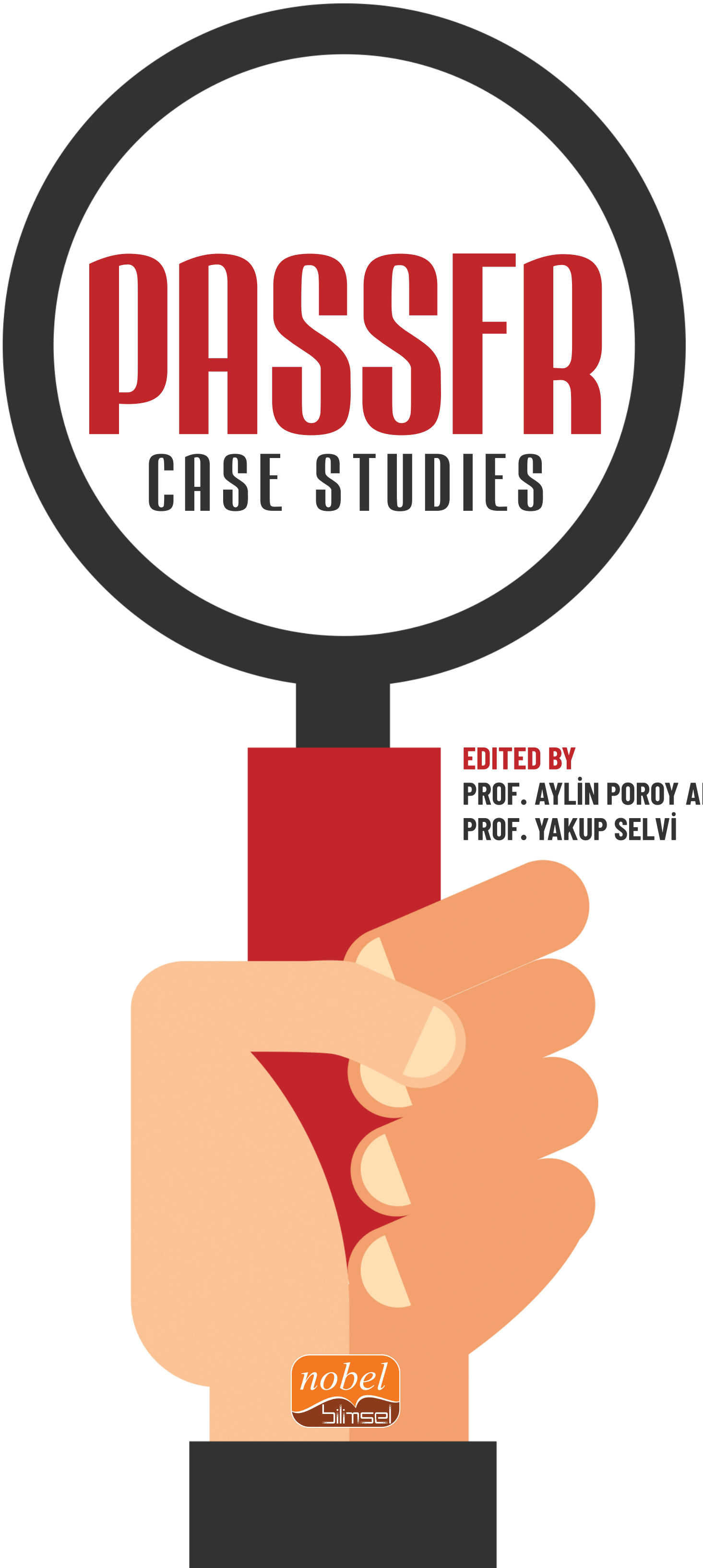
PASSFR
CASE STUDIES



EDITED BY
PROF. AYLİN POROY ARSOY
PROF. YAKUP SELVİ

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Editors

Prof. Aylin Poroy Arsoy
Prof. Yakup Selvi

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Publishing Coordinator: Gülfem Dursun -gulfem@nobelyayin.com-

Interior Designer: Furkan Mülayim -furkan@nobelyayin.com-
Proofreader: Seval Sezer -seval@nobelyayin.com-
Cover Designer: Emine Sırakaya -emine@nobelyayin.com-
Visual Design Specialist: Mehtap Asiltürk -mehtap@nobelyayin.com-

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Edited by

PROF. AYLİN POROY ARSOY

PROF. YAKUP SELVİ

Authors

Prof. Catalin ALBU

Prof. Nadia ALBU

Prof. Agim MAMUTI

Prof. Aslı TÜREL

Assoc. Prof. Erika BESUSPARIENE

Assoc. Prof. Yasemin ERTAN

Assoc. Prof. Diana PAPRADANOVA

Assoc. Prof. Emre Selçuk SARI

Assoc. Prof. Turgay SAKİN

Assoc. Prof. Ventsislav VECHEV

Assoc. Prof. Elif YÜCEL

Assist. Prof. Alp AYTAÇ

Assist. Prof. Tuba BORA KILINÇARSLAN

Lecturer Jevgenija FURGASE

Lecturer Kristina GESEVICIENE

Lecturer Silva KATUTYTE

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CASE STUDY - CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

Catalin Albu* - Nadia Albu**

Introduction

IFRS financial statements are expected to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity (CF.1.2). To this purpose, the information must meet the qualitative characteristics of useful financial information as presented in the Conceptual Framework for Financial Reporting (thereafter, the Framework). Financial statements should faithfully represent relevant economic phenomena in both words and numbers; therefore, entities should report both numbers (in the main financial statements) and words (in the notes), about how items are recognised and measured.

The aim of this case study is to develop a wider understanding of how entities should respond to the requirements of the Framework.

The Case Information

You are a financial analyst covering several small entities applying for funding for their investment projects to your financial institution. Before moving forward with the approval process, you are expected to conduct a general review of the quality of the financial statements provided by the applicant entities.

Now you study the financial statements of two entities, Black Ltd., and White Ltd. These entities operate in the construction industry in Buildland and must prepare IFRS financial statements. However, the application of IFRS in Buildland started only a few years ago and the local profession is not very experienced with these standards. Moreover, studies of the local application of IFRS found that entities, particularly the smaller ones, face many difficulties in applying IFRS, and that the

* Prof., ASE Bucharest, catalin.albu@cig.ase.ro, ORCID: 0000-0002-3282-8414
** Prof., ASE Bucharest, nadia.albu@cig.ase.ro, ORCID: 0000-0003-2953-9619

levels of compliance with IFRS are quite low. Therefore, the first step in the coverage of any entities (which is the overall work of reviewing financial statements and reporting on the entities' activity) is to conduct a general analysis of how financial statements are prepared.

The financial statements excerpt regarding inventories are the following, for each entity:

- **Black Ltd.** (financial statements are not audited; they are released within a month from the end of the year)

Statement of financial position	**Year 20X1** (CU thousands)
Assets	
……………	………..
Raw materials	125,000
Work in progress	45,500
Finished goods	242,000
………..	………….

Note X: Inventories

Inventories are measured at cost.

- **White Ltd.** (financial statements are audited; they are released within three months from the end of the year)

Statement of financial position	**Year 20X1** (CU thousands)	**Year 20X0** (CU thousands)
Current assets		
Inventories	487,500	456,000
……..	…….	…………

Note X: Inventories

Inventories are measured at the lower of cost and net realisable value.

The entity has the following types of inventories: raw materials (materials for construction), work in progress and finished goods. [Then, the entity reports for each inventory type their beginning and ending values, and any increases, decreases, and write-downs recognised during the period].

First-In-First-Out (FIFO) is used for inventories of raw materials since it is common within the construction industry. Inventories of work in progress and finished goods refer to 5 projects (3 projects in progress and 2 finished). [Then, the entity reports for each project its location and the number of apartments that are being constructed].

Discussion Questions

Prepare a short note with some general comments regarding the presentation of the financial statements by each entity, particularly considering the principles stated in the Framework.

SOLUTION OF CASE STUDY - CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING

Black Ltd.

The fundamental qualitative characteristics are relevance and faithful representation. The value of assets (inventory) is relevant information. However, the faithful representation is negatively impacted by the measurement at cost (prudence might not be respected) and by the lack of information regarding the types of inventories and their measurement (completeness and free from error characteristics are impacted).

Several enhancing qualitative characteristics are also impacted. The information is timely, since financial statements are released within a month from year end. But the entity's financial statements are not audited, which impedes on the characteristic of verifiability. Moreover, assets are not classified as current and non-current, which impedes on the understandability of financial statements. Finally, and importantly, only one year of data are reported, which impedes on comparability.

White Ltd.

The fundamental qualitative characteristics of relevance and faithful representation seem to be well ensured. The value of assets (inventories) is relevant information. Moreover, information is faithfully represented since the entity provides all the relevant information regarding the types of inventories it uses and their measurement. The details presented in the notes contribute to the completeness of the information reported.

The enhancing characteristics are also achieved in this case. White's financial statements are audited, which supports their verifiability, and relevant aggregation (in the statement of financial position) and details (in the notes) help ensure understandability. Financial statements are released within three months from year end, which ensures a reasonable timeliness of the information. Data reported for two years ensure comparability over time, and the use of the FIFO method ensures comparability with other entities in the industry. This in turn allows for predicting future cash flows (thus enhancing the relevance of financial statements).

CASE STUDY - IAS 1 PRESENTATION OF FINANCIAL STATEMENTS

Ventsislav Vechev*

Introduction

Information from financial statements is a source for decision-making by a wide range of users, both internal and external to the entity. As a result, there is a need to know the content of the components of the financial statements. The main purpose of the information in the financial statements is to objectively present the results of the activity and the financial condition of the entity.

The aim of this case study is for students to apply the rules for presenting information about individual reporting objects in the components of financial statements, according to the provisions of IAS 1 Presentation of Financial Statements.

The Case Information

In the month of December 2022, the following operations were carried out in entity "Building" Ltd:

The entity accrues liabilities to the staff in the form of additional social security payments in the amount of CU 120,000 and liabilities to suppliers in the amount of CU 45,000. The specified obligations should be settled by April 2024.

The entity has overdue four instalments on a long-term loan granted by a commercial bank. The balance of the loan is in the amount of CU 320,000. At the end of the month, the bank concludes an agreement with the borrower to repay the overdue instalments. The agreement expires at the end of May 2024. Interest was charged on the bank loan for the month of December in the amount of CU 1,342.

At the end of the reporting period, the entity has the following information about its inventories:

* Assoc. Prof., D. A. Tsenov Academy of Economics, Svishtov, v.vechev@uni-svishtov.bg, ORCID: 0000-0003-1700-9055

Raw materials and components:

Cost: CU 2,500;

Net realisable value: CU 1,900.

Finished goods in stock:

Cost: CU 3,000;

Net realisable value: CU 2,750.

