

Lesson #3

Accounting Standards and Regulations

NATIONAL REGULATION

LAWS

INTERNATIONAL REGULATION

ACCOUNTING
PROFESSION/INSTITUTION

European
Union

United
States of
America

Private
standard
setter

Directives

Regulations

Overview

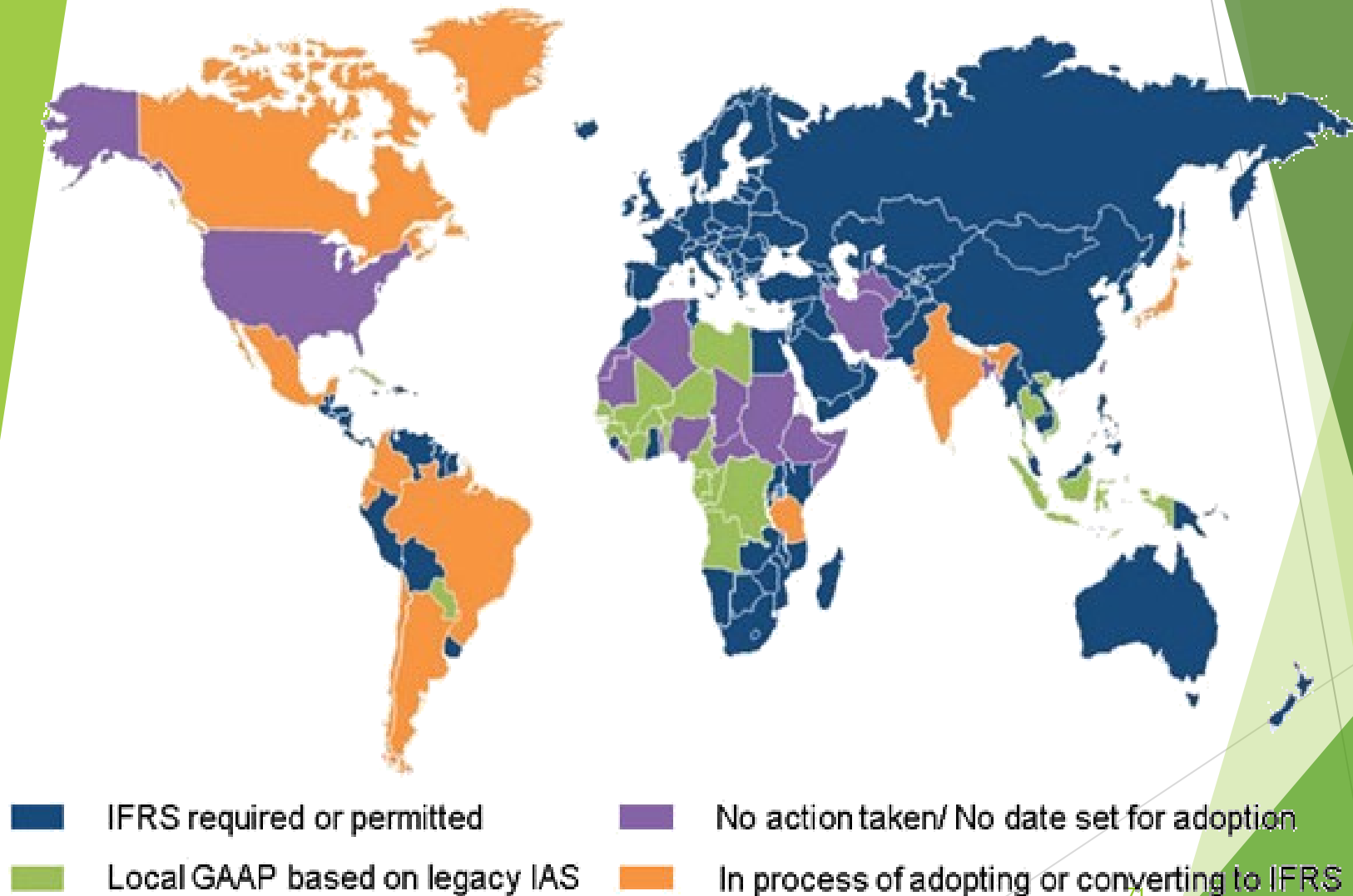
Università degli Studi di Trieste

70

D.E.A.M.S.
Paolo Altin

Status of implementation of IFRS

<https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/>



Source: www.pkf-ng.com

Status of implementation of IFRS

The 116 jurisdictions in **blue** require IFRS for all or most domestic publicly accountable entities (listed companies and financial institutions).

Jurisdictions that permit or require IFRS for at least some domestic publicly accountable entities are in **grey**.

Jurisdictions that do not require or permit IFRS for any domestic publicly accountable entities are in **white**.

Status of implementation of IFRS

Afghanistan	Denmark	Latvia	Rwanda
Albania	Dominica	Lesotho	Saint Lucia
Angola	Dominican Republic	Liechtenstein	Saudi Arabia
Anguilla	Ecuador	Lithuania	Serbia
Antigua and Barbuda	Egypt	Luxembourg	Sierra Leone
Argentina	El Salvador	Macao	Singapore
Armenia	Estonia	Macedonia	Slovakia
Australia	European Union	Madagascar	Slovenia
Austria	Fiji	Malaysia	South Africa
Azerbaijan	Finland	Maldives	Spain
Bahamas	France	Malta	Sri Lanka
Bahrain	Georgia	Mauritius	St Kitts and Nevis
Bangladesh	Germany	Mexico	St Vincent and the Grenadines
Barbados	Ghana	Moldova	Suriname
Belgium	Greece	Mongolia	Swaziland
Belarus	Grenada	Montserrat	Sweden
Belize	Guatemala	Myanmar	Switzerland
Bermuda	Guinea-Bissau	Nepal	Syria

Source: www.ifrs.org

Paolo Altin

Status of implementation of IFRS

Bhutan	Guyana	Netherlands	Taiwan
Bolivia	Honduras	New Zealand	Tanzania
Bosnia and Herzegovina	Hong Kong	Nicaragua	Thailand
Botswana	Hungary	Niger	Trinidad & Tobago
Brazil	Iceland	Nigeria	Turkey
Brunei Darussalam	India	Norway	Uganda
Bulgaria	Indonesia	Oman	Ukraine
Cambodia	Iraq	Pakistan	United Arab Emirates
Canada	Ireland	Palestine	United Kingdom
Cayman Islands	Israel	Panama	United States
Chile	Italy	Paraguay	Uruguay
China	Jamaica	Peru	Uzbekistan
Colombia	Japan	Philippines	Venezuela
Costa Rica	Jordan	Poland	Vietnam
Croatia	Kenya	Portugal	Yemen
Cyprus	Korea (South)	Romania	Zambia
Czech Republic	Kosovo	Russia	Zimbabwe

IFRS

- ▶ *No mandatory formats for the financial statements (only a minimum content, IAS 1).*
- ▶ *Fair value measurements (required or allowed).*
- ▶ *Financial derivatives are reported at fair value.*
- ▶ *Mandatory cash flow statement.*
- ▶ *Prevalence of substance over form.*
- ▶ *Little emphasis on prudence as one of the main characteristics of financial reporting.*
- ▶ *Leased assets are reported in lessee's financial statements, and depreciated (IAS 17).*
- ▶ *No amortization of goodwill and of other intangibles with an indefinite useful life.*

Governing Organizations

FASB

- Financial Accounting Standards Board
- A privately funded organization, formulates accounting standards.

SEC

- Securities and Exchange Commission
- U.S. governmental agency that oversees U.S. financial markets.

AICPA

- American Institute of Certified Public Accountants
- Private organization of public accountants

GAAP

- Generally Accepted Accounting Principles
- Main U.S. accounting rule book

IASB

- International Accounting Standards Board
- Publishes the International Financial Reporting Standards, the international accounting rule book

Accounting Principles

**Entity
Concept**

**Faithful
Representation
Principle**

**Cost
Principle**

**Going- Concern
Concept**

**Stable Monetary
Unit Concept**

Accounting Principles

Entity Concept

- A business is separate from its owners

Faithful Representation Principle

- Accounting information is complete, neutral, and free from material error

Cost Principle

- Assets are recorded at purchase price

Accounting Principles

Going-Concern

- Assumption that business will remain in operation for the foreseeable future

Stable Monetary Unit Concept

- In the U.S. amounts are recorded in dollars
- The dollar is considered a stable unit of measure

The Financial Statements

Business documents that report on a business in monetary terms.

The main purpose of financial statements is to help people to make business decisions.

The financial statements are:

- ▶ income statement,
- ▶ statement of retained earnings,
- ▶ balance sheet,
- ▶ statement of cash flows.

Each of them show a different view of the company's overall results.

The Financial Statements

Headings provide:

Name of the business, name of the financial statement, date or time period covered by the statement.

Examples:

«Year Ended December 31, 2015» [year]

«Month Ended September 30, 2015» [monthly statement]

«Quarter Ended June 30, 2015» [quarterly statement]

The Financial Statements

INCOME STATEMENT

Or **statement of earnings** or **statement of operations**.

A summary of a business entity's revenues and expenses for a period of time (a month, quarter, or year.)

Did the business make a profit? The income statement tells us whether the business enjoyed net income or suffered a net loss. Remember, **net income** means total revenues are greater than total expenses; **net loss** means total expenses are greater than total revenues.

The Financial Statements

STATEMENT OF RETAINED EARNINGS

The statement of retained earnings shows the changes in retained earnings for a business entity during a time period (a month, quarter, or year).

Retained earnings increase when the business has a net income (revenues exceed expenses). Retained earnings decrease when the business has a net loss (expenses exceed revenues), or declares dividends for the shareholders.

$$\begin{aligned} &\text{Beginning Retained Earnings} \\ &+ \text{Net Income (or - Net Loss)} \\ &- \text{Dividends} \\ &= \text{Ending Retained Earnings} \end{aligned}$$

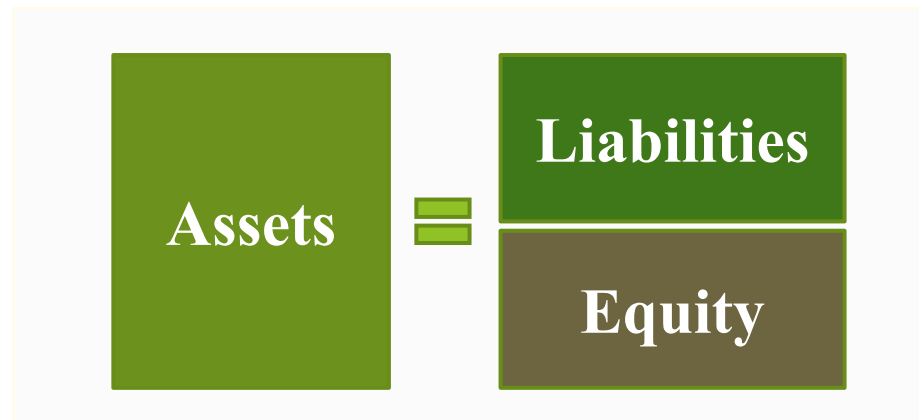
The Financial Statements

BALANCE SHEET

The balance sheet lists a business entity's assets, liabilities, and stockholders' equity as of a specific date, usually the end of a month, quarter, or year. The balance sheet is like a snapshot of the entity.

It is also called the statement of financial position.

The balance sheet mirrors the accounting equation.



The Financial Statements

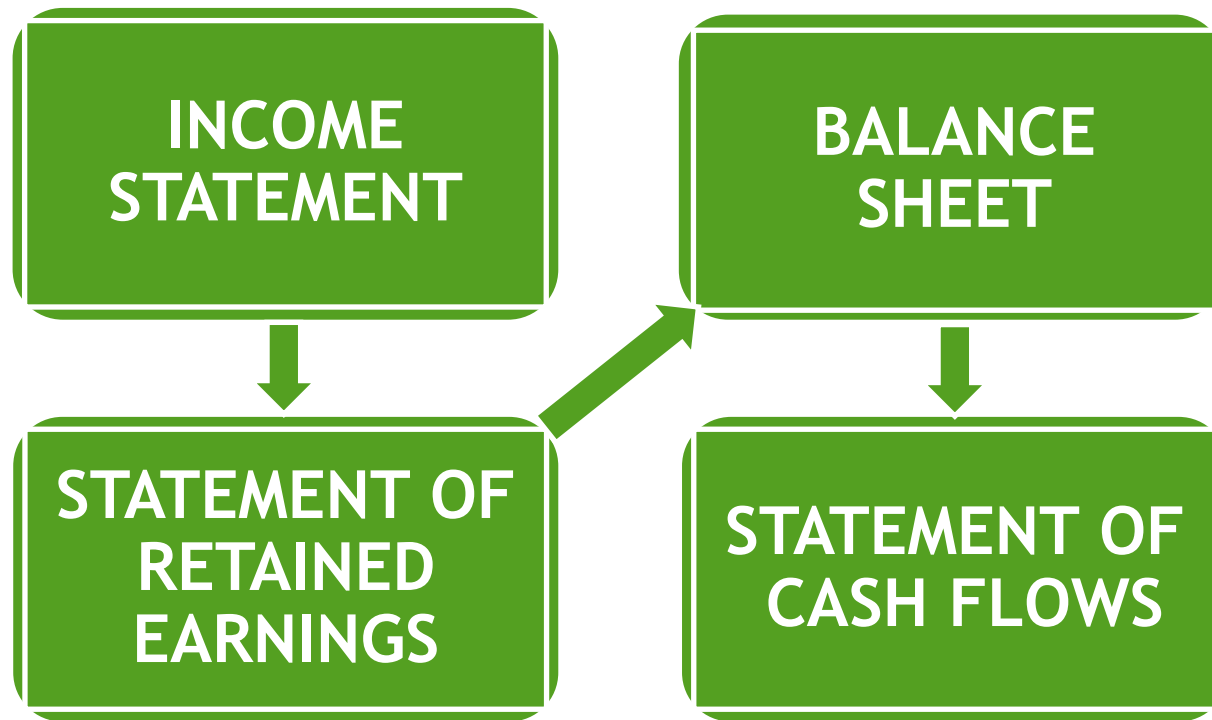
STATEMENT OF CASH FLOWS

It reports the cash coming in (positive amounts) and the cash going out (negative amounts) during a period.

Business activities result in a net cash inflow or a net cash outflow.

The statement of cash flows reports the net increase or decrease in cash during the period and the ending cash balance.

The Financial Statements



Structures of Income Statement

Structures of Income Statement

There are three factors that can influence the structure of the income statement:

- 1) The business of the company: banks and insurance have a specific structure while all the other companies (manufacturing, commercial and service) use a common structure.
- 2) Accounting principles and praxis: we have two different approach according to the two most widespread accounting traditions (Anglo-Saxon vs. Continental).
- 3) Legislation: some countries adopt a minimal content (Anglo-Saxon approach)

Anglo-Saxon vs. Continental approach

2 big differences:

1

Anglo-Saxon approach	Continental approach
Cost of goods sold	Value of production
It compares production sold in a certain period with resources consumed in order to produce and sell it.	It focuses on the obtained production and the expenses incurred in order to produce it.

Anglo-Saxon vs. Continental approach

2

Anglo-Saxon approach	Continental approach
Function of expenses	Nature of expenses
Expenses are aggregated according to the function they refer to.	Expenses are aggregated according to their nature (e.g. materials expense, services expense, etc.).

Classification of expenses by function

- Manufacturing expenses
 - Selling expenses
 - R&D expenses
- Administrative expenses
 - Interest expenses

Classification of expenses by nature

- ▶ Materials
- ▶ Services
- ▶ Labor
- ▶ Interest expense
- ▶ Depreciation and amortisation
- ▶ Provisions
- ▶ Taxes

COST OF FINISHED GOODS MANUFACTURED:

DIRECT MATERIALS

DIRECT LABOR

MANUFACTURING OVERHEAD

- CHANGE IN INVENTORY OF WIP

- COST OF UNSOLD PRODUCTION:

- CHANGE IN INVENTORY OF FINISHED GOODS

- COST OF PRODUCTIONS FOR INTERNAL USE (PRODUCTS ASSIGNED TO EMPLOYEES, RE-USED, SELF-GENERATED ASSETS, ETC.)

= COST OF GOODS SOLD

Sample Income Statement

MY COMPANY Income Statement Year Ended December 31, 2015		
Sales revenue		\$ 75.000
Less: Sales returns and allowances	\$ (5.000)	
Sales discounts	(3.500)	(8.500)
Net sales revenue		66.500
Cost of goods sold		32.000
Gross profit		34.500
Operating expenses		
Salary expense	\$12.000	
Supplies expense	1.500	
Depreciation expense	2.000	
Utilities expense	1.200	16.700
Operating income		17.800
Other revenue and (expense)		
Interest expense		\$ (8.500)
Net Income		9.300

Two formats for reporting financial performance

Anglo-Saxon Approach

Sales revenues	
- cost of sales	
- selling, administrative and other operating expenses	
OPERATING INCOME	
- interest expenses	
± extraordinary items	
- taxes	
NET PROFIT (LOSS)	

Continental Approach

Value of production	
- costs of production:	
Materials, Services, Personnel, Depreciations Provisions...	
OPERATING INCOME	
- interest expenses	
± extraordinary items	
- taxes	
NET PROFIT (LOSS)	

Value of production format

- ▶ The «value of production» comprises sold and unsold production. It also includes production not meant to be sold, such as self-production.
- ▶ The operating profit is determined by comparing the value of production with the cost of production.
- ▶ The operating profit determined in the two formats («cost of sales» and «value of production») is exactly the same.

Sample 'Value of production' income statement

Revenue from sales

Change in inventory of finished products and work in process

Work performed by the enterprise and capitalized

Total value of production

- Value of materials used
 - Personnel expenses
 - Depreciation & amortization
 - Other operating expenses
-

Operating profit (loss)

Comparison of the two formats

Anglo-Saxon Approach

Sales revenues	
- cost of sales	
- selling, administrative and other operating expenses	
OPERATING INCOME	
- interest expenses	
± extraordinary items	
- taxes	
NET PROFIT (LOSS)	

Classified by function

Continental Approach

Value of production	
- costs of production:	
Materials, Services, Personnel, Depreciations Provisions...	
OPERATING INCOME	
- interest expenses	
± extraordinary items	
- taxes	
NET PROFIT (LOSS)	

Classified by nature

Preparing the statements according to the two formats

MyCompany inc. starts production in year 1, without selling anything. In the second year, the company sells the entire production obtained in the previous financial period, without manufacturing anything.

Data are reported below:

	Year 1	Year 2
Units produced	1,000	0
Unit cost of prod.	5	
Units sold	0	1,000
Unit price		6.5
Period costs	400	400

Cost of sales format

	Year 1	Year 2
Sales	0	6,500
- Cost of Goods Sold	0	(5,000)
Gross profit	0	1,500
- Period costs	(400)	(400)
Net profit (loss)	(400)	1,100

Value of production format

	Year 1	Year 2
Sales	0	6,500
+ Change in Products	5,000	(5,000)
Value of production	5,000	1,500
- Manufacturing expenses	(5,000)	0
- Other expenses (Period costs)	(400)	(400)
Net profit (loss)	(400)	1,100

In the value of production format, **all expenses are considered period costs**, and reported in the income statement in the period in which they are incurred.

Exercise

- a) Prepare a statement of cost of goods sold for the year ended Dec. 31st, 2014.
- b) Prepare an income statement using the cost of goods sold format, clearly showing the gross margin from sales and the operating income.
- c) Prepare an income statement using the value of production format, clearly showing the operating income.

Exercise

Inventories	Beginning	Ending
Materials	5.200	3.400
Work in process	8.500	9.540
Finished goods	12.500	9.800

Administrative salaries	18.000
Cash sales	185.000
Credit sales	514.000
Depreciation of factory equipment	65.000
Depreciation of office equipment	11.000
Direct Labor	215.000
Income taxes	12.000
Insurance expense	8.500
Interest expenses	54.000
Legal fees and consultancies	18.000
Lease of manufacturing equipment	18.000
Purchases of direct material	225.000
Research and development expenses	58.000
Sales commissions expense	26.000
Shipping costs to customers	12.500