling interests (within equity)
- Issued capital and reserves attributable to equity of the parent
- Liabilities of disposal group

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Statement of Financial Position Minimum Line Items continued

- The following should be presented on the face of the statement of financial position or in the notes:
  - Further sub-classifications of line items as required by other accounting standards
  - Information on each class of share capital
  - Details about the nature and purpose of each reserve within equity

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Statement of Comprehensive Income

- **Must present all non-owner changes in equity ("comprehensive income") either:**
  - In single statement of comprehensive income, or
  - In two statements (income statement and separate statement of comprehensive income)

Statement of Comprehensive Income

Either

Statement of comprehensive income	
Revenue	1000
Costs	(500)
Tax	(200)
Profit for the year	300
Other comprehensive income	150
Tax	(50)
Total comprehensive income	400

Or

Income statement	
Revenue	1000
Costs	(500)
Tax	(200)
Profit for the year	300

And

Statement of comprehensive income	
Profit for the year	300
Other comprehensive income	150
Tax	(50)
Total comprehensive income	400

Statement of Comprehensive Income

- **Minimum line items on face of SCI**
  - Revenue
  - Gains and losses from derecognition of financial assets measured at amortised cost (per SLFRS 9)
  - Finance costs
  - Share of associates & joint ventures (equity method)
  - Gains and losses from reclassifying financial assets to fair value (per SLFRS 9)
  - Tax expense
  - Single amount comprising discontinued operations
  - Profit or loss – allocated to non-controlling interests and owners of parent

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Statement of Comprehensive Income Minimum Line Items

- **Each component of other comprehensive income classified by nature**
- **Share of comprehensive income of associates and joint ventures accounted for using the equity method**
- **Total comprehensive income**
- **Allocations of profit for the period**
  - Profit or loss for the period
    - Attributable to non-controlling interests
    - Attributable to owners of the parent
  - Total comprehensive income for the period
    - Attributable to non-controlling interests
    - Attributable to owners of the parent

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Statement of Comprehensive Income

- **Includes:**
  - Profit or loss for the period, plus
  - Other comprehensive income recognised in that period
- **Profit or loss for the period**
  - All items of income and expense in a period must be recognised in profit or loss unless an SLFRS requires of permits
  - Presentation of income or expenses as extraordinary items is not allowed

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Statement of Comprehensive Income

- **Other Comprehensive Income**
  - Comprises items of income and expense, including reclassification adjustments, that are not required or permitted to be recognised in profit or loss
  - Components of other comprehensive income include:
    - Changes in revaluation surpluses (LKAS 16)
    - Remeasurements (including actuarial gains and losses) on defined benefit plans (LKAS 19)
    - Gains and losses from translating financial statements of a foreign operation (LKAS 21)
    - Gains and losses on re-measuring available-for-sale financial assets (LKAS 39)
    - Effective portion of gains/ losses on hedging instruments in a cash flow hedge (LKAS 39)

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LKAS 1 – Amendments

- **In June 2011 the IASB made limited amendments to the Statement of comprehensive income**
  - Joint project with FASB
  - Effective for annual periods beginning on or after 1 July 2012; earlier adoption permitted
  - In Sri Lanka, effective date is 01 January 2014.
- **Introduced new titles (non-mandatory)**
  - Statement of Profit or Loss, and
  - Statement or Profit or Loss and Other Comprehensive Income
- **Requirement to distinguish other comprehensive income between items that will never be reclassified to profit or loss and those that may be reclassified to profit or loss.**

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LKAS 1: Amendment

- **Reclassification of other comprehensive income items**
  - The individual statements specify whether reclassification of an OCI item to the profit and loss is required or permitted
  - Those items that are reclassified are:
    - Gains and losses from translating financial statements of a foreign operation on disposal of the operation (LKAS 21)
    - Gains and losses on re-measuring available-for-sale financial assets on disposal of the investment(LKAS 39)
    - Gains/ losses on hedging instruments in a cash flow hedge when the cash flow affects the income statement (LKAS 39)

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Statement of Comprehensive Income

- **The following should be presented in the statement of comprehensive income or in the notes:**
  - Analysis of material expenses classified by **nature** of expense or **function**, whichever is more relevant
  - If classified by function, disclose information on the nature of expenses including cost of sales, depreciation, amortisation and employee benefits
  - Material items of income or expense

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Nature of Expense Method

Revenue		XXXX
Other income		XXXX
Changes in inventories	XXXX	
Raw materials used	XXXX	
Employee benefits expense	XXXX	
Depreciation and amortisation		
Expense	XXXX	
Other expenses	XXXX	
Total expenses		XXXX
Profit		XXXX

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Function of Expense Method

Revenue	XXXX
Cost of sales	(XXXX)
Gross profit	XXXX
Other income	XXXX
Distribution costs	(XXXX)
Administrative expenses	(XXXX)
Other expenses	(XXXX)
Profit	XXXX

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Material Items of Income or Expense

- **Examples are given but list in LKAS 1 is not exhaustive**
  - Write-downs of inventories to net realisable value or of pp&e to recoverable amount, as well as reversals of such write-downs
  - Restructurings of activities and reversals of restructuring provisions
  - Disposals of items of ppe
  - Discontinued operations
  - Litigation settlements
  - Other reversals of provisions
- **What is meant by 'material'?**

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LKAS 1 and LKAS 8 on Materiality

- **LKAS 8 and LKAS 1 state that accounting policies and disclosures specified by the SLFRSs need not be applied or provided where the effect is immaterial**
- **'Material' is defined in both standards as follows**
  - Based on the description of materiality in the *Framework*

    "Omissions or misstatements are material if they could, individually or collectively, influence the economic decisions that users make on the basis of financial statements"

    "Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor"
  - Matter of judgement

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Notes – Capital

- **Notes should disclose information to allow users to evaluate objectives, policies and processes for managing capital**
  - Qualitative information
    - Description of capital
    - Any externally imposed capital requirements
    - How entity is meeting its capital management objectives
  - Quantitative data
    - Capital and changes
    - Meeting capital requirements / consequences of non-compliance

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Statement of Changes in Equity

- **Comprises**
  - Total comprehensive income for the period
    - Showing separately total amounts attributable to:
      - Owners of the parent
      - Non-controlling interest
  - For each component of equity, a reconciliation between the carrying amount at the beginning and end of the period, separately disclosing changes resulting from:
    - Profit or loss
    - Each item of other comprehensive income, and
    - Transactions with owners in their capacity as owners
  - The effects of retrospective application or restatement under LKAS 8

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Statement of Changes in Equity

- **Dividends**
  - Show dividends recognised as distributions to owners during the period, and the related amount per share
  - Present either:
    - In the Statement of Changes in Equity, or
    - In the notes

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Notes

- **Notes should:**
  - Present information about the basis of preparation of the FS and specific accounting policies used
  - Disclose information required by SLFRSs that is not presented elsewhere in the FS
  - Provide additional information that is not presented elsewhere in the FS which is necessary for a fair presentation
  - Be presented in a systematic manner
    - Cross-referencing system

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Notes – Accounting Policies

- **Summary of accounting policies should disclose:**
  - Measurement basis (bases) used in preparing the financial statements
  - Other accounting policies used that are relevant to an understanding of the financial statements
  - Judgements made by management in process of applying accounting policies that have a significant effect on amounts recognised in the financial statements
- **Key assumptions concerning future and other sources of estimation uncertainty**
  - Detail of their nature
  - Carrying amounts

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Other Disclosures

- **Dividends proposed or declared before the financial statements were authorised, but not recognised as a distribution during the period**
- **Cumulative preference dividends not recognised**
- **Legal corporate information, if not disclosed elsewhere**
  - Domicile and legal form of entity
  - Country of incorporation
  - Address of registered office
  - Description of nature of entity's operations and principal activities
  - Name of parent and ultimate parent of group

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Amendments effective from 01st Jan 2015

Current Liabilities - Amendment to Paragraph 69 (d)

Classification of CL criteria to include "when it does not have a right at the reporting date to defer settlement of the liability by the transfer of cash or other assets for at least twelve months after the reporting period",(instead of unconditional right.)

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Disclosure Initiative - Amendments effective from 1 January 2016.

Objective:

- Apply professional judgement in determining;
  - what information to disclose and
  - how to structure it in their financial statements.

Effective Date:

- The amendments may be applied immediately and become mandatory for annual periods beginning on or after 1 January 2016.

Disclosure Initiative - Amendments to LKAS 1

Areas of Narrow – focus Improvements:

- ❑ Materiality
- ❑ Disaggregation and subtotals
- ❑ Notes structure
- ❑ Disclosure of accounting policies
- ❑ Presentation of items of other comprehensive income (OCI) arising from equity accounted investments

Disclosure Initiative - Amendments to LKAS 1

Materiality

- The amendments clarify that an entity must not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions.
- The amendments re-emphasise that, when a standard requires a specific disclosure, the information must be assessed to determine whether it is material and, consequently, whether presentation or disclosure of that information is warranted.

(New para 30A & amend para 31)

Disclosure Initiative - Amendments to LKAS 1

Disaggregation and subtotals

- Clarify that specific line items in the statement(s) of profit or loss and OCI and the statement of financial position may be disaggregated.
- Specify the presentation of additional subtotals, in the statement(s) of profit or loss and OCI and the statement of financial position:
  - Be comprised of line items made up of amounts recognised and measured in accordance with SLFRS
  - Be presented and labelled in a manner that makes the line items that constitute the subtotal clear and understandable
  - Be consistent from period to period
  - Not be displayed with more prominence than the subtotals and totals currently required in SLFRS for the statement of financial position or the statement(s) of profit or loss and OCI
- For additional subtotals presented in the statement(s) of profit or loss and OCI, an entity must also present the line items that reconcile any such subtotals with the subtotals or totals currently required in SLFRS for such statement(s).

Disclosure Initiative - Amendments to LKAS 1

Notes structure

Clarify that entities have flexibility as to the order in which they present the notes to financial statements, but also emphasise that understandability and comparability should be considered by an entity when deciding on that order.

Examples of systematic ordering or groupings of the notes include:

- Giving prominence to the areas of its activities that the entity considers to be most relevant to an understanding of its financial performance and financial position, such as grouping together information about particular operating activities
- Grouping together information about items measured similarly, such as assets
- measured at fair value
- Following the order of the line items in the statement(s) of profit or loss and OCI and the statement of financial position, similarly to the order listed in the current paragraph 114 of IAS 1

Disclosure Initiative - Amendments to LKAS 1

Disclosure of accounting policies

Remove the examples of significant accounting policies in the current paragraph 120 of IAS 1, i.e., the income taxes accounting policy and the foreign currency accounting policy, as these were considered unhelpful in illustrating what significant accounting policies could be.

Disclosure Initiative - Amendments to LKAS 1

Presentation of items of OCI arising from equity accounted investments

Clarify that the share of OCI of associates and joint ventures accounted for using the equity method must be presented in aggregate as a single line item, classified between those items that will or will not be subsequently reclassified to profit or loss.

Exposure Draft on Disclosure Initiative - Materiality Practice Statement

Exposure Draft on Disclosure Initiative - Materiality Practice Statement

- A Practice Statement is non-mandatory guidance, consisting of a series of examples and explanations to help management.
- ED has been issued in Oct 2015 & the project is in progress (targeting to issue final guidance in 2017 Q1)
- The objective of this project is to help preparers, auditors and regulators to use judgement when applying the concept of materiality.

Objectives of the Project

- to change the current definition of materiality within IFRS only to align the definitions in IAS 1, IAS 8 and the Conceptual Framework with each other.
- clarifying the key characteristics of materiality.
- to provide guidance on the application of materiality, which will take the form of a Practice Statement

Current Guidance in IFRSs

- Materiality is one of the qualitative characteristic of useful financial information.
- According to LKAS 1, items are material, **if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements**.
- Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

Scope

- The Practice Statement applies to the preparation of financial statements in accordance with IFRS.
- This does not directly cover application of materiality in an audit (which is covered by auditing standards).

Highlights…

- Materiality is an entity-specific aspect of relevance; all information that is material to an understanding of an entity will be relevant to that entity's activities, but not all relevant information will be material.
- Materiality depends on the nature and magnitude of information, and must be judged in the particular circumstances of the entity.
- If material information is excluded from the financial statements, this may adversely affect decisions made by the users of the financial statements.
- At a practical level, those responsible for preparing the financial statements need to assess the likelihood that a change in the content of the financial statements, or how the information is presented, could influence the decisions made by the **primary users** of those financial statements.
- primary users of general purpose financial statements, are existing and potential investors, lenders and other creditors who cannot require entities to provide information directly to them and must rely on general purpose financial reports.

Highlights (contd..)

- The concept of materiality is pervasive to the preparation of the financial statements. If information is material, it is required to be recognised, measured, presented and disclosed, as appropriate, in accordance with IFRS.
- IFRS requires management to think beyond the specific requirements in IFRS and provide additional information that is relevant to an understanding of the financial statements. This involves judgement about how the information contributes to the overall picture of the entity's financial position, financial performance and cash flows.

Highlights (contd..)

Qualitative assessment:

- Applying materiality involves a qualitative assessment.
- Management could use quantitative thresholds to assist their judgements about materiality in the preparation of the financial statements.

  Eg: preliminary assumption that any income or expenses lower than a particular % of profit or a particular percentage of revenue would be unlikely to be material to the financial statements.
- However, for some disclosures, materiality considerations are more sensitive.

  Eg: a relatively small amount might be material if it relates to directors' remuneration.
- At a practical level, those responsible for preparing the financial statements need to assess the likelihood that a change in the content of the financial statements, or how the information is presented, could influence the decisions made by the primary users of those financial statements.

Types of considerations in applying materiality

- What are the characteristics of the primary users of general purpose financial reports (decision-makers)?

  (focusing on common information needs does prevent the reporting entity from including additional information that is most useful to a particular type of primary user)
- What types of decisions are the primary users making and is information likely to influence those decisions ('influence' does not necessarily mean 'change')?

  (Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit)
- What is the appropriate context for assessing whether information is material?

  (on the face of the financial statements (sometimes; in the notes; or on the basis of the financial statements as a whole)

Immaterial information:

- If transactions, events or conditions are material they must be presented or disclosed in the financial statements (and recognised and measured in accordance with IFRS if appropriate).
- When a transaction, event or condition is not material, it does not mean that it should not be recorded in the financial system, but it means instead that it would not be necessary to separately provide information about it in the financial statements.
- Moreover, providing too much immaterial information can obscure useful information and consequently mean that the financial statements are less understandable.

Aggregation of information

- If a line item on the face of the statements is not individually material, it can be aggregated with other items.

  Eg: an entity may decide to combine all of its financial assets measured at fair value together in one line item on the face of the statement of financial position, if separate presentation is not considered material.

Omissions and misstatements

If an entity presents a complete set of financial statements knowing that it has omitted or misstated any information (collectively referred to as misstatements in this document), it shall be required to amend the financial statements, if the misstatement is considered material.

Eg:

(a) bookkeeping errors.

(b) some relevant information could come to light later. (eg: company lawyer forgetting to pass on details of a letter received by the entity indicating that another party was claiming damages against the entity, or the accountant failing to notice the recent issuance of a new IFRS that is relevant to the entity.

Misstatements can arise in a number of ways including:

(a) human error;

(b) incorrect judgement of the needs of the primary users;

(c) different measurement or accounting methods; and

(d) intentional misstatements.

Upcoming Discussion Paper on Disclosure Initiative - Principles of disclosure

Background and Status

- **Target DP in end 2016**

- The objective of this research project is to improve existing guidance in IFRS that helps entities determine the basic structure and content of a complete set of financial statements.
- The focus is on reviewing the general disclosure guidance in IAS 1 and IAS 8. The aim is to develop a Disclosure Standard that improves and brings together the principles for determining the basic structure and content of the financial statements, in particular the notes.
- This project will not consider the removal or addition of specific disclosure requirements in other Standards. The disclosure requirements in all Standards will be reviewed systematically in the light of the revised Conceptual Framework and of work undertaken in this project. . In addition, the work that the FRC had undertaken on Cash Flows under this research project was moved to the Performance Reporting project.
- As part of the revision of the Conceptual Framework the IASB has decided to add a new chapter on presentation and disclosure. This would be included in the upcoming ED on CF in which the target date is 2015 quarter 3.

IFRS guidance

- ❑ Paragraph 10 of IAS 1 *Presentation of Financial Statements* specifies that a complete set of financial statements comprises:
  a. a statement of financial position as at the end of the period;
  b. a statement of profit or loss and other comprehensive income for the period;
  c. a statement of changes in equity for the period;
  d. a statement of cash flows for the period;
  e. notes, comprising a summary of significant accounting policies and other explanatory information;
  f. comparative information in respect of the preceding period; and
  g. a statement of financial position as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.
- ❑ Statements of financial position, profit or loss and other comprehensive income, changes in equity and cash flows as mentioned in (a)–(d) in paragraph 3 are considered as forming the set of the Statements.

Sections to be addressed in DP

- **Terminology**
  - when the set of Statements is referred to as financial statements, it is often not clear whether reference is being made to the set of Statements or the complete set of financial statements (ie including the notes).

    Recommendation is that the term "primary financial statements" is the most suitable terminology to refer to a set of Statements
  - At present, not having a descriptor (ie present and disclose) to differentiate where to disclose information in a complete set of financial statements.

    Recommend to give reference to disclosure in either the primary financial statements or in the notes as preferable.

Sections to be addressed in DP

- **Materiality;**
  - Main problem is the decision about what makes the information important enough to be displayed 'on the face' (ie in the primary financial statements) or 'in the notes', and what makes an individual statement important enough to be presented as one of the primary financial statements.
  - IASB highlights the importance of understanding the role of primary financial statements and the implications of a statement becoming part of the set of primary financial statements.
  - Also, the upcoming Materiality Practice Statement would guide the preparers with the application of materiality.

Sections to be addressed in DP

- **What the "set of Statements"**
  - Question is on which individual statements make up a set of primary financial statements?
  - IASB recommends to describe financial statements excluding the notes as primary financial statements with explanations of what they mean.

THANK YOU