Discussion Questions

Classify the liabilities (to the staff and to suppliers) whether they are current or non-current, based on the provisions of IAS 1 Presentation of financial statements. Specify the provisions of the standard according to which the classification was made. Indicate in which component of the financial statements these liabilities will be presented.

Classify the liabilities (related to a long-term loan) whether they are current or non-current, based on the provisions of IAS 1 Presentation of financial statements. Specify the provisions of the standard according to which the classification was made. Prepare the journal entries for accrued interest. Indicate in which components of the financial statements the information about the performed business operations will be presented.

Prepare the accounting entries for the impairment, based on information for the materials and goods. Indicate in which components of the financial statements information about the performed business operations will be presented.

SOLUTION OF CASE STUDY - IAS 1 PRESENTATION OF FINANCIAL STATEMENTS

Regardless of the fact that these liabilities will be settled (repaid) after more than twelve months, according to paragraph 70 of IAS 1 Presentation of financial statements, they should be classified as current. This is so because some current liabilities, such as trade payables and some accruals for employee and other operating costs, are part of the working capital used in the entity's normal operating cycle. Information about these liabilities is presented in the Statement of Financial Position.

Since the entity has entered into an agreement with the bank to repay the overdue instalments over a term longer than twelve months after the end of the reporting period, according to paragraph 75 of IAS 1 Presentation of financial statements this obligation is classified as non-current.

The following accounting entries will be done:

Dr. Interest expenses 1,342

Cr. Interest payable 1,342

Information about these liabilities will be presented in the Statement of Financial Position and interest expense will be presented in the Statement of Profit and Loss and other comprehensive income as finance costs.

Inventories are valued according to IAS 2 Inventories at the lower of cost and net realisable value. In our case, the cost is the accounting (balance sheet) value. Since the book value of the materials and goods is higher than the net realisable value, the same should be reduced by the amount of the excess. The following accounting entries will be created:

For write-down to net realisable value of the materials:

Dr. Impairment losses 600

Cr. Inventory 600

For write-down to net realisable value of the goods:

Dr. Impairment losses 250

Cr. Goods 250

Information about these impairment losses will be reflected in the Statement of Profit and Loss and other comprehensive income. Information about the impairment of materials and goods will be reflected in the Statement of Financial Position.

CASE STUDY - IAS 2 INVENTORIES

Jevgenija Furgase*

Introduction

The main goal of each entity is to maximize the profits from its activities, and inventories are usually used to achieve this goal. They usually make up most of the company's current assets and may include goods for resale, raw materials or consumables, finished products or work in progress, as well as various acquisitions that will be used in the production process.

To ensure the accuracy and reliability of the information presented in the financial statements, entities must select and apply inventory accounting policies that provide a true and fair representation of their financial position, results and cash flows. Any choice of inventory accounting policies and formulas must be based on the need for the entity to employ appropriate accounting policies and financial statements that introduce a fair, objective and accurate image of its financial position as well as the results of operations to external and internal users of information.

The aim of this case study is to provide understanding on these essential requirements for the rules regulating the inventories. It also establishes formulas for the determination of the cost of inventories and its subsequent recognition as an expense, as well as presents the cost formulas that are used to assign costs to inventories.

The Case Information

The company "Happy Dog" sells specialized healthy food for dogs and uniquely designed bowls for dog food. The company uses the FIFO formula to calculate the cost of dog food (product A) and the weighted average cost for bowls (product B), because, according to IAS 2, different cost formulas may be applied for inventories with different nature or use.

* Lecturer, Vytautas Magnus University, jevgenija.furgase@vdu.lt, ORCID: 0000-0001-6445-3314

The following inventory transactions occurred during the period:

Date	Transactions
1 December 20X0	Purchase: product A – 10 units of CU50; product B – 15 units of CU20; Transportation costs for both product – CU50.
2 December 20X0	Sales: product A – 5 units of CU65; product B – 6 units of CU30.
10 December 20X0	Purchase: product A – 8 units of CU55; product B – 10 units of CU23.
15 December 20X0	Sales: product A – 11 units of CU65; product B – 16 units of CU30.
31 December 20X0	Estimated net realizable value: product A – unit CU50; product B – unit CU30

Discussion Questions

1. Calculate and explain the purchase cost of inventories;
2. Calculate and explain the cost of sales and prepare the inventories cards for both products (A and B);
3. Determine and explain the value at which the inventories will be shown in the statement of the financial positions;
4. Present the entry record which will be made for all transactions of case study.

SOLUTION OF CASE STUDY - IAS 2 INVENTORIES

Question No. 1

When explaining the purchase cost of inventories, we need to have in mind that in IAS 2 Inventories, it is stated that the cost of inventories consists of purchase price, import duties and other taxes, as well as transportation, insurance and other costs directly attributable to the acquisition of inventories.

It might be needed to calculate the purchase cost of products for each purchase if needed. We have two purchases in case study – on 1st December and 10th December 20x0.

Product A and product B were purchased on 1st December 20X0. Transportation costs (CU50) increase the cost of products, and since these costs are common to several types of goods (A and B), they need to be allocated.

Purchase on December 1

Goods	Units	Price, CU	Total, CU	Proportion of goods value, %	Allocation of transportation, CU	Total costs of goods, CU	Costs per unit, CU
A	10	50.00	500.00	62.50% (500/800x100%)	31.25 (50.00x62.50%)	531.25 (500.00+31.25)	53.13 (531.25/10)
B	15	20.00	300.00	37.50% (300/800x100%)	18.75 (50.00x37.50%)	318.75 (300.00+18.75)	21.25 (318.75/15)
Total:			800.00	100%	50.00	850.00	-

After the purchase of 10th of December 20X0, there is no need to calculate the purchase cost, as there were no other costs directly attributable to the acquisition of inventories and purchase cost is equal to purchase price.

Question No. 2

If we want to identify the costs of sales, first, we have to know the following key points from the IAS 2 Inventories:

- ✔ When using the FIFO formula, it is assumed that the inventory that is produced or acquired first will be the first to be retired;
- ✔ When applying the weighted average approach, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period.

Secondly, we have to follow the accounting policy of company A, which has chosen to use FIFO formula for product A and weighted average formula for product B. Then we have to fill the inventories cards taking into account these costs formulas.

After calculating the purchase cost of each product, it is possible to fill in the inventories cards for each product, and they will represent the cost of sales and the balance at the end.

Card of goods A

Date	Record	Receipt of inventories			Write-off of inventories			Balance at end		
		Units	Costs, CU/unit	Total Costs, CU	Units	Costs, CU/unit	Total Costs, CU	Units	Costs, CU/unit	Total Costs, CU
1/12/20X0	Purchase	10	53.13	531.3				10	53.13	531.3
2/12/20X0	Sales				5	53.13	265.65	5	53.13	265.65
10/12/20X0	Purchase	8	55	440				5	53.13	265.65
								8	55	440
15/12/20X0	Sales				5	53.13	265.65			
					6	55	330	2	55	110

It can be seen that the purchase of goods A consists of two purchases (on the 1st of December and the 10th of December); therefore, when writing off the goods for sale, the earliest goods (of the 1st of December) are written off first, and then the amount needed from the newer purchase (of the 10th of December).

Therefore, in sales case on the 2nd of December, the costs of sales is CU265.65 and on the 15th of December – CU595.65 (265.65+330) from two different purchases.

Card of goods B

Date	Record	Receipt of inventories			Write-off of inventories			Balance at end		
		Units	Costs, CU/unit	Total Costs, CU	Units	Costs, CU/unit	Total Costs, CU	Units	Costs, CU/unit	Total Costs, CU
1/12/20X0	Purchase	15	21.25	318.75				15	21.25	318.75
2/12/20X0	Sales				6	21.25	127.5	9	21.25	191.25
10/12/20X0	Purchase	10	23.00	230.00				19	22.17	421.25
15/12/20X0	Sales				16	22.17	354.74	3	22.17	66.51

It can be seen that in the case of goods B, after the second purchase on the 10th of December, we recalculated the unit cost using the following formula: (9x21.25 balance at end + 10x23.00 second purchase) / 19 = CU22.17.

The cost of sales on the 2nd of December is CU127.50 which calculated by purchase costs of 1st December, but the costs of sales on 15th December is CU354.74 which was calculated using the average cost CU22.17 per unit in product B case.

The total cost of products (A and B) sold on 2st December 20X0 is CU393.15 (265.65+127.5) and on 15th December 20X0, it is CU950.39 (265.65+330.00+354.74).

Question No. 3

According to IAS 2 Inventories, inventories presented at the lower cost and net realisable value in statement of financial position.

Inventories (products A and B) are different, so we must evaluate each one individually, depending on which costs is lower. According to the measurement made by the company, net realisable value has been identified and it was compared with the costs of purchase.

Measurement of inventories

Inventory	Costs of purchase, CU	Net realisable value, CU	Lowest value, CU
A	110.00 (2x50.00)	100 (2x50.00)	100.00 (Net realisable value)
B	66.51 (3x22.17)	90 (3x30.00)	66.51 (Costs of purchase)

The minimum cost for product A is its net realisable value – CU100, for product B – the costs of the purchase – CU66.51.

Therefore, to show the net realisable value of product A in the statement of financial position, it is necessary to make record for a devaluation of inventories value at CU10 (110-100).

Question No. 4

Once the purchase price has been calculated and the inventories cards have been completed, the appropriate entries records can be made in the accounts.

Date	Transactions	Record
1 December 20X0	Purchase: product A – 10 units of CU50; product B – 15 units of CU20; Transportation costs for both product - CU50.	Dr. Inventories CU850.00 Cr. Cash CU850.00 *(10x50.00+15x20.00+50.00)*
2 December 20X0	Sales: product A – 5 units of CU65; product B – 6 units of CU30.	Dr. Receivables CU505.00 Cr. Revenue CU505.00 *(5x65.00+6x30.00)* Dr. Costs of Sales (Expenses) CU393.15 Cr. Inventories CU393.15 *(265.65+127.50)*
10 December 20X0	Purchase: product A – 8 units of CU55; product B – 10 units of CU23.	Dr. Inventories CU670.00 Cr. Cash CU670.00 *(8x55.00+10x32.00)*
15 December 20X0	Sales: product A – 11 units of CU65; product B – 16 units of CU30.	Dr. Receivables CU1195.00 Cr. Revenue CU1195.00 *(11x65.00+16x30.00)* Dr. Costs of Sales (Expenses) CU950.39 Cr. Inventories CU950.39 *(265.65+330.00+354.74)*
31 December 20X0	Estimated net realisable value: product A – unit CU50; product B – unit CU30	Dr. Expenses CU10.00 Cr. Write-down of inventories CU10.00 *(Product A 110.00-100.00)*

The value of inventories presented in the statement of financial position is CU166.51 (Product A CU100.00 + Product B CU66.51).

CASE STUDY - IAS 7 STATEMENT OF CASH FLOWS

Catalin Albu* - Nadia Albu**

Introduction

Information about the entity's cash flows is fundamental for external users in assessing the entity's evolution and its prospects. The statement of cash flows presents the changes in cash and cash equivalents during an accounting period and complements the information reported in the statement of financial position and the statement of profit or loss.

The aim of this case study is to prepare and interpret the statement of cash flow. You are a junior analyst working with a bank and you prepare various analyses to support decision making (to grant loans or not).

The Case Information

You have on your desk the simplified financial statements of Cashy Co., a small, listed company applying for an additional loan. The owners of the Cashy Co. regularly decide to invest in additional property, plant and equipment, but they also cash in significant amounts of dividends. Now they must face a decrease in the market, resulting in increases in inventories, decrease in sales, profit, and cash. So, they apply for an additional loan to face the increasing challenges that they encounter.

The full financial statements are prepared in accordance with IFRS. However, to provide a more aggregated picture of the company, you prepared a synthesised statement of financial position and the statement of profit or loss. The simplified financial statements you prepared are the following:

* Prof., ASE Bucharest, catalin.albu@cig.ase.ro, ORCID: 0000-0002-3282-8414
** Prof., ASE Bucharest, nadia.albu@cig.ase.ro, ORCID: 0000-0003-2953-9619

Statement of financial position as of 31 December 20X1

Assets	20X1 (in CU)	20X0 (in CU)
Non-current assets		
Property, plant and equipment	180,000	160,000
Total non-current assets	**180,000**	**160,000**
Current assets		
Inventories	40,000	20,000
Accounts receivable	30,000	10,000
Cash and cash equivalents	10,000	30,000
Total current assets	**80,000**	**60,000**
Total assets	**260,000**	**220,000**
Equity and liabilities		
Share capital	80,000	80,000
Retained earnings	20,000	20,000
Profit	10,000	30,000
Total equity	**110,000**	**130,000**
Non-current liabilities		
Bank loans	80,000	50,000
Total non-current liabilities	**80,000**	**50,000**
Current liabilities		
Accounts payable	50,000	30,000
Bank loans	20,000	10,000
Total current liabilities	**70,000**	**40,000**
Total equity and liabilities	**260,000**	**220,000**

Statement of profit or loss for the year ended 31 December 20X1

	20X1 (in CU)	20X0 (in CU)
Sales	180,000	210,000
Cost of merchandise sold/merchandise expense	(110,000)	(125,000)
Wages expenses	(30,000)	(22,000)
Depreciation expense	(10,000)	(10,000)
Interest expense	(12,000)	(8,000)
Income tax expense	(8,000)	(15,000)
Profit	10,000	30,000

Now you must continue the analysis, but you misplaced the entity's full financial statements. However, you are confident that you can prepare a simplified statement of cash flow based on the simplified versions of the financial statements presented above. You remember that Cashy Co. employs the indirect method to present its operating cash flow and classifies interest paid as operating and dividends paid as financing cash flows. All bank loans are long term. The changes in the values reported in the statement of the financial position are a very good representation of the entity's main cash flows incurred for the specific elements over the period.

Discussion Questions

Prepare the entity's statement of cash flows for the year 20X1. What is a preliminary indication of the entity's prospects based on this?

SOLUTION OF CASE STUDY - IAS 7 STATEMENT OF CASH FLOWS

First, we analyse the changes in the amounts reported in the statement of the financial position to identify the main investing and financing cash flows.

The change in property, plant and equipment indicates acquisitions. The net change in amount is CU20,000, but the statement of profit or loss indicates CU10,000 depreciation for the year. Therefore, the value of non-current acquisitions is CU30,000.

The 20X0 profit was appropriated. Since there is no change in retained earnings, it was fully distributed as dividends.

There are changes in the bank loans. The current portion of the bank loan from 20X0 (that is, of CU10,000) was paid in 20X1.

The current portion of the bank loan from 20X1 (CU20,000) was reclassified in current liabilities from the non-current ones. Therefore, the new bank loans contracted (affecting non-current liabilities) are CU50,000 (80,000 – (50,000 – 20,000)).

Statement of cash flows

Cash flows from operating activities (all amounts in CU)	
Profit	10,000
1) adjustment for non-cash income or expense items	
Depreciation expense	+10,000
2) adjustment for income or expense resulting in investing or financing cash flows	
Interest expense	0
3) changes in inventories, receivables, payables and other operating items	
Increase in inventories	(20,000)
Increase in accounts receivable	(20,000)
Increase in accounts payable	+20,000
= Net cash flows from operating activities (I)	=0
Cash flows from investing activities	
Cash payments to suppliers of non-current assets	(30,000)
= Net cash flow from investing activities (II)	=(30,000)
Cash flows from financing activities	
Cash received from bank loans	50,000
Payments for loan reimbursements	(10,000)
Dividends paid	(30,000)
= Net cash flow from financing activities (III)	=10,000
Total net cash flow (IV) = (I) + (II) + (III)	(20,000)
Cash and cash equivalents as of 01.01.20X0 (V)	30,000
Cash and cash equivalents as of 31.12.20X1 (VI) = (IV) + (V)	10,000

The statement of cash flows indicates the following:

- the entity does not generate a positive operating cash flow, which is crucial for the long-term stability of the business;
- the entity employed bank loans to finance investments but also to pay dividends (since there is no operating cash flow generated), which is again not a sustainable model.
- This may indicate that the entity may not receive any additional loans, as it may face cash issues in the future, given its current challenges and changes to financial position.

CASE STUDY – IAS 8 ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

Alp Aytaç* - Agim Mamuti**

Introduction

Companies should ensure constant control and take necessary precautions to changing situations to continue their activities. When a change is required, showing the effects of this change helps the financial statements to meet the principle of relevance and faithful presentation. The aim of International Accounting Standard 8 Accounting Policies, Changes in Accounting Estimates and Errors is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors.

With this case study, it is aimed to show the effects of estimate and policy change on financial statements.

The Case Information

Act&Count Company has been operating in the furniture sector and they have a high-tech production line. Act&Count Company has a considerable property, plant and equipment especially production machines. The Company has been using First-In-First-Out (FIFO) for their inventory valuation. Act&Count Company has been preparing their financial statements in line International Accounting/Financial Reporting Standards (IAS/IFRS). Kevin IRVING has been working on the Accounting Department of Act&Count Company. When he examined the 2022 financial statements, he found the following results:

* Assist. Prof., Bursa Uludag University, alpaytac@uludag.edu.tr, ORCID: 0000-0003-4949-4884
** Prof., "Mother Teresa" University, agim.mamuti@yahoo.com, ORCID: 0000-0003-2499-0216

- In the beginning of 2019, the company purchased a machine with CU200,000 which has a estimated 10 year useful live and CU 10,000 residual value. In 2023, the company re-estimated the useful life and residual value and found that the machine has a 15 year useful life and CU 4,000 residual value. Act&Count Company has been using straight-line method for depreciation.
- The Company has been using First-In-First-Out (FIFO) for their inventory valuation. In 2022, they switched to weighted-average method. If the FIFO method is used ending inventory is worth CU 2,500 whereas based on the weighted-average method the ending inventory is worth CU 1,500 as of 31.12.2022. Act&Count Company's beginning inventory for both valuation methods is CU 1,500. In addition, the sales revenue is CU 10,000, yearly purchases are CU 5,000 and other expenses for period is CU 750.

Discussion Questions

a) How should Kevin IRVING calculate the depreciation in line with changing useful life and residual value? How will this change affect the financial statements? Based on IAS 8 is this an error or is it a policy or estimate change?

b) How Kevin IRVING reflect the change of inventory valuation method to the financial statements? How will this change appear in the comprehensive income statement? Based on IAS 8 is this an error or is it a policy or estimate change?

SOLUTION OF CASE STUDY - IAS 8 ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

a) According to IAS 8, change of useful life and residual value on a machine is considered change in accounting estimates and required recordings are made prospectively. Kevin IRVING should make the following calculations:

Yearly depreciation for 2019= 200,000 – 10,000 = 190,000 / 10 years = CU19,000

Cumulative depreciation expense by 2023 =19,000*4 = CU 76.000

Depreciated amount due to change in forecast in 2023 = 200,000 – 76,000 = CU 124,000

Yearly depreciation for 2023= 124,000 – 4,000 =120,000/15 = CU 8,000

Yearly depreciation expense is CU 19,000 while it is decreased to CU 8,000 after the change in accounting estimates. Therefore, on the comprehensive income statement depreciation expense is reported CU 11,000 less.

b) According to IAS 8, change of inventory valuation is considered change in accounting policy and required recordings are made retrospectively. As a result of policy change, ending inventory information is as follows:

FIFO	Weighted-Average Cost
CU 2,500	CU 1,500

Based on both calculation method, the comprehensive income statement is as follows:

	FIFO	Weighted-Average Cost
Revenue	10,000	10,000
Cost of Sales	4,000	5,000
Beginning Inventory (+)	1,500	1,500
Purchases (+)	5,000	5,000
Ending Inventory (-)	2,500	1,500
Gross Profit	6,000	5,000
Other Expenses	750	750
Income Before Tax	**5,250**	**4,250**

With the change of inventory valuation from FIFO to weighted-average cost method, gross profit and income before tax amount decreased CU1,000 compared to FIFO method.

CASE STUDY - IAS 10 EVENTS AFTER THE REPORTING PERIOD

Emre Selçuk Sarı*

Introduction

Purpose of standard is to determine the length of the period of time a company can make adjustments on events after the reporting period. Another purpose is to determine the authorization date of the financial statements and to determine the disclosures that should be made after the reporting period. It is of great importance for companies and financial statement users whether events occurring after the reporting period will require adjustments in the financial statements. The existence of an event that requires an adjustment after the reporting period will also require changes in the financial statements and this will also affect the decisions of the users of the financial statements. In addition, it is also important for decision makers to determine the events that will require explanation in the financial statement notes, even if they do not require adjustment.

The aim of this case is to discuss how it can be determined which events require adjustment after the reporting period and what differences of opinion may arise on this issue.

Case Information

Rain Company is one of the prestigious enterprises of the sector, which produces automobiles. Rain Company has decided to offer some of its shares to the public. For this reason, the company's financial statements are audited by an independent audit company for the first time. During the independent audit process, there are some differences of opinion between the business management and the independent auditors. The points where these differences of opinion are most concentrated are related to the events that occurred after the financial reporting date.

The events that occurred after December 31, 2021, which is the reporting date in Rain Company, are as follows.

a) A lawsuit was filed against the entity in 2021. The amount of compensation claimed is CU120,000. The case was concluded on January 3, 2022. The entity

* Assoc. Prof., İstanbul University, emresari@istanbul.edu.tr, ORCID: 0000-0001-6675-3214

lost the case and is required to pay CU120,000 in damages. There is no provision recorded for the case. The business management claims that the case was concluded in 2022 and it is not concern the 2021 financial statements.

b) The entity distributes a 3% premium to its employees each year from its pre-tax profits. The profit before tax for 2021 was determined on January 23, 2022. The premium amount the entity must distribute to its employees is CU220,000. The business management says that this obligation to the employees is certain in 2022 and does not concern the 2021 period.

c) The firm's finished goods inventories are measured at the lower of cost or net realizable value. The carrying amount of the entity's finished goods inventories is CU1,300,000 at 31 December 2021. Net realizable value calculation was completed on 13 January 2022 and net realizable value determined by independent auditors as CU1,150,000. The business management says that there should be no inventory impairment in the 2021 financial statements, and the measurement was completed in 2022.

In addition to the above-mentioned issues, the following events occurred after the reporting period.

d) On January 20, 2022, Rain Company acquired a competitor in the industry for CU10,000,000.

e) On February 2, 2022, the entity decided to classify certain equipment as non-current assets held for sale.

f) On February 11, 2022, it was found that a sales invoice issued by Rain Company on December 1, 2021 was incorrectly recorded as CU9,000 instead of CU90,000.

g) Renovation were made in the factory building. The renovation started on 12 November 2021 and was completed on 23 December 2021. An invoice was awaited from the architectural firm in order to finalize the cost of the renovation. The invoice was sent to Rain Company on January 2, 2022. The total renovation cost is CU300,000.

h) A lawsuit was filed against Rain Company on 11 January 2022 on the grounds that it did not fulfill its contractual obligations. The amount of compensation claimed is CU25,000. The company's legal counsel stated that the probability of losing the case is high.

Discussion Questions

What is your approach to the events that cause a difference of opinion between the business management and the independent auditors? Which of the events after the reporting period require adjustments to the 2021 financial statements?

SOLUTION OF CASE STUDY - IAS 10 EVENTS AFTER THE REPORTING PERIOD

a) It is an event after the reporting period because the lawsuit was claimed in 2021. Even though the case was concluded in 2022, it is a liability occured in 2021. With the adjustment, the compensation expense and the lawsuit compensation liability should be included in the financial statements.

Dec.31, 2021	Dr. Lawsuit Compensation Expense (P&L)	120,000
	Cr. Lawsuit Compensation Liability (Liabilities)	120,000

b) Even if the premium amount is finalized in 2022, the obligation in question belongs to 2021. Therefore, this event is an event that requires adjustment after the reporting period. The expense and liability related to the premium should be recognized.

Dec.31, 2021	Dr. Salaries Expense (P&L)	220,000
	Cr. Salaries Payables (Liabilities)	220,000

c) Although the net realizable value calculation for the inventories was completed in 2022, this calculation was made for the inventories held by the enterprise as of 31 December 2021. It is an event that requires correction after the reporting period. Inventories should be reduced to net realizable value and impairment expense for inventories should be recognized.

Dec.31, 2021	Dr. Loss on Inventory (P&L)	150,000
	Cr. Write-Down for Inventories (Assets)	150,000

d) It is a significant event for the business, but is not an event after reporting period that requires adjustment as the acquisition occurred later in 2021. Explanations on the subject can be made in the notes.

e) The decision to classify as non-current assets held for sale was taken in 2022. It is not an event requiring adjustment after the reporting period. Explanations on the subject can be made in the notes.

f) Incorrect accounting of the invoice is an event that requires adjustment after the reporting period. With the adjustment, sales revenue and accounts receivable should be corrected.

Dec.31, 2021	Dr. Accounts Receivables (Sales)	81,000
	Cr. Sales Revenue (P&L)	81,000

g) Exact costs for events occurring before the reporting period can be determined after the reporting period ends. It is an event that requires adjustment after the reporting period.

Dec.31, 2021	Dr. Property, Plant & Equipment (Assets)	300,000	
	Cr. Other Payables (Liabilities)		300,000

h) Since the lawsuit was filed in 2022, it is not an event requiring adjustment after the reporting period. The entity may make explanations on the subject in the notes.

CASE STUDY - IAS 12 INCOME TAXES

Catalin Albu[*] - Nadia Albu[**]

Introduction

IFRS-based accounting must represent the economic substance of transactions, which in many cases might differ from the treatments that are acceptable from a tax perspective. The temporary differences between financial reporting and taxation are dealt with via the deferred tax mechanism; they result in the recognition of deferred tax liabilities and assets in the statement of financial position, respectively of deferred tax expenses or income in the statement of profit or loss.

The aim of this case study is to assess the consequences on the financial statements of the temporary differences that may exist between accounting and tax treatments.

The Case Information

You work in the subsidiary of a listed group. This subsidiary is located in Taxland, a country where the tax treatments traditionally prevail for financial reporting purposes as well.

Given the limited IFRS expertise in Taxland, IFRS financial statements were prepared before this year by an external consultant. However, management would like to achieve more internal involvement in understanding and preparing the IFRS financial statements. Now the managers desire to understand the consequences on the financial statements of the following accounting policies, as they are different from the ones that are accepted for tax purposes.

The main differences between accounting and taxation occur in 20X1 only for assets. This is the case for the following items:

[*] Prof., ASE Bucharest, catalin.albu@cig.ase.ro, ORCID: 0000-0002-3282-8414
[**] Prof., ASE Bucharest, nadia.albu@cig.ase.ro, ORCID: 0000-0003-2953-9619

a) a production line that was purchased 5 years ago for CU120,000. A useful life of 10 years, and a residual value of CU30,000, were estimated for financial reporting purposes for this asset, based on the estimated pattern of consumption of the asset. For tax purposes though, the production line is depreciated over 15 years (no residual value is recognised). The straight-line method is used for depreciating the asset for both reporting and tax purposes.
b) equipment that was purchased at the beginning of 20X1 for CU60,000. The entity intends to use it for 5 years. The asset should be depreciated over 4 years for tax purposes. The straight-line method is used for depreciating the asset for both reporting and tax purposes. Some indications of impairment appeared at the end of 20X1. An impairment test is conducted and an impairment loss of CU2,000 is recognised. This decrease in value is not tax deductible.
c) land that was purchased 15 years ago for CU80,000. The land was revalued at the end of 20X1 for a fair value of CU85,000. The revaluation is not accepted from a tax perspective.
d) the entity recognised prepaid expenses for CU5,000, representing rent paid in 20X1 for the months of January and February of 20X2. Rent is deductible for tax purposes on a cash basis.
e) inventories whose cost is CU16,000. Their net realisable value at the end of 20X1 is estimated at CU15,000. Any write downs are not tax deductible.

The entity has a deferred tax liability of CU500 at the beginning of 20X1. The income tax rate in Taxland is 20%.

Discussion Questions

1) Explain the context of any differences appearing between financial reporting and taxation.
2) Determine any temporary differences between financial reporting and taxation for the entity for the 20X1year.
3) What are the consequences of these differences on the financial statements of 20X1?

SOLUTION OF CASE STUDY - IAS 12 INCOME TAXES

1) Differences may exist between the items' carrying amount (their value reported in financial reporting) and their tax base (value recognised for tax purposes). Some of these differences are permanent, while others are temporary. For example, fines are not deductible from a tax perspective (in the determination of income tax paid). They are an example of permanent differences existing between the reporting and the tax treatments, respectively. However, if assets are consumed differently by the entity from what the tax authorities consider appropriate for the payment of taxes, this is a temporary difference that is reversible over time. If this is the case, then the deferred tax mechanism helps dealing with the different time effect of these treatments.
2) For assets, if their carrying amount is higher than their tax base, taxable temporary differences and deferred tax liabilities appear. This is because, in the future, when assets are recovered, their carrying amount is expensed but is not deductible in full for the determination of income tax paid (as the tax base is lower than the carrying amount, the entity will pay a higher income tax in the future). Vice versa, if the carrying amount of assets is lower than their tax base, this results in deductible temporary differences and the recognition of deferred tax assets (as the tax base is higher than the carrying amount, the entity will pay a lower income tax in the future).

Specifically, the following temporary differences appear for the entity's assets (all amounts in CU):

Items	Carrying amount	Tax base	Taxable temporary differences	Deductible temporary differences
Production line	120,000 – (120,000 – 30,000) /10 * 5 = 75,000	120,000 – 120,000/15 * 5 = 80,000		5,000
Equipment	60,000 – 60,000/5*1 – 2,000 = 46,000	60,000 – 60,000/4 = 45,000	1,000	
Land	85,000	80,000	5,000	
Prepaid expenses	5,000	0	5,000	
Inventories	15,000	16,000		1,000
Total	-	-	11,000	6,000

3) CU11,000 are the taxable temporary differences at the end of 20X1 = □ a deferred tax liability of CU2,200 is needed (CU11,000 * 20%).

The entity has a deferred tax liability at the beginning of the year of CU500, therefore the liability to be recognised in 20X1 amounts to CU1,700. This is partly recognised in equity (revaluation reserve) for the items that are revalued (CU5,000 of revaluation reserve*20% = CU1,000), and the rest (CU700) is recognised in profit or loss.

Therefore, the entity will journalise:

Dr. Deferred tax recognized in equity	1,000	
Cr. Deferred tax liability		1,000
Dr. Deferred tax expense	700	
Cr. Deferred tax liability		700

CU6,000 are the deductible temporary differences at the end of 20X1 = □ a deferred tax asset of CU1,200 is needed (CU6,000 * 20%).

The entity has no deferred tax assets recognized at the beginning of 20X1, therefore it must recognise an asset for the full amount of CU1,200.

Dr. Deferred tax asset	1,200	
Cr. Deferred tax income		1,200

The differences between accounting and taxation treatments both impact the statement of financial position and the statement of profit or loss. As such, the entity reports at the end of the year a deferred tax asset of CU1,200 and a deferred tax liability of CU1,700 in the statement of financial position. These represent the amounts of income taxes that are recoverable in future periods, and respectively, the amounts of income taxes that are payable in future periods.

The statement of profit or loss is impacted by a deferred tax expense of CU700 and a deferred tax income of CU1,200. These amounts will determine, together with the current income tax expense, the income tax expense for the period. Moreover, the statement of other comprehensive income is impacted since the entity revalued its land. The revaluation reserve will be reported at CU4,000 (CU5,000 increase resulting from the revaluation minus CU1,000 the deferred tax recognized in equity).

CASE STUDY - IAS 16 PROPERTY, PLANT AND EQUIPMENT

Ventsislav Vechev[*] - Diana Papradanova[**]

Introduction

In order to carry out their activities, entities need different types of durable tangible assets. As a result of their use and market changes, their value changes over time. The main goal of the accounting of long-term tangible assets is to ensure that the information presented in the financial statements about them is as objective and reliable as possible.

The aim of this case study is for students to apply the rules for accounting for fixed tangible assets owned by the entity. The case study includes questions related to initial evaluation; follow-up assessment; depreciation and write-off of a fixed tangible asset owned by the entity.

The Case Information

The entity carries out the following business operations related to property, plant and equipment:

Entity "Steel" Ltd. is a producer of metal products.

The entity purchases a production machine (lathe for processing metal parts), with the following data:

Purchase price: CU 150,000;

Customs duties and fees: CU 11,900;

Transportation costs: CU 6,000;

Fees of consultants for the preparation of the asset for exploitation: CU 2,100;

Installation costs: CU 3,000;

Administrative costs: CU 2,000.

[*] Assoc. Prof., D. A. Tsenov Academy of Economics, Svishtov, v.vechev@uni-svishtov.bg, ORCID: 0000-0003-1700-9055

[**] Assoc. Prof., D. A. Tsenov Academy of Economics, Svishtov, d.imalova@uni-svishtov.bg, ORCID: 0000-0002-3639-6436

The entity has adopted the straight-line method of depreciation for this class of assets. The useful life of the machine is 25 years.

After initial recognition, the entity adopts one of the two approaches provided for by IAS 16 Property, Plant and Equipment, namely: the revaluation approach.

At the end of the fifth year, a revaluation of the production machine was carried out. The fair value of the machinery at the revaluation date is CU 160,000.

At the end of the sixth year, a revaluation of the production machine was carried out. The fair value of the machinery at the revaluation date is CU 110,000.

At the end of the seventh year, a revaluation of the production machine was carried out. The fair value of the machinery at the revaluation date is CU 140,000.

Discussion Questions

What is the cost of the production machine, according to the provisions of IAS 16 Property, plant and equipment?

Determine the depreciation rate and depreciation quota for the purposes of depreciating the production machinery.

Prepare the accounting entries for the revaluation of the production machine at the end of the fifth year and explain the changes in the affected accounts for both revaluation options:

First option: writing off the accumulated depreciation at the expense of the carrying amount and

Second option: recalculation of carrying amount and accumulated depreciation in proportion to the change in carrying amount at the date of revaluation.

Make the revaluation of the production machine at the end of the sixth year. Prepare the ledger entries and explain the changes in the affected ledger accounts. Compile the accounting records and explain the changes in the affected accounts according to the revaluation option: writing off the accumulated depreciation at the expense of the carrying amount.

Make the revaluation of the production machine at the end of the seventh year. Prepare the ledger entries and explain the changes in the affected ledger accounts. Compile the accounting records and explain the changes in the affected accounts according to the revaluation option: writing off the accumulated depreciation at the expense of the carrying amount.

SOLUTION OF CASE STUDY - IAS 16 PROPERTY, PLANT AND EQUIPMENT

Determination of the cost of the production machine:

Elements of the cost	**Amount (CU)**	**Classification of elements**
Purchase price	150,000	Capitalise
Customs duties and fees	11,900	Capitalise
Transportation costs	6,000	Capitalise
Consultants' fees	2,100	Capitalise
Installation costs	3,000	Capitalise
Administrative costs	2,000	Expense
Total:	**173,000**	

Determination of the depreciation rate and the depreciation quota of the production machine.

Determining the depreciation rate:

$$Depreciation\ rate\ = \frac{100}{Useful\ life\ of\ assets\ \ (years)} = \frac{100}{25} = 4\ \%$$

Determining the depreciation quota for one year:

Depreciation quota = CU 173,000 * 4% = CU 6,920

Determination of the result of the revaluation at the end of the fifth year.

First option writing off the accumulated depreciation at the expense of the carrying amount

Accumulated depreciation to date

5 years * CU 6,920 = CU 34,600

Carrying amount of the asset before the revaluation

Net carrying amount = Gross carrying amount – Accumulated depreciation = CU 173,000 – CU 34, 600 = CU 138,400

Fair value at the revaluation date: CU 160,000

First option to reflect the revaluation, according to IAS 16 Property, plant and equipment

Writing off the accumulated depreciation at the expense of the gross carrying amount:

Values after revaluation:

Depreciation = CU 34,600 – CU 34,600 = 0

Difference between fair value and carrying amount = CU 160,000 – CU 138, 400 = CU 21,600 (increase)

This difference will increase the net book value to the fair (revalued) value.

Accounting entries:

To write off accumulated depreciation:

Dr. Accumulated depreciation	34,600	
Cr. Property, plant and equipment		34,600

To accounting the increase in the book value of the revaluation asset in a revaluation reserve:

Dr. Property, plant and equipment	21,600	
Cr. Revaluation Reserve		21,600

Statement of Accounts

Account Accumulated Depreciation

Depreciation write-off CU 34, 600	Before revaluation CU 34,600
	Balance after revaluation: 0

Account Property, Plant and Equipment

Acquisition of the machine CU 173,000 Correction (increase) of the balance carrying amount CU 21,600	Write-off of part of the gross carrying amount CU 34,600
	Balance after revaluation: CU 160,000

Account Revaluation Reserve

	Formation of revaluation reserve CU 21,600
	Balance after revaluation: CU 21,600

Second option to reflect the revaluation, according to IAS 16 Property, plant and equipment

Recalculation of carrying amount and accumulated depreciation in proportion to the change in carrying amount at the date of revaluation.

Calculation of conversion coefficient:

$$K = \frac{Difference\ between\ carrying\ amount\ and\ fair\ value}{Carrying\ amount} = \frac{21{,}600}{138{,}400}$$
$$= 0.15606936$$

Recalculation of the gross carrying amount by means of a coefficient = CU 173 000 x $0.15606936 \approx$ CU 27,000

Recalculation of depreciation, by coefficient = CU34,600 $*$ 0.15606936 = CU 5,400

Recalculated gross carrying amount = CU 173,000 + CU 27,000 = CU 200,000

Recalculated depreciation = CU 34,600 + CU 5,400 = CU 40,000

Carrying amount after revaluation = Gross carrying amount – Depreciation = CU 200, 000 – CU 40,000 = CU 160,000

Accounting entries:

To correction the carrying amount of the asset in the direction of increase:

Dr. Property, plant and equipment	27,000	
Cr. Accumulated depreciation		5,400
Cr. Revaluation reserve		21,600

Statement of Accounts

Account Accumulated Depreciation

	Before revaluation CU 34,600 Increase in depreciation after the revaluation CU 5 ,400
	Balance after revaluation: CU 40,000

Account Property, Plant and Equipment

Acquisition of the machine CU 173,000 Correction (increase) of the carrying amount CU 27 ,000	
	Balance after revaluation: CU 200,000

Account Revaluation Reserve

	Formation of revaluation reserve CU 21,600
	Balance after revaluation: CU 21,600

Determination of the outcome of the reassessment at the end of the sixth year.

Since the production machine was revalued in the previous year, this resulted in a change in the gross carrying amount and, accordingly, the depreciation allowance for the following years of the machine's useful life.

Write-off of depreciation to date at the expense of the gross book value:

At the end of the fifth year, the depreciation was fully written off. For the following years of the asset's useful life, the depreciation quota will change, because as a result of the revaluation, the gross carrying amount, which is the basis for determining the depreciation quota, has also changed.

Before the first revaluation, the depreciation quota is CU 6,920 per year. In the following year, it will change as a result of the changed book value of the asset. The new net book value of the asset is CU 160,000. This will be the new gross book value. Since the straight-line method is applied for the remaining period of the asset's useful life, the depreciation allowance is CU 8,000 (CU 160,000 / 20 = CU 8,000).

Thus, at the end of the year, the revaluation will be carried out under the following parameters:

Gross carrying amount: CU 160,000

Accumulated depreciation to date (for one year after the last revaluation): CU 8,000

Net carrying amount: CU 152,000

Formed reserve from previous revaluation: CU 21,600

New fair value: CU 110,000

Values after revaluation:

Depreciation = CU 8,000 – CU 8,000 = 0

Difference between fair value and carrying amount = CU 152,000 – CU 110,000 = CU 42,000

This difference will reduce the net carrying amount of the production machinery to the revalued (fair) value.

Accounting entries:

To correct the carrying amount of the asset in the direction of decrease:

Dr. Accumulated depreciation	8,000	
Dr. Impairment loss	20,400	
Dr. Revaluation reserve	21,600	
Cr. Property, plant and equipment		50,000

Statement of Accounts

Account Accumulated Depreciation

Depreciation write-off CU 8,000	Before revaluation CU 8,000
	Balance after revaluation: 0

Account Property, Plant and Equipment

Gross carrying amount of machine CU 160,000	Decrease of a part of gross carrying amount at the expense of depreciation CU 8,000 Decrease of a part of gross carrying amount at the expense of accumulated revaluation reserve CU 21,600 Decrease of a part of gross carrying amount at the expense of accumulated Impairment costs CU 20,400
	Balance after revaluation: CU 110,000

Account Revaluation Reserve

Using the reserve to cover the reduction from the revaluation CU 21,600	Reserve formation from the previous one reassessment CU21,600
	Balance after revaluation: CU 0

Account Impairment loss

Accrual of costs for depreciation CU 20,400	
	Balance after revaluation: CU 20,400 [1]

[1] At the end of the year, the account is included in the financial result and closed.

Determination of the result of the reassessment at the end of the seventh year

Since the production machine was revalued in the previous year, this resulted in a change in the gross carrying amount and, accordingly, the depreciation allowance for the following years of the machine's useful life.

Write-off of depreciation to date at the expense of the gross carrying amount:

At the end of the sixth year, the depreciation was fully written off. For the following years of the asset's useful life, the depreciation quota will change, because as a result of the revaluation, the gross carrying amount, which is the basis for determining the depreciation quota, has also changed.

Prior to the last revaluation, the depreciation quota was CU 8,000 per year. In the following year, it will change as a result of the changed carrying amount of the asset. The new net carrying amount of the asset is CU 110,000. This will be the new gross carrying amount. Since the straight-line method is applied for the remaining period of the useful life of the asset, the depreciation quota is CU 5,789. 47 (CU 110,000 / 19 = CU 5, 789.47)

Thus, at the end of the year, the revaluation will be carried out under the following parameters:

Gross carrying amount: CU 110,000

Accumulated depreciation to date (for one year after the last revaluation): CU 5,789.47

Net carrying amount: CU 104,210.53

Reported impairment charges for previous revaluation: CU 20,400

New fair value: CU 140,000

Values after revaluation:

Depreciation = CU 5,789.47 – CU 5,789.47 = 0

Difference between fair value and carrying amount = CU 140,000 – CU 104,210.53 = CU 35,789.47

This difference will increase the net carrying amount of the production machinery to the revalued (fair) value.

Accounting entries:

To write off accumulated depreciations to date

Dr. Accumulated depreciation	5,789,47	
Cr. Property, plant and equipment		5,789,47

To correct the carrying amount of the asset in the direction of increase

Dr. Property, plant and equipment 35,789,47

Cr. Revaluation reserve 15,389,47[2]

Cr. Income from subsequent asset valuations 20,400

Statement of Accounts

Account Accumulated Depreciation

Depreciation write off CU 5,789.47	Before revaluation CU 5,789.47
	Balance after revaluation: 0

Account Property, Plant and Equipment

Gross carrying amount of the machine CU 110,000 Increase in carrying amount CU 35,789.47	Decrease of a part of gross carrying amount at the expense of accumulated depreciation CU 5,789.47
	Balance after revaluation: CU 140,000

Account Revaluation Reserve

	Formation of a reserve from a previous revaluation CU 15,389.47
	Balance after revaluation: CU 15,389.47

Account Income from Subsequent Asset Valuations

	Accounting of income up to the amount of reported expense from a previous period CU20,400
	Balance after revaluation: CU 20,400 [3]

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[2] The increase in the carrying amount of the asset as a result of the revaluation is in the amount of CU 35,789.47. For this purpose, revaluation income will be reported up to the amount of impairment losses reported in the previous period (in this case CU 20,400), and the difference above this amount is reported as a revaluation reserve (in this case CU 15,389.47).

[3] The income recovers the amount of the previous reduction in the asset's book value from revaluation on account of reported expenses.

CASE STUDY - IAS 19 EMPLOYEE BENEFITS

Aslı Türel*

Introduction

The objective of IAS 19 Employee Benefits is to prescribe the accounting and disclosure for employee benefits. The main principle underlying all of the detailed requirements of IAS 19 is that the cost of providing employee benefits shall be recognized in the period when services are provided, rather than when employee benefits are paid or payable. The standard outlines how each category of employee benefits is measured, providing detailed guidance, in particular, about post-employment benefits.

The entity or employer is the organization sponsoring the pension plan. It incurs the cost and makes contributions to the pension fund. The fund or plan is the entity that receives the contributions from the employer, administers the pension assets, and makes the benefit payments to the retired employees (pension recipients).

A defined benefit plan outlines the benefits that employees will receive when they retire. These benefits typically are a function of an employee's years of service and of the compensation level in the years approaching retirement.

In accounting for an entity’s pension plan, two questions arise. (1) What is the defined benefit obligation that an entity should report in financial statements? (2) What is the pension expense for the period?

This case has been prepared to explain how the defined benefit pension plans will be accounted and reported by the entities.

The Case Information

Star sponsors a defined benefit pension plan for its 50 employees. On January 1, 2022, the entity’s accountant provided the following information related to the pension plan.

* Prof., Istanbul University, gunduzay@istanbul.edu.tr, ORCID: 0000-0002-2658-4636

Defined Benefit Plan Asset (January 1, 2022)	CU 340,000
Defined Benefit Plan Liability (January 1, 2022)	CU 480,000
Plan Asset / Liability	CU 140,000
Other Comprehensive Income - Loss	CU 22,000

As a result of the operation of the plan during 2022, the actuary provided the following additional data at December 31, 2022.

Current Service Cost	CU 90,000
Return on Plan Assets	CU 34,000
Contributions Paid In	CU 170,000
Benefits Paid Out	CU 21,000

The discount rate is 7%. Changes in actuarial assumptions result in a defined benefit obligation end-of-year balance of CU 670,000.

Discussion Questions

a) Compute pension expense for Star for the year 2022.

b) Indicate the pension amounts reported in the financial statements.

SOLUTION OF CASE STUDY - IAS 19 EMPLOYEE BENEFITS

Using the data given above, the table presents the beginning balances and all of the pension entries recorded by Star in 2022. Star records the beginning balances for the defined benefit plan liability and defined benefit plan asset on the first line of table.

	Defined Benefit Plan Liability	Defined Benefit Plan Asset
January 1, 2022	**480,000**	**340,000**
Service Cost	90,000	
Interest Expense	33,600*	
Interest Revenue		23,800**
Contributions Paid		170,000
Benefits Paid	(21,000)	(21,000)
Asset Gain		10,200***
Liability Loss	87,400****	
December 31, 2022	**670,000**	**523,000**

* CU 33,600 = 480,000 * 7%

** CU 23,800 = 340,000 * 7%

*** CU 10,200 = 34,000 – 23,800

**** CU 87,400 = 670,000 – (480,000+90,000+33,600-21,000)

Star records the service cost component, which increases pension expense by CU90,000 and increases the liability (defined benefit plan liability) by CU90,000. Star accrues the interest expense component, which increases both the liability and the pension expense by CU33,600 (the beginning defined benefit liability multiplied by the discount rate of 7 percent). In the third line Star records the interest revenue component, which increases plan assets and decreases pension expense by CU23,800. This is computed by multiplying the beginning plan assets by the discount rate of 7 percent. In the fourth line Star records the contribution (funding) of assets to the pension fund, thereby decreasing cash by CU170,000 and increasing defined benefit plan assets by CU170,000. In the fifth line Star records the benefit payments made to retirees, which results in equal CU21,000 decreases to the defined benefit plan assets and the defined benefit plan liability.

	Current Pension Expense	Other Comprehensive Income	Plan Asset / Liability**
January 1, 2022		**(22,000)**	**140,000**
Service Cost	90,000		
Interest Expense	33,600		
Interest Revenue	(23,800)		
Asset Gain		10,200	
Liability Loss		(87,400)	
			7,000*
December 31, 2022	**99,800**	**(99,200)**	**147,000**

* CU 7,000 comes from the following journal entry.

** Defined Benefit Plan Asset – Defined Benefit Plan Liability

Asset and liability gains and losses are recognized in other comprehensive income.

For the year 2022 Star Entity should make the following journal entry:

Dr. Pension Expense	99,800	
Dr. Other Comprehensive Income	77,200*	
Cr. Cash		170,000
Cr. Plan Asset / Liability		7,000

* CU77,200 = 87,400 – 10,200

The pension amounts reported in the 2022 financial statements are as follows.

Star Entity's Statement of Profit and Loss and Other Comprehensive Income For the Year 2022 (in CU)	
Pension Expense	(99,800)
Other Comprehensive Income	
Asset Gain	10,200
Liability Loss	(87,400)

Star Entity's **Statement of Financial Position** **As of December 31, 2022 (in CU)**	
Plan Liability	147,000
Other Comprehensive Income	
Other Comprehensive Income	(99,200)

CASE STUDY - IAS 20 ACCOUNTING FOR GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNMENT ASSISTANCE

Emre Selçuk Sarı*

Introduction

Government grants are assistance made by the transfer of monetary (cash and cash equivalents) or non-monetary (land, building, machinery, etc.) resources to companies or other types of organizations. How government grants are accounted for is an issue addressed in IFRSs. There are different reasons for this. First of all, it is necessary to distinguish whether it is a government grant or a government assistance. After determining this, it should be determined what kind of government grant it is. Because the accounting treatments differs according to the type of government grant (asset related grants or income related grants). How government grants will be accounted for will also affect the financial position and financial performance results of the company. In this case, the aim is to discuss how the accounting treatment should be according to IFRS when different types of government grants received, and also to provide an understanding of its effects on financial statements.

The Case Information

Storm Company was established in Türkiye in the last months of 2020. Storm Company, which will produce chemical products, planning to make some fixed asset investments necessary for its operations. Since significant amounts of investment are required during the establishment phase, the company tries to choose between different investment alternatives and to choose the most cost-effective ones. In this process, the CEO of the company learned that they could benefit from government grants in some of the investments as a result of his meetings with his legal adviser.

* Assoc. Prof., İstanbul University, emresari@istanbul.edu.tr, ORCID: 0000-0001-6675-3214

A factory building was purchased on January 1, 2021. The factory building purchased costs CU 3,000,000 with an estimated useful life of 50 years and an expected residual value of CU 500,000. Storm company will apply straight-line depreciation method as depreciation method. A government grant of CU 1,000,000 was received while purchasing the factory building. Storm Company decides to use the deducting from related asset method as accounting method for government grants.

On April 1, 2021, a machine was purchased to be used in production. The cost of the machine is CU 500,000, the estimated useful life is 1,000,000 kg of product production, the residual value is estimated at zero. Storm Company will apply the units of product depreciation method for the machine. A government grant of CU 100,000 was received when purchasing this machine. Storm Company has chosen the deferred income method for accounting for this government grant related to assets.

The use of the machine in 2021 and 2022 is as follows:

Year	**Usage**
2021	200,000 kg
2022	250,000 kg
Total	**450,000 kg**

In addition, Storm Company considers that the production process may harm the environment. In order to cover these costs, CU 100,000 government grants were received. To account this revenue-related government grant, the entity will use the other income method.

Environmental costs incurred in 2021 and 2022 are as follows:

Year	**Cost**
2021	CU 90,000
2022	CU 60,000
Total	**CU 150,000**

One of the conditions of the government grants used in the purchase of the factory building is to exceed a certain production amount for two years. However, Storm Company could not reach the necessary production amount at the end of 2022 and had to pay back the government incentive.

Discussion Questions

How should government grants be accounted in 2021 and 2022, and how will it affect the statement of financial position and statement of profit of loss?

SOLUTION OF CASE STUDY - IAS 20 ACCOUNTING FOR GOVERNMENT GRANTS AND DISCLOSURE OF GOVERNMENT ASSISTANCE

There are deducting from related asset and deferred income methods in the recognition of government grants for assets.

The method of deducting from the book value of related asset has been chosen for the factory building. In this case, before to calculate depreciation for the factory building, the grants received must be deducted from the book value of the factory while determining the depreciable amount.

$$Book\ Value = Cost - Grant\ Amount = CU\ 3{,}000{,}000\ - CU\ 1{,}000{,}000$$
$$= CU\ 2{,}000{,}000$$

Annual depreciation expense for the factory building will be calculated as follows.

$$Yearly\ Depreciation = \frac{Book\ Value - Residual\ Value}{Useful\ Life}$$
$$= \frac{CU\ 2{,}000{,}000 - CU\ 500{,}000}{50\ years} = CU\ 30{,}000$$

The journal entries for the factory building of the Storm Company for the year 2021 and 2022 will be as follows.

2021, Jan.1	Dr. Property, Plant & Equipment (Assets)	3,000,000
	Cr. Bank (Assets)	3,000,000
2021, Jan.1	Dr. Bank (Assets)	1,000,000
	Cr. Property, Plant & Equipment (Assets)	1,000,000
2021, Dec.31	Dr. Depreciation Expense – Plant (P&L)	30,000
	Cr. Accumulated Depreciation (Assets)	30,000
2022, Dec.31	Dr. Depreciation Expense – Plant (P&L)	30,000
	Cr. Accumulated Depreciation (Assets)	30,000

The deferred income method has been selected for the machine. In this case, the grant amount will not be deducted from the book value of the asset, but income will be recognized every year in accordance with the expensed depreciation amount.

The depreciation rate of the machine is calculated as follows.

$$Depreciation\ Rate = \frac{Book\ Value}{Useful\ Life} = \frac{CU\ 500{,}000}{1{,}000{,}000\ kg} = 0.5\ CU/kg$$

The depreciation expense to be recognized in 2021 and 2022 is as follows.

$$Yearly\ Depreciation\ (2021) = Depreciation\ Rate\ x\ Usage$$
$$= 0.5\ x\ 200{,}000\ kg = CU\ 100{,}000$$

$$Yearly\ Depreciation\ (2022) = Depreciation\ Rate\ x\ Usage$$
$$= 0.5\ x\ 250{,}000\ kg = CU\ 125{,}000$$

Government grant income should be recognized in proportion to the annual depreciation expense.

$$Yearly\ Income = \frac{Depreciation\ Expense}{Book\ Value}\ x\ Government\ Grant$$

$$Yearly\ Income\ (2021) = \frac{CU\ 100{,}000\ (2021)}{CU\ 500{,}000}\ x\ CU\ 100{,}000 = CU\ 20{,}000$$

$$Yearly\ Income\ (2022) = \frac{CU\ 125{,}000\ (2022)}{CU\ 500{,}000}\ x\ CU\ 100{,}000 = CU\ 25{,}000$$

The journal entries of the Storm Company for the year 2021 and 2022 regarding the machine will be as follows.

2021, Apr.1	Dr. Property, Plant & Equipment (Assets)	500,000
	Cr. Bank (Assets)	500,000
2021, Apr.1	Dr. Bank (Assets)	100,000
	Cr. Deferred Income (Liabilities)	100,000
2021, Dec.31	Dr. Depreciation Expense – Equipment (P&L)	100,000
	Cr. Accumulated Depreciation (Assets)	100,000
2021, Dec.31	Dr. Deferred Income (Liabilities)	20,000
	Cr. Other Income – Government Grants (P&L)	20,000
2022, Dec.31	Dr. Depreciation Expense – Equipment (P&L)	125,000
	Cr. Accumulated Depreciation (Assets)	125,000
2022, Dec.31	Dr. Deferred Income (Liabilities)	25,000
	Cr. Other Income – Government Grants (P&L)	25,000

Government grants related to income must be matched with the relevant expense and systematically recognized in profit or loss.

Year	**Costs**	**Ratio of Annual Cost to Total Cost**	**Grants Recognized by Year**
2021	CU 90,000	CU 90,000/CU 150,000 = **0,60**	0,60 * CU 100,000 = **CU 60,000**
2022	CU 60,000	CU 60,000/CU 1,600,000 = **0,40**	0,40 * CU 100,000 = **CU 40,000**
Total	**CU 150,000**	**1,00**	**100.000 PB**

The accounting for the government grants received by the company for environmental expenses will be as follows.

2021	Dr. Bank (Assets)	100,000
	Cr. Deferred Income (Liabilities)	100,000
2021, Dec.31	Dr. Environmental Expenses (P&L)	90,000
	Cr. Bank (Assets)	90,000
2021, Dec.31	Dr. Deferred Income (Liabilities)	60,000
	Cr. Other Income – Government Grants (P&L)	60,000
2022, Dec.31	Dr. Environmental Expenses (P&L)	60,000
	Cr. Bank (Assets)	60,000
2022, Dec.31	Dr. Deferred Income (Liabilities)	40,000
	Cr. Other Income – Government Grants (P&L)	40,000

The company could not fulfill the conditions regarding the government grants it benefited from in the purchase of the factory building. Government grants affected both tangible assets in the statement of financial position and annual depreciation expenses in the statement of profit and loss. When the government grant is repaid, the tangible assets and accumulated depreciation must be adjusted.

The cost of the factory building is CU 3,000,000 but is reported in the property, plant and equipment account as CU 2,000,000, because of government grants received. Depreciation expense for 2021 and 2022 also totals CU 60,000 (CU 30,000 + CU 30,000).

If the government grants had not been taken, the annual depreciation expense would have been calculated as follows.

$$Yearly\ Depreciation = \frac{CU\ 3{,}000{,}000 - CU\ 500{,}000}{50\ years} = CU\ 50{,}000$$

In this case, the depreciation expense to be recognized in profit or loss would be CU 50,000 per year instead of CU 30,000. Total depreciation expense for 2021 and 2022 would also be CU 100,000 (CU 50,000 + CU 50,000).

The adjusting entry to be made in case of repayment of the government grants is as follows.

2022, Dec.31	Dr. Property, Plant & Equipment (Assets)	1,000,000
	Dr. Depreciation Expense – Equipment (P&L)	40,000
	Cr. Bank (Assets)	1,000,000
	Cr. Accumulated Depreciation (Assets)	40,000

The effects of government grant on the financial statements in 2021 and 2022 will be as follows.

Statement of Financial Position
Dec.31, 2021
CU

Assets		**Lia.&OE**	
PP&E	2,500,000	Deferred Income	120,000
Acc.Depreciation	(130,000)		

Statement of Financial Position
Dec.31, 2022
CU

Assets		**Lia.&OE**	
PP&E	2,500,000	Deferred Income	55,000
Acc.Depreciation	(325,000)		

Statement of Profit & Loss (2021) PB	
<u>Operating Expenses</u>	
Depreciation Expense	(130,000)
Environmental Expenses	(90,000)
<u>Other Income</u>	
Government Grants	80,000

Statement of Profit & Loss (2022) PB	
<u>Operating Expenses</u>	
Depreciation Expense	(195,000)
Environmental Expenses	(60,000)
<u>Other Income</u>	
Government Grants	65,000

CASE STUDY - IAS 21 THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Aslı Türel*

Introduction

IAS 21 outlines how to account for foreign currency transactions and foreign operations in financial statements, as well as accounting for how to convert financial statements to a presentation currency.

The choice of a functional currency of a business whose operations are mainly concentrated in one country is normally the currency of that country. However, for a large number of companies that operate regionally or globally, the choice of a functional currency is less straightforward. IAS 21 has provided a set of indicators to assist in the determination of the functional currency.

IAS 21 requires that a foreign currency transaction be recorded by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.

In the case of a group entity, the presentation currency of the group is the presentation currency of the parent company, which is the reporting entity. IAS 21 specifies two approaches to translation and the conditions under which each approach should be used. The translation approach to be used depends on whether the functional currency of the foreign subsidiary is the same as the presentation currency and whether the books are kept in the functional currency.

This case shows the process of translation of the foreign currency financial statements of a foreign operation to the presentation currency.

* Prof., Istanbul University, gunduzay@istanbul.edu.tr, ORCID: 0000-0002-2658-4636

The Case Information

On December 31, 2020 Spruce Entity whose functional and presentation currency is the CUX, acquired the entire share capital of Star Entity, a foreign entity whose financial statements are prepared in the local currency (CUY).

Star Entity's statement of financial position on December 31, 2020 is presented below in CUY.

Star Entity Statement of Financial Position as of December 31, 2020 (in CUY)			
Cash	28,000	Accounts Payable	200,000
Accounts Receivable	100,000		
Inventories	120,000		
Prepaid Insurance	36,000	Retained Earnings	600,000
Fixed Assets (net)	580,000	Share Capital	64,000
Total Assets	**864,000**	**Total Liabilities and Owner's Equity**	**864,000**

Additional Information:

1- Fixed assets comprised the following:

	Net Book Value (CUY)	Annual Depreciation (CUY)
Land	100,000	-
Buildings	210,000	10,000
Equipments	336,000	56,000

2- Prepaid insurance expired on June 30, 2020.

Star Entity's statement of financial position on December 31, 2021, and December 31, 2022 and its statement of profit and loss and other comprehensive income for the year ending on December 31, 2021 and December 31, 2022 are presented below in CUY.

Star Entity Statement of Profit and Loss and Other Comprehensive Income
For the Year Ending 2021 and 2022

	2021 (CUY)		2022 (CUY)	
Sales		1,200,000		1,600,000
Cost of Good Sold		(760,000)		(860,000)
Beginning Inventory	120,000		160,000	
Purchases	800,000		900,000	
Cost of Goods Available for Sale	920,000		1,060,000	
Ending Inventory	(160,000)		(200,000)	
Gross Profit		**440,000**		**740,000**
Operating Expenses		(246,000)		(266,000)
Depreciation Expense	66,000		86,000	
Insurance Expense	24,000		12,000	
Other Operating Expenses	156,000		168,000	
Income Before Tax		**194,000**		**474,000**
Tax		(40,000)		(96,000)
Net Income		**154,000**		**378,000**

Star Entity Statement of Financial Positions as of December 31, 2021 and as of December 31, 2022 (CUY)

	31.12.2021	31.12.2022
Cash	178,000	300,000
Accounts Receivable	140,000	210,000
Inventories	160,000	200,000
Prepaid Insurance	12,000	-
Fixed Assets (net)	514,000	668,000
TOTAL ASSETS	**1,004,000**	**1,378,000**
Accounts Payable	196,000	232,000
Tax Payable	40,000	60,000
Retained Earnings	168,000	446,000
Revaluation Surplus	-	40,000
Share Capital	600,000	600,000
TOTAL LIABILITIES AND OWNER'S EQUITY	**1,004,000**	**1,378,000**

	2021	2022
Retained Earnings (January 1)	**64,000**	**168,000**
Net Income	154,000	378,000
Dividends Paid	(50,000)	(100,000)
Retained Earnings (December 31)	**168,000**	**446,000**

Additional Information:

1. During 2021, additional plant and equipment costing CUY 200,000 were purchased. The exchange rate at the date of purchase was CUY 1 = CUX 2,95. The plant and equipment were depreciated on a straightline basis over ten years. Assume a full year's depreciation was recorded in 2021.
2. Land was revalued from CUY 100,000 to CUY 140,000 on September 30, 2021.
3. On May 15, 2021 CUY 50,000 and on May 20, 2022 CUY 1000,000 dividends paid.
4. Various assumed exchange rates for 2021 and 2022 are as follows:

December 31, 2020	CUY 1 = CUX 2.32
Weighted average rate for 2021	CUY 1 = CUX 2.70
Weighted average rate when closing inventories (2021) were acquired	CUY 1 = CUX 2.94
May 15, 2021	CUY 1 = CUX 2.78
December 31, 2021	CUY 1 = CUX 2.91
Weighted average rate for 2022	CUY 1 = CUX 3.06
Weighted average rate when closing inventories (2022) were acquired	CUY 1 = CUX 3.03
May 20, 2022	CUY 1 = CUX 3.01
September 30, 2022	CUY 1 = CUX 3.00
December 31, 2022	CUY 1 = CUX 3.52

5. Sales and expenses were incurred evenly throughout each reporting period.

Discussion Questions

- Please show the process of translation of the foreign currency financial statements of Star Entity to the presentation currency of Spruce Entity.
- Where do you think the foreign currency translation gain (loss) will be reported? And why?

SOLUTION OF CASE STUDY - IAS 21 THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Star Entity's financial statements for 2021 will be translated into CUX, the reporting currency of the parent company, Spruce Entity.

Star Entity
Statement of Profit and Loss and Other Comprehensive Income Translation
For the Year 2021

	CUY	**Exchange Rate**	**CUX**
Sales	1,200,000	(*) 2.70	3,240,000
Cost of Goods Sold	(760,000)	2.70	(2,052,000)
Gross Profit	**440,000**		**1,188,000**
Operating Expenses			
Depreciation Expense	(66,000)	2.70	(178,200)
Insurance Expense	(24,000)	2.70	(64,800)
Other Operating Expenses	(156,000)	2.70	(421,200)
Income Before Tax	**194,000**		**523,800**
Tax	(40,000)	2.70	(108,000)
Net Income	**154,000**		**415,800**

The balance of the retained earnings, which will be reported on the statement of financial position of Star Entity as of December 31, 2021, will be calculated as follows.

	CUY	**Exchange Rate**	**CUX**
Retained Earnings (January 1, 2021)	64,000	(**) 2.32	148,480
Dividend Paid	(50,000)	2.78	(139,000)
Net Income of the Year 2021	154,000		415,800
Retained Earnings (December 31, 2021)	**168,000**		**425,280**

(*) Sales and expenses, including tax expense, are translated at the average rate as they occur evenly throughout the year. The exception is dividends paid, which is translated at the actual rate as it is a one-time transaction.

(**) The beginning retained earnings represent entirely the pre-acquisition retained earnings. Therefore, it is translated using the historical rate. However, if the beginning retained earnings are a composite of pre-acquisition and post-acquisition retained earnings, it is not possible to translate the amount at a single rate, as the amount is an accumulation of two or more years' earnings. In practice, the translated figure is used from the previous year's translated financial statements.

Star Entity **Statement of Financial Position Translation** **As of December 31, 2021**			
	CUY	**Exchange Rate**	**CUX**
Cash	178,000	2.91	517,980
Accounts Receivable	140,000	2.91	407,400
Prepaid Insurance	12,000	2.91	34,920
Inventories	160,000	2.91	465,600
Plant, Property and Equipment	514,000	2.91	1,495,740
TOTAL ASSETS	**1,004,000**		**2,921,640**
Accounts Payable	(196,000)	2.91	(570,360)
Tax Payable	(40,000)	2.91	(116,400)
TOTAL NET ASSETS	**768,000**		**2,234,880**
Retaned Earnings	168,000		425,280
Gain on Foreign Currency Translation			***417,600***
Share Capital	600,000	2.32	1,392,000
OWNER'S EQUITY	**768,000**		**2,234,880**

The translation gain of CUX 417,600 can be obtained in one of two ways. It can be obtained as a balancing figure by first translating the net assets at the closing rate. This figure should equal the translated amount on the owner's equity side of the accounting equation. The share capital is translated at the historical rate and the translated retained earnings are obtained from the statement of profit and loss and other comprehensive income. This leaves the ***gain on foreign currency translation*** as a balancing figure.

The translation difference can also be obtained by doing a reconciliation check as follows:

	CUY	**Exchange Rate**	**CUX**
Net Assets (January 1, 2020)	**664,000**	**2.32**	**1,540,480**
Adjustments for Changes in Net Asset Position During Year:			
Net Income	154,000	2.70	415,800
Dividends Paid	(50,000)	2.78	(139,000)
			(A) 1,817,280
Net Assets (December 31, 2020)	**768,000**	**2.91**	**(B) 2,234,880**
Foreign Currency Translation Gain (Loss) (B-A)			***417,600***

The foreign currency translation gain is the result of the depreciation of the CUY against CUX during the year. the translation difference resulted from:

a) The exposed opening net assets (CUY 664.000) that were brought forward at the previous closing rate;
b) Movements in net assets during the year – the net profit for the year translated at the average rate and the dividends paid at the actual rate.

The sum of a) and b) represented by (A) is the unadjusted net assets in CUY at year-end. At year-end, the net assets carried forward (CUY 768,000) are translated at the closing rate to obtain CUX 2,234,880 (B). The difference between the two amounts (B and A) is the translation difference for the year.

Star Entity's financial statements for 2022 will be translated into CUX, the reporting currency of the parent company, Spruce Entity.

Star Entity
Statement of Profit and Loss and Other Comprehensive Income Translation
For the Year 2022

	CUY	**Exchange Rate**	**CUX**
Sales	1,600,000	3.06	4,896,000
Cost of Goods Sold	(860,000)	3.06	(2,631,600)
Gross Profit	**740,000**		**2,264,400**
Operating Expenses			
Depreciation Expense	(86,000)	3.06	(263,160)
Insurance Expense	(12,000)	3.06	(36,720)
Other Operating Expenses	(168,000)	3.06	(514,080)
Income Before Tax	**474,000**		**1,450,440**
Tax	(96,000)	3.06	(293,760)
Net Income	**378,000**		**1,156,680**

The balance of the retained earnings, which will be reported on the statement of financial position of Star Entity as of December 31, 2022, will be calculated as follows.

	CUY	**Exchange Rate**	**CUX**
Retained Earnings (January 1, 2022)	168,000		425,280
Dividends	(100,000)	3.01	(301,000)
Net Income of the Year 2022	378,000		1,156,680
Retained Earnings (December 31, 2022)	**446,000**		**1,280,960**

Star Entity Statement of Financial Position Translation As of December 31, 2022			
	CUY	**Exchange Rate**	**CUX**
Cash	300,000	3.52	1,056,000
Accounts Receivable	210,000	3.52	739,200
Inventories	200,000	3.52	704,000
Plant, Property and Equipment	668,000	3.52	2,351,360
TOTAL ASSETS	**1,378,000**		**4,850,560**
Accounts Payable	(232,000)	3.52	(816,640)
Tax Payable	(60,000)	3.52	(211,200)
TOTAL NET ASSETS	**1,086,000**		**3,822,720**
Retained Earnings	446,000		1,280,960
Revaluation Surplus	40,000	3.00	120,000
Gain on Foreign Currency Translation	**-**	***(1)***	***1,029,760***
Share Capital	600,000	2.32	1,392,000
OWNER'S EQUITY	**1,086,000**		**3,822,720**

The foreign currency translation gain of CUX 1,029,760 can be obtained in one of two ways. It can be obtained as a balancing figure by first translating the net assets at the closing rate. This figure should equal the translated amount on the owner's equity side of the accounting equation. The share capital is translated at the historical rate and the translated retained earnings are obtained from the statement of profit and loss and other comprehensive income. This leaves the ***gain on foreign currency translation*** as a balancing figure.

The translation difference can also be obtained by doing a reconciliation check as follows:

(1) Gain on Foreign Currency Translation

	CUY	**Exchange Rate**	**CUX**
Net Assets (January 1)	768,000	2.91	2,234,880
Net Income	378,000	3.06	1,156,680
Revaluation Surplus	40,000	3.00	120,000
Dividends	(100,000)	3.01	(301,000)
			(A) 3,210,560
Net Assets (December 31)	1,086,000	3.52	(B) 3,822,720
Gain on Foreign Currency Translation (B-A)			612,160
Gain on Foreign Currency Translation (January 1)			417,600
Gain on Foreign Currency Translation (December 31)			**1,029,760**

CASE STUDY - IAS 23 BORROWING COSTS

Turgay Sakin*

Introduction

Calculating and capitalizing borrowing costs in qualifying assets is an ongoing activity throughout the construction/production process. Borrowing for the construction or production process may be directly related to the qualifying asset, or some (or all) of the construction or production cost may be financed from other general borrowings. In addition, expenditures financed by borrowing costs are not realized in one time and are not evenly distributed throughout the construction period. Also, long-term construction and production activities may be suspended for various reasons.

In this case, the aim is to provide an understanding of how borrowing costs are accounted for during a long-term construction period, by associating them with the construction process.

The Case Information

Yellow Co. management had decided to build a new warehouse at the beginning of 2020 as part of their plan to increase the effectiveness of their supply chain. The construction of the warehouse started in early November 2020 and was finished at the end of December 2021. A total of CU700,000 was spent on the construction of the warehouse and the warehouse was recognized at the beginning of August at a cost of CU700,000. However, at the end of 2021, the auditors who came for the audit of the entity informed the management that the recognized cost of the warehouse was not correct as a result of their evaluation and that this error should be corrected. The entity management responded to this request by stating that their calculations were correct. Auditors, on the other hand, stated in their evaluation that the construction of the warehouse is a qualifying asset and related borrowing costs should be capitalized. The management and auditors decided to make a study on detailed information about the warehouse construction in order to make an accurate assessment.

* Assoc. Prof., İstanbul University, tsakin@istanbul.edu.tr, ORCID: 0000-0001-6953-3516

The construction of the warehouse started on November 1, 2020 and ended on December 31, 2021. Warehouse construction stopped between February 1, 2021 and April 1, 2021 due to workers' strike. The following expenditures were made during the construction.

Months	**2020**	**2021**
January, 1		40,000
February, 1		
March, 1		
April, 1		210,000
May, 1		
June, 1		90,000
July, 1		
August, 1		150,000
September, 1		
October, 1		
November, 1	120,000	60,000
December, 1	30,000	
Total	**150,000**	**550,000**

Yellow Co. has the following debts outstanding at January 1, 2020 through December 31, 2021.

- %14, 4 year note, CU 12,000,000. Interest is paid annually at December, 31.
- %11, 5 year note, CU 8,000,000. Interest is paid annually at December, 31.

Yellow Co. furthermore, on December 31, 2020, borrowed CU200,000 loan with 10% interest payable annually to be used in the construction of this warehouse. Interest expense on this particular loan in 2021 was CU20,000. In 2021, the entity used this loan for temporary investments, generating a total income of CU2,000.

Discussion Questions

a) Is it correct to recognize the total of the expenditures made for the warehouse as the cost of this warehouse?

b) How long do you think the construction of this warehouse lasted? Should interest expense for the period February 1-April 1 2021 be capitalized?

c) What should be the values of the warehouse in the statement of financial position dated December 31, 2020 and December 31, 2021?

SOLUTION OF CASE STUDY - IAS 23 BORROWING COSTS

a) In addition to the production costs of the warehouse, the entity should include the financial expenses incurred due to the financing of the warehouse construction in the cost of the warehouse. The construction of this warehouse requires substantial time to make it suitable for the intended use. Therefore, the warehouse meