

TRAINING & CONSULTANCY

International Financial Reporting Standards (IFRS) and 2026 Updates

DATE

July, 2026

TRAINER

Dr. Eman Attia

Day 1

Presentation of financial statements (IAS1)

Overview

- Objective of financial statements
- Components of financial statements
- General features
- Frequency of reporting
- Identification of the financial statements
- The statement of financial position
- The statement of comprehensive income
- The statement of changes in equity
- The notes to the financial statements

Objective of financial statements

According to IAS1, the objective of general purpose financial statements is *"to 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"*.

This information is presented in four primary financial statements together with a set of accompanying notes.

Components of financial statements

- Statement of financial position
- Statement of profit or loss and other comprehensive income
- Statement of changes in equity
- Statement of cash flows (IAS7)
- Notes

For the sake of brevity, the statement of profit or loss and other comprehensive income may be referred to as the "statement of comprehensive income"

General features

- Fair presentation
- Compliance with international standards
- Going concern basis
- Accruals basis
- Materiality and aggregation
- Offsetting
- Frequency of reporting
- Comparative information
- Consistency of presentation

Fair presentation and compliance with international standards

Financial statements must present fairly the financial position, financial performance and cash flows of the entity to which they relate.

It is assumed that the application of international standards will result in a fair presentation.

An entity which complies with international standards must make an explicit and unreserved statement to that effect in the notes.

Going concern and accruals basis

Financial statements are generally prepared on the going concern basis unless the entity intends to cease trading or has no realistic alternative but to do so.

Financial statements other than the statement of cash flows should be prepared on the accruals basis.

Materiality and aggregation

Items are "material" if they could influence the economic decisions made by users on the basis of the financial statements.

If an item is not individually material it may be aggregated with other items.

Each material class of similar items should be presented separately in the financial statements.

The requirements of international standards need not be applied to items that are immaterial.

Offsetting

In general, assets and liabilities should be reported separately in the statement of financial position and should not be offset against one another.

Similarly, income and expenses should be reported separately in the statement of comprehensive income.

However, this rule does not apply if offsetting is permitted or required by an international standard.

Frequency of reporting

Financial statements should normally be presented at least annually. An entity which presents financial statements for a period which is longer or shorter than one year should disclose:

- (a) the reason for using a period that is longer or shorter than one year;
- (b) the fact that the comparative amounts given for the previous period are not directly comparable with those given for the current period.

Comparative information and consistency of presentation

As a minimum, entities should present comparative information in respect of the previous period for all amounts reported in the financial statements.

To maintain comparability, the way in which items are presented and classified should generally be consistent from one accounting period to the next.

Identification of the financial statements

- Name of the reporting entity
- Whether a single entity or a group
- Date at the end of the reporting period or the period covered
- Presentation currency used
- Level of rounding (e.g. £000 or £m)

Statement of financial position

- formerly referred to in the standards as the "balance sheet"
- the current/non-current distinction
- information that must be presented in the statement of financial position
- information that may be presented in the statement of financial position or in the notes

Current and non-current assets

An asset is a current asset if it satisfies **any** of the following criteria:

- (a) it is expected to be realised within the entity's normal operating cycle;
- (b) it is held for the purpose of being traded;
- (c) it is expected to be realised within 12 months after the reporting period;
- (d) it is cash or a cash equivalent as defined by IAS7.

All other assets are non-current assets.

Current/non-current liabilities

A liability is a current liability if it satisfies **any** of the following criteria:

- (a) it is expected to be settled within the entity's normal operating cycle;
- (b) it is held for the purpose of being traded;
- (c) it is due to be settled within 12 months after the reporting period;
- (d) the entity does not have the right to defer settlement for at least 12 months after the reporting period.

All other liabilities are non-current liabilities.

Information to be presented in the statement of financial position

- property, plant and equipment
- investment property
- intangible assets
- financial assets
- inventories
- trade receivables
- cash and cash equivalents
- trade payables
- provisions
- financial liabilities
- tax assets and liabilities
- equity capital and reserves

To be presented in the statement of financial position or in the notes

- Sub-classification of line items as appropriate to the entity's operations and/or as required by other international standards.
(e.g. analysis of property, plant and equipment as required by IAS16)
- Analysis of share capital and reserves.

Statement of comprehensive income

All items of income and expense recognised in an accounting period must be presented in either:

- (a) a single statement of comprehensive income, or
- (b) two separate statements, comprising:
 - (i) a statement showing the components of profit or loss, and
 - (ii) a second statement beginning with the profit or loss for the period and showing the entity's "other comprehensive income".

Information to be presented in the statement of comprehensive income

- revenue
- finance costs
- tax expense
- profit or loss from discontinued operations
- profit or loss for the period
- each class of other comprehensive income
- total comprehensive income for the period.

The first five items on this list may be presented in a separate statement of profit or loss.

To be presented in the statement of comprehensive income or in the notes

- further items of income and expense should be disclosed separately, if material
- an analysis of expenses should be presented using a classification based on either:
 - the nature of the expenses, or
 - the function of the expenses within the entity (e.g. cost of sales, distribution costs, administrative expenses).

Entities are encouraged to present the analysis of expenses in the statement of comprehensive income, but may present it in the notes instead.

Statement of changes in equity

- shows how each component of equity has changed during an accounting period
- items presented include:
 - total comprehensive income for the period;
 - effects of any changes in accounting policies;
 - share issues; and
 - dividends paid.
- provides a reconciliation of the opening and closing balance on each component of equity

Notes to the financial statements

- measurement bases and other accounting policies
- further information required by international standards
- additional information relevant to an understanding of the financial statements

Cross-referenced to the statement of financial position, the statement of comprehensive income, the statement of cash flows and the statement of changes in equity.

Day 2

International Financial Reporting

Alan Melville (7th edition)

INTERNATIONAL FINANCIAL REPORTING

A PRACTICAL GUIDE

Seventh edition



Chapter 5

Property, plant and equipment and some other standards (IAS16, IAS23, IAS20, IAS40)

Overview

- Property, plant and equipment (IAS16):
 - definition
 - recognition
 - initial measurement
 - subsequent measurement
 - depreciation
 - disclosure requirements
- Borrowing costs (IAS23)
- Government grants (IAS20)
- Investment property (IAS40)

Definition of property, plant and equipment

IAS16 defines property, plant and equipment as *"tangible items that:*

- (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and*
- (b) are expected to be used during more than one period."*

This definition covers the majority of the tangible non-current assets that might normally be held by a business entity.

Recognition of property, plant and equipment

An item of property, plant and equipment should be recognised as an asset if and only if:

- (a) it is probable that future economic benefits associated with the item will flow to the entity concerned, and
- (b) the cost of the item can be measured reliably.

Routine servicing, repair and maintenance costs are not capital expenditure. But the cost of major replacements should be treated as capital expenditure and recognised as an addition to the carrying amount of the asset concerned.

Initial measurement of property, plant and equipment

On initial recognition, property, plant and equipment should be measured at cost. Cost includes:

- purchase price, including import duties and non-refundable purchase taxes, less trade discounts
- costs that are directly attributable to bringing the item to the location and condition necessary for it to be operated as intended
- the estimated costs of dismantling and removing the item and restoring the site on which the item is located, as long as the obligation to meet these costs is incurred when the item is acquired

Subsequent measurement of property, plant and equipment

After initial recognition, items of property, plant and equipment may be measured using either:

- **The cost model;** items are carried at cost less any accumulated depreciation and less any accumulated impairment losses.
- **The revaluation model;** items are carried at fair value at the date of revaluation, less any subsequent accumulated depreciation and less any subsequent accumulated impairment losses.

If the revaluation model is used it must be applied to entire classes of property, plant and equipment.

Revaluation gains and losses

In general, revaluation gains and losses are accounted for as follows:

- revaluation gains are credited to a revaluation reserve and recognised as other comprehensive income
- revaluation losses are recognised as an expense in the calculation of profit or loss

The situation is more complex if an item is revalued upwards after a previous downwards revaluation (or vice versa).

Depreciation

IAS16 defines depreciation as *"the systematic allocation of the depreciable amount of an asset over its useful life"*.

Depreciable amount is *"the cost of an asset, or other amount substituted for cost, less its residual value"*.

Residual value is *"the estimated amount that an entity would ... obtain from disposal of the asset, after deducting the estimated costs of disposal..."*.

Useful life is *"the period over which an asset is expected to be available for use by an entity ..."*.

Example to compute depreciation by straight line method

- Equipment: acquired Jan. 1, 2020
- Cost = \$52,000
- Residual or salvage value= 7,000
- Life = 5 years

Depreciable amount = $52,000 - 7,000 = 45,000$

Annual depreciation expense = $45,000 / 5 = 9,000$

Depreciation expense	9,000
Accumulated depreciation	9,000

Income statement

Depreciation expense	9,000
----------------------	-------

Statement of financial position (balance sheet)

Noncurrent assets:

Property, plant and equipment	52,000
Less: Accumulated depreciation	<u>9,000</u>
	43,000

Purpose of depreciation

The sole purpose of charging depreciation is to allocate an expense between accounting periods. In particular:

- The depreciation process makes no attempt to show assets at their current values.
- Charging depreciation does not guarantee that there will be funds available to replace assets when they come to the end of their useful lives.

Review of residual values and useful lives

The residual value and useful life of property, plant and equipment should be reviewed at least at the end of each financial year.

If expectations differ from previous estimates, these should be accounted for as a change in an accounting estimate in accordance with IAS8.

The asset's depreciable amount is revised to reflect any change in residual value and then this amount is allocated as depreciation over the remainder of the asset's expected useful life.

Depreciation methods

The depreciation method chosen in relation to an item of property, plant and equipment should match the usage pattern of that item.

Available depreciation methods include:

- the straight-line method;
- the diminishing balance method;
- the units of production method.

Review of depreciation methods

The depreciation method applied to an item of property, plant and equipment should be reviewed at least at the end of each financial year. If the usage pattern of the asset has changed, the depreciation method should be changed accordingly.

A change in depreciation method is accounted for as a change in an accounting estimate in accordance with the requirements of IAS8.

Main disclosure requirements of IAS16

For each class of property, plant and equipment:

- the measurement bases used;
- the depreciation methods used;
- the gross carrying amount and accumulated depreciation at the beginning and end of the accounting period;
- a reconciliation of the carrying amount at the beginning and end of the period, showing additions, disposals, revaluation increases and decreases, depreciation, impairment losses and any other movements.

Borrowing costs

IAS23 defines borrowing costs as *"interest and other costs that an entity incurs in connection with the borrowing of funds"*.

Borrowing costs that are directly attributable to the acquisition, construction or production of a "qualifying asset" must be capitalised as part of the cost of that asset.

Other borrowing costs are recognised as an expense in the period in which they are incurred.

The company started establishing new building on Jan. 1, 2019.

The company borrow 8% loan from Ahly bank \$500,000 on Jan. 1, 2019.

On Dec. 31, 2020, had completed the building, and the following are the costs of the building:

The cost of material \$250,000

The cost of labor \$300,000

The other costs \$150,000

Compute the cost of the building and prepare the journal entry.

Cost of the building = $250,000 + 300,000 + 150,000 + \text{interest } 80,000 = 780,000$

The interest = $\text{Loan} * \text{period} * \text{rate} = 500,000 * 2 \text{ years} * 8\% = 80,000$

The journal entry:

Building	780,000	
Cash		780,000

Qualifying assets

Qualifying assets are those which take a substantial period of time to get ready for use or sale.

The capitalisation of borrowing costs should begin when:

- (a) expenditure is being incurred on the asset;
- (b) borrowing costs are being incurred, and
- (c) activities are in progress that are necessary so as to prepare the asset for its intended use or sale.

Capitalisation ends when substantially all of the activities necessary to prepare the asset for its intended use or sale are complete.

Government grants (IAS20)

- Government grants should be recognised in profit or loss *"over the periods in which the entity recognises as expenses the related costs which the grants are intended to compensate"*.
- Therefore a grant for the acquisition of an asset should be recognised when calculating profit or loss for the periods in which depreciation is charged on that asset.
 - The grant may be credited to a deferred income account and then systematically transferred to the statement of comprehensive income over the useful life of the asset, or
 - The grant may be deducted from the carrying amount of the asset. This will result in reduced depreciation charges over the asset's useful life.

Example: On Jan. 1, 2020, The company received equipment as government grant, the fair value is \$800,000, the useful life is estimated 4 years.

Prepare the required entries and the balance sheet and income statement on Jan. 1, 2020, and Dec. 31, 2020,

Jan. 1, 2020: The journal entry:

Equipment	800,000	
Deferred government grant revenue		800,000

The balance sheet: Jan. 1, 2020

Assets:

Noncurrent assets:

Equipment 800,000

Liabilities:

Deferred government grant revenue 800,000

On Dec. 31, 2020

The depreciation expense = $800,000 / 4 \text{ years} = 200,000$, the journal entry:

Depreciation expense	200,000	
Accumulated depreciation		200,000

The revenue per the year = $800,000 / 4 \text{ years} = 200,000$ (income statement) the entry:

Deferred government grant revenue	200,000	
Government grant revenue		200,000

The income statement: Dec. 31, 2020

Operating expenses: depreciation expense 200,000

Other revenue:

Government grant revenue 200,000

The balance sheet: Dec. 31, 2020

Assets:

Noncurrent assets:

Equipment 800,000

Less: accumulated depreciation 200,000

600,000

Liabilities:

Deferred government grant revenue 600,000

Investment property (IAS40)

Investment property is property (land and buildings) which is *"held ... to earn rentals or for capital appreciation or both, rather than:*

- (a) for use in the production or supply of goods or services;*
- (b) for administrative purposes, or*
- (c) for sale in the ordinary course of business".*

Measurement of investment property

Initial measurement is at cost. Subsequently, investment property may be measured using either:

- **The fair value model;** the property is carried at fair value; gains and losses on adjusting fair value are recognised in the calculation of profit or loss.
- **The cost model;** the property is carried at cost less any accumulated depreciation and less any accumulated impairment losses.

Day 3



IAS 2

Inventories: Additional Valuation Issues

LOWER-OF-COST-OR-NET REALIZABLE VALUE (LCNRV)

- ❑ A company abandons the historical cost principle when the future utility (revenue-producing ability) of the asset drops below its original cost.
- ❑ Whatever the reason for a decline—obsolescence, price-level changes, or damaged goods—a company should write down the inventory to net realizable value to report this loss.
- ❑ Net realizable value (NRV) refers to the net amount that a company expects to realize from the sale of inventory.

Net Realizable Value

Estimated selling price in the normal course of business less

- ◆ estimated costs to complete and
- ◆ estimated costs to make a sale.

ILLUSTRATION 9-1
Computation of Net
Realizable Value

Inventory value—unfinished		€1,000
Less: Estimated cost of completion	€ 50	
Estimated cost to sell	<u>200</u>	<u>250</u>
Net realizable value		<u><u>€ 750</u></u>

LCNRV

ILLUSTRATION 9-3 Determining Final Inventory Value

Illustration of LCNRV: Jinn-Feng Foods computes its inventory at LCNRV (amounts in thousands).

Food	Cost	Net Realizable Value	Final Inventory Value
Spinach	¥ 80,000	¥120,000	¥ 80,000
Carrots	100,000	110,000	100,000
Cut beans	50,000	40,000	40,000
Peas	90,000	72,000	72,000
Mixed vegetables	95,000	92,000	92,000
			<u>¥384,000</u>

Final Inventory Value:

Spinach	Cost (¥80,000) is selected because it is lower than net realizable value.
Carrots	Cost (¥100,000) is selected because it is lower than net realizable value.
Cut beans	Net realizable value (¥40,000) is selected because it is lower than cost.
Peas	Net realizable value (¥72,000) is selected because it is lower than cost.
Mixed vegetables	Net realizable value (¥92,000) is selected because it is lower than cost.

LCNRV

Methods of Applying LCNRV

ILLUSTRATION 9-4
Alternative Applications
of LCNRV

			LCNRV by:		
	<u>Cost</u>	<u>LCNRV</u>	<u>Individual Items</u>	<u>Major Groups</u>	<u>Total Inventory</u>
Frozen					
Spinach	¥ 80,000	¥120,000			
Carrots	100,000	110,000			
Cut beans	50,000	40,000			
Total frozen	230,000	270,000			
Canned					
Peas	90,000	72,000			
Mixed vegetables	95,000	92,000			
Total canned	185,000	164,000			
Total	¥415,000	¥434,000			

LCNRV

Methods of Applying LCNRV

- ◆ In most situations, companies price inventory on an item-by-item basis.
- ◆ Tax rules in some countries require that companies use an individual-item basis.
- ◆ Individual-item approach gives the lowest valuation for statement of financial position purposes.
- ◆ Method should be applied consistently from one period to another.

Recording Net Realizable Value

Illustration: Data for Ricardo Company

Cost of goods sold (before adj. to NRV)	€108,000
Ending inventory (cost)	82,000
Ending inventory (at NRV)	70,000

Loss Method

Loss Due to Decline to NRV	12,000	
Inventory (€82,000 - €70,000)		12,000

COGS Method

Cost of Goods Sold	12,000	
Inventory		12,000

Recording Net Realizable Value

Partial Statement of Financial Position

	Loss Method	COGS Method
Current assets:		
Inventory	€ 70,000	€ 70,000
Prepays	20,000	20,000
Accounts receivable	350,000	350,000
Cash	100,000	100,000
Total current assets	540,000	540,000

Recording Net Realizable Value

Income Statement	Loss Method	COGS Method
Sales	€ 200,000	€ 200,000
Cost of goods sold	108,000	120,000
Gross profit	92,000	80,000
Operating expenses:		
Selling	45,000	45,000
General and administrative	20,000	20,000
Total operating expenses	65,000	65,000
Other income and expense:		
Loss due to decline of inventory to NRV	12,000	-
Interest income	5,000	5,000
Total other	(7,000)	5,000
Income from operations	20,000	20,000
Income tax expense	6,000	6,000
Net income	€ 14,000	€ 14,000

Use of an Allowance

Instead of crediting the Inventory account for net realizable value adjustments, companies generally use an allowance account.

Loss Method

Loss Due to Decline to NRV	12,000	
Allowance to Reduce Inventory to NRV		12,000

Use of an Allowance

Partial Statement of Financial Position

	No Allowance	Allowance
Current assets:		
Inventory	€ 70,000	€ 82,000
Allowance to reduce inventory		(12,000)
Inventory at NRV		70,000
Prepays	20,000	20,000
Accounts receivable	350,000	350,000
Cash	100,000	100,000
Total current assets	540,000	540,000

Recovery of Inventory Loss

- ◆ Amount of write-down is reversed.
- ◆ Reversal limited to amount of original write-down.

Continuing the Ricardo example, assume the net realizable value increases to €74,000 (an increase of €4,000). Ricardo makes the following entry, using the loss method.

Allowance to Reduce Inventory to NRV	4,000	
Recovery of Inventory Loss		4,000

Recovery of Inventory Loss

Allowance account is adjusted in subsequent periods, such that inventory is reported at the LCNRV.

Illustration shows net realizable value evaluation for Vuko Company and the effect of net realizable value adjustments on income.

<u>Date</u>	<u>Inventory at Cost</u>	<u>Inventory at Net Realizable Value</u>	<u>Amount Required in Allowance Account</u>	<u>Adjustment of Allowance Account Balance</u>	<u>Effect on Net Income</u>
Dec. 31, 2015	₱188,000	₱176,000	₱12,000	₱12,000 inc.	Decrease
Dec. 31, 2016	194,000	187,000	7,000	5,000 dec.	Increase
Dec. 31, 2017	173,000	174,000	0	7,000 dec.	Increase
Dec. 31, 2018	182,000	180,000	2,000	2,000 inc.	Decrease

ILLUSTRATION 9-8

Effect on Net Income of Adjusting
Inventory to Net Realizable Value

Evaluation of LCM Rule

LCNRV rule suffers some conceptual deficiencies:

1. A company recognizes decreases in the value of the asset and the charge to expense in the period in which the loss in utility occurs—not in the period of sale.
2. Application of the rule results in inconsistency because a company may value the inventory at cost in one year and at net realizable value in the next year.
3. LCNRV values the inventory in the statement of financial position conservatively, but its effect on the income statement may or may not be conservative. Net income for the year in which a company takes the loss is definitely lower. Net income of the subsequent period may be higher than normal if the expected reductions in sales price do not materialize.

LCNRV

P9-1: Remmers Company manufactures desks. Most of the company's desks are standard models and are sold on the basis of catalog prices. At December 31, 2015, the following finished desks appear in the company's inventory.

Finished Desks	A	B	C	D
Catalog selling price	€ 500	€ 540	€ 900	€ 1,200
FIFO cost per inventory list 12/31/15	470	450	830	960
Estimated cost to complete and sell	50	110	260	200

Instructions: At what amount should the desks appear in the company's December 31, 2015, inventory, assuming that the company has adopted a lower-of-FIFO-cost-or-net realizable value approach for valuation of inventories on an individual-item basis?

LCNRV

P9-1: Remmers Company manufactures desks. Most of the company's desks are standard models and are sold on the basis of catalog prices. At December 31, 2015, the following finished desks appear in the company's inventory.

Finished Desks	A	B	C	D
Catalog selling price	€ 500	€ 540	€ 900	€ 1,200
FIFO cost per inventory list 12/31/15	470	450	830	960
Estimated cost to complete and sell	50	110	260	200
Net realizable value				
Lower-of-cost-or-NRV				

VALUATION BASES

Purchase Commitments—A Special Problem

- ◆ Generally seller retains title to the merchandise.
- ◆ Buyer recognizes no asset or liability.
- ◆ If material, the buyer should disclose contract details in note in the financial statements.
- ◆ If the contract price is **greater than the market price**, and the **buyer expects that losses will occur** when the purchase is effected, the buyer should recognize a liability and corresponding loss in the period during which such declines in market prices take place.

Purchase Commitments

Illustration: Apres Paper Co. signed timber-cutting contracts to be executed in 2016 at a price of €10,000,000. Assume further that the market price of the timber cutting rights on December 31, 2015, dropped to €7,000,000. Apres would make the following entry on December 31, 2015.

Unrealized Holding Gain or Loss—Income	3,000,000	
Purchase Commitment Liability		3,000,000

Other expenses and losses in the Income statement.

Current liabilities on the balance sheet.

Purchase Commitments

Illustration: When Apres cuts the timber at a cost of €10 million, it would make the following entry.

Purchases (Inventory)	7,000,000	
Purchase Commitment Liability	3,000,000	
Cash		10,000,000

Assume Apres is permitted to reduce its contract price and therefore its commitment by €1,000,000.

Purchase Commitment Liability	1,000,000	
Unrealized Holding Gain or Loss—Income		1,000,000

PRESENTATION AND ANALYSIS

Presentation of Inventories

Accounting standards require disclosure of:

- 1) Accounting policies adopted in measuring inventories, including the cost formula used (weighted-average, FIFO).
- 2) Total carrying amount of inventories and the carrying amount in classifications (merchandise, production supplies, raw materials, work in progress, and finished goods).
- 3) Carrying amount of inventories carried at fair value less costs to sell.
- 4) Amount of inventories recognized as an expense during the period.

PRESENTATION AND ANALYSIS

Presentation of Inventories

Accounting standards require disclosure of:

- 5) Amount of any write-down of inventories recognized as an expense in the period and the amount of any reversal of write-downs recognized as a reduction of expense in the period.
- 6) Circumstances or events that led to the reversal of a write-down of inventories.
- 7) Carrying amount of inventories pledged as security for liabilities, if any.

Day 4

Fundamentals of Revenue Recognition

LEARNING OBJECTIVE 1

Understand the fundamental concepts related to revenue recognition and measurement.

Background

Both the IASB and the FASB have indicated that the state of reporting for revenue was unsatisfactory.

Recently, the IASB issued a converged standard on revenue recognition entitled *Revenue from Contracts with Customers*.

Revenue Recognition

New Revenue Recognition Standard

Revenue from Contracts with Customers, adopts an asset-liability approach.

- ◆ Companies account for revenue based on the asset or liability arising from contracts with customers.
- ◆ Companies analyze contracts with customers because contracts initiate revenue transactions.
 - ▶ Contracts indicate terms of the transaction,
 - ▶ provide the measurement of the consideration, and
 - ▶ specify the promises that must be met.

New Revenue Recognition Standard

ILLUSTRATION 18.1 Key Concepts of Revenue Recognition

KEY OBJECTIVE

Recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration that the company receives, or expects to receive, in exchange for these goods or services.

FIVE-STEP PROCESS FOR REVENUE RECOGNITION

1. Identify the contract with customers.
2. Identify the separate performance obligations in the contract.
3. Determine the transaction price.
4. Allocate the transaction price to the separate performance obligations.
5. Recognize revenue when each performance obligation is satisfied.

REVENUE RECOGNITION PRINCIPLE

Recognize revenue in the accounting period when the performance obligation is satisfied.



Performance Obligation is Satisfied

Overview of the Five-Step Process

Assume that **Airbus** (FRA) Corporation signs a contract to sell airplanes to **Cathay Pacific Airlines** (HKG) for €100 million.

ILLUSTRATION 18.2
Five Steps of Revenue Recognition

Step 1: Identify the contract with customers.

A contract is an agreement between two parties that creates enforceable rights or obligations. In this case, Airbus has signed a contract to deliver airplanes to Cathay Pacific.

Step 2: Identify the separate performance obligations in the contract.

Airbus has only one performance obligation—to deliver airplanes to Cathay Pacific. If Airbus also agreed to maintain the planes, a separate performance obligation is recorded for this promise.

Overview of the Five-Step Process

ILLUSTRATION 18.2 Five Steps of Revenue Recognition

Step 3: Determine the transaction price.

Transaction price is the amount of consideration that a company expects to receive from a customer in exchange for transferring a good or service. In this case, the transaction price is straightforward—it is €100 million.

Step 4: Allocate the transaction price to the separate performance obligations.

In this case, Airbus has only one performance obligation—to deliver airplanes to Cathay Pacific.

Revenue Recognition Over Time

Long-term contracts frequently provide that seller (builder) may bill purchaser at intervals.

▶ Examples:

- Development of military and commercial aircraft
- Weapons-delivery systems
- Space exploration hardware

Revenue Recognition Over Time

A company satisfies a performance obligation and recognizes revenue over time if at least one of the following three criteria is met:

1. Customer simultaneously receives and consumes the benefits of the seller's performance as the seller performs.
2. Company's performance creates or enhances an asset (for example, work in process) that the customer controls as the asset is created or enhanced; or
3. Company's performance does not create an asset with an alternative use. In addition to this alternative use element, at least one of the following criteria must be met:

Revenue Recognition Over Time

In addition to this alternative use element, at least one of the following criteria must be met:

- a. Another company would not need to substantially re-perform the work the company has completed to date if that other company were to fulfill the remaining obligation to the customer.
- b. The company has a right to payment for its performance completed to date, and it expects to fulfill the contract as promised.

Revenue Recognition Over Time

If criterion 1, 2 or 3 is met, then a company recognizes revenue over time if it can reasonably estimate its progress toward satisfaction of the performance obligations.

- ◆ Company recognizes revenues and gross profits each period based upon the progress of the construction—referred to as the **percentage-of-completion method**.
- ◆ If criteria are not met, the company recognizes revenues and gross profit when the contract is completed, referred to as the **cost-recovery (zero-profit) method**.

Revenue Recognition Over Time

Percentage-of-Completion Method

Measuring the Progress Toward Completion

Most popular input measure used to determine the progress toward completion is the **cost-to-cost basis**.

Percentage-of-Completion Method

Revenue to be Recognized on Cost-to-Cost Basis

ILLUSTRATION 18A.1

$$\frac{\text{Costs Incurred to Date}}{\text{Most Recent Estimate of Total Costs}} = \text{Percent Complete}$$

ILLUSTRATION 18A.2

$$\text{Percent Complete} \times \text{Estimated Total Revenue (or Gross Profit)} = \text{Revenue (or Gross Profit) to Be Recognized to Date}$$

$$\text{Revenue (or Gross Profit) to Be Recognized to Date} - \text{Revenue (or Gross Profit) Recognized in Prior Periods} = \text{Current-Period Revenue (or Gross Profit)}$$

ILLUSTRATION 18A.3

Percentage-of-Completion Method

Illustration: Hardhat Construction Company has a contract to construct a £4,500,000 bridge at an estimated cost of £4,000,000. The contract is to start in July 2019, and the bridge is to be completed in October 2021. The following data pertain to the construction period.

	2019	2020	2021
Costs to date	£1,000,000	£2,916,000	£4,050,000
Estimated costs to complete	3,000,000	1,134,000	—
Progress billings during the year	900,000	2,400,000	1,200,000
Cash collected during the year	750,000	1,750,000	2,000,000

Percentage-of-Completion Method

	<u>2019</u>	<u>2020</u>	<u>2021</u>
Costs to date	£1,000,000	£2,916,000	£4,050,000
Estimated costs to complete	3,000,000	1,134,000	—
Progress billings during the year	900,000	2,400,000	1,200,000
Cash collected during the year	750,000	1,750,000	2,000,000

	<u>2019</u>	<u>2020</u>	<u>2021</u>
Contract price	£4,500,000	£4,500,000	£4,500,000
Less estimated cost:			
Costs to date	1,000,000		
Estimated costs to complete	3,000,000		
Estimated total costs	4,000,000		
Estimated total gross profit	£ 500,000		

Percent complete

$$25\%$$

$$\left(\frac{£1,000,000}{£4,000,000} \right)$$

ILLUSTRATION 18A.4

Application of Percentage-of-Completion Method, Cost-to-Cost Basis

Percentage-of-Completion Method

	2019	2020	2021
Costs to date	£1,000,000	£2,916,000	£4,050,000
Estimated costs to complete	3,000,000	1,134,000	—
Progress billings during the year	900,000	2,400,000	1,200,000
Cash collected during the year	750,000	1,750,000	2,000,000

ILLUSTRATION 18A.5

To record costs of construction:

	2019	2020	2021
Construction in Process	1,000,000		
Materials, Cash, Payables, etc.		1,000,000	

To record progress billings:

Accounts Receivable	900,000		
Billings on Construction in Process		900,000	

To record collections:

Cash	750,000		
Accounts Receivable		750,000	

Percentage-of-Completion Method

Illustration: Percentage-of-Completion Revenue, Costs, and Gross Profit by Year

ILLUSTRATION 18A.6

	<u>To Date</u>	<u>Recognized in Prior Years</u>	<u>Recognized in Current Year</u>
<u>2019</u>			
Revenues (£4,500,000 × 25%)	£1,125,000		£1,125,000
Costs	<u>1,000,000</u>		<u>1,000,000</u>
Gross profit	<u>£ 125,000</u>		<u>£ 125,000</u>
<u>2020</u>			
Revenues (£4,500,000 × 72%)	£3,240,000	£1,125,000	£2,115,000
Costs	<u>2,916,000</u>	<u>1,000,000</u>	<u>1,916,000</u>
Gross profit	<u>£ 324,000</u>	<u>£ 125,000</u>	<u>£ 199,000</u>
<u>2021</u>			
Revenues (£4,500,000 × 100%)	£4,500,000	£3,240,000	£1,260,000
Costs	<u>4,050,000</u>	<u>2,916,000</u>	<u>1,134,000</u>
Gross profit	<u>£ 450,000</u>	<u>£ 324,000</u>	<u>£ 126,000</u>

Percentage-of-Completion Method

ILLUSTRATION 18A.6

	To Date	Recognized in Prior Years	Recognized in Current Year
2019			
Revenues ($\pounds 4,500,000 \times 25\%$)	<u>£1,125,000</u>		<u>£1,125,000</u>
Costs	<u>1,000,000</u>		<u>1,000,000</u>
Gross profit	<u>£ 125,000</u>		<u>£ 125,000</u>
2020			
Revenues ($\pounds 4,500,000 \times 72\%$)	<u>£3,240,000</u>	<u>£1,125,000</u>	<u>£2,115,000</u>
Costs	<u>2,916,000</u>	<u>1,000,000</u>	<u>1,916,000</u>
Gross profit	<u>£ 324,000</u>	<u>£ 125,000</u>	<u>£ 199,000</u>
2021			
Revenues ($\pounds 4,500,000 \times 100\%$)	<u>£4,500,000</u>	<u>£3,240,000</u>	<u>£1,260,000</u>
Costs	<u>4,050,000</u>	<u>2,916,000</u>	<u>1,134,000</u>
Gross profit	<u>£ 450,000</u>	<u>£ 324,000</u>	<u>£ 126,000</u>

ILLUSTRATION 18A.7

To recognize revenue and gross profit:

	2019	2020	2021
Construction in Process (gross profit)	125,000		
Construction Expenses	1,000,000		
Revenue from Long-Term Contracts			
			1,125,000

To record completion of the contract:

Billings on Construction in Process			
Construction in Process			

Percentage-of-Completion Method

Illustration: Content of Construction in Process Account— Percentage-of-Completion Method

ILLUSTRATION 18A.8

Construction in Process			
2019 construction costs	£1,000,000	12/31/21	to close
2019 recognized gross profit	125,000		completed
2020 construction costs	1,916,000		project
2020 recognized gross profit	199,000		£4,500,000
2021 construction costs	1,134,000		
2021 recognized gross profit	126,000		
Total	<u>£4,500,000</u>	Total	<u>£4,500,000</u>

Percentage-of-Completion Method

Financial Statement Presentation—Percentage-of-Completion

Computation of Unbilled Contract Price at 12/31/19

Contract revenue recognized to date: £4,500,000	$\times \frac{£1,000,000}{£4,000,000}$	£1,125,000
Billings to date		<u>(900,000)</u>
Unbilled revenue		<u><u>£ 225,000</u></u>

ILLUSTRATION 18A.9

Percentage-of-Completion Method

Financial Statement Presentation—Percentage-of-Completion (2019)

ILLUSTRATION 18A.10

HARDHAT CONSTRUCTION

Income Statement (from Illustration 18A.6)

	2019
Revenue from long-term contracts	£1,125,000
Costs of construction	1,000,000
Gross profit	<u>£ 125,000</u>

Statement of Financial Position (12/31)

	2019
Current assets	
Inventory	
Construction in process	£1,125,000
Less: Billings	<u>900,000</u>
Costs and recognized profit in excess of billings	£225,000
Accounts receivable (£900,000 – £750,000)	150,000

Percentage-of-Completion Method

Financial Statement Presentation—Percentage-of-Completion (2020)

ILLUSTRATION 18A.11

HARDHAT CONSTRUCTION

Income Statement (from Illustration 18A.6)

	2020
Revenue from long-term contracts	£2,115,000
Costs of construction	1,916,000
Gross profit	£ 199,000

Statement of Financial Position (12/31)

Current assets		
Accounts receivable ($£150,000 + £2,400,000 - £1,750,000$)		£ 800,000
Current liabilities		
Billings	£3,300,000	
Less: Construction in process	3,240,000	
Billings in excess of costs and recognized profit		60,000

Percentage-of-Completion Method

Financial Statement Presentation—Percentage-of-Completion (2021)

ILLUSTRATION 18A.12

HARDHAT CONSTRUCTION

Income Statement (from Illustration 18A.6)

2021

Revenue from long-term contracts

£1,260,000

Costs of construction

1,134,000

Gross profit

£ 126,000

Day 5

Leases (IFRS16)

Overview

- Definitions
- Lease accounting by lessees:
 - Right-of-use assets and lease liabilities
 - Initial measurement
 - Subsequent measurement
 - Presentation and disclosure
- Lease accounting by lessors:
 - Finance leases and operating leases
 - Accounting for finance leases
 - Accounting for operating leases
 - Disclosure requirements

Definitions

IFRS16 defines a lease as *"a contract ... that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration"*.

The inception date of a lease is *"the earlier of the date of a lease agreement and the date of commitment by the parties to the principal terms and conditions of the lease"*.

The commencement date of a lease is *"the date on which a lessor makes an underlying asset available for use by a lessee"*.

Lease accounting by lessees

At the commencement of a lease, the lessee should normally recognise a right-of-use asset and a corresponding lease liability.

A right-of-use asset is "*an asset that represents a lessee's right to use an underlying asset for the lease term*".

The requirement to recognise a right-of-use asset and a lease liability is not mandatory for short-term leases (12 months or less) or for leases of low-value assets.

Initial measurement of the lease liability and the right-of-use asset

The lease liability is measured initially at the present value of the lease payments which fall due after the commencement date of the lease.

The right-of-use asset is measured initially at cost. This is composed of the following elements:

- a) the amount of the initial lease liability
- b) any lease payments made at or before commencement
- c) any initial direct costs incurred by the lessee
- d) the estimated costs of restoring the underlying asset to the condition required at the end of the lease.

- **Lease of an equipment for 4 years and we will pay \$100,000 annually (interest rate 9%)**
- **Liability = present value of the 4 annual payments (depend on the interest rate)**
- **The PV for 1\$ for 4 years by interest rate 9% = 3.24,**
- **so the PV for the lease = $100,000 * 3.24 = 324,000$**

The journal entry to record the initial measurement of the lease liability:

Right of use asset	324,000	
Lease liability		324,000

Subsequent measurement of the right-of-use asset

In most cases, the right-of-use asset should be measured subsequently at cost, less accumulated depreciation and accumulated impairment losses.

If the lease transfers ownership of the underlying asset to the lessee by the end of the lease term, the right-of-use asset is depreciated up to the end of the useful life of the underlying asset.

Otherwise, the right-of-use asset is depreciated up to the *earlier* of the end of the lease term and the end of the useful life of the right-to-use asset.

Subsequent measurement of the lease liability

Each lease payment is apportioned between the interest (finance charge) element, which is recognised as an expense, and the amount which reduces the outstanding liability.

IFRS16 requires that interest on the lease liability should be calculated so as to produce "*a constant periodic rate of interest on the remaining balance of the lease liability*".

The interest rate applied should be the same as the discount rate which was used when measuring the lease liability initially.

Presentation and disclosure requirements for lessees

Presentation

- right-of-use assets and lease liabilities should be presented separately from other assets and liabilities (or the lessee should disclose the line items in which they are included)

Disclosure

- the depreciation charge for right-of-use assets
- the interest expense on lease liabilities
- the carrying amount of right-of-use assets at the end of the period, analysed by class of underlying asset
- maturity analysis of lease liabilities

Lease accounting by lessors

Lessors are required to classify each of their leases as either a finance lease or an operating lease.

A **finance lease** is *"a lease that transfers substantially all the risks and rewards incidental to ownership of an underlying asset"*.

An **operating lease** is *"a lease that does not transfer substantially all the risks and rewards incidental to ownership of an underlying asset"*.

Factors which indicate a finance lease

- the lease transfers ownership of the asset to the lessee by the end of the lease term
- the lessee has the option to purchase the asset at a price expected to be lower than fair value
- the lease term is for the major part of the economic life of the asset
- the present value of the lease payments amounts to (at least) substantially all of the fair value of the underlying asset
- the underlying asset is of such a specialised nature that only the lessee can use it

Lessor accounting for finance leases

- At the commencement of a finance lease, the lessor derecognises the underlying asset and recognises a receivable equal to the "net investment" in the lease.
- The net investment is initially measured at the present value of the lease payments receivable from the lessee after the commencement date, plus the present value of the residual value of the underlying asset for the lessor (if any) at the end of the lease term.
- Subsequently, the interest element of each lease payment made by the lessee is recognised as finance income and the remainder of each payment reduces the net investment in the lease.

Lessor accounting for operating leases

The lessor has retained the risks and rewards of ownership, so the underlying asset is shown as an asset in the lessor's financial statements and is depreciated as usual.

The lease payments made by the lessee are recognised as income, generally on a straight-line basis over the lease term.

Any direct costs incurred by the lessor on arranging an operating lease are added to the carrying amount of the underlying asset and written off over the lease term.

Disclosure requirements for lessors

Finance leases

- the amount of finance income for the reporting period
- a maturity analysis of lease payments receivable, showing undiscounted amounts to be received in each of the following five years and the total to be received in remaining years (reconciled to the net investment in finance leases)

Operating leases

- the amount of lease income for the reporting period
- a maturity analysis of lease payments receivable, showing undiscounted amounts to be received in each of the following five years and the total to be received in remaining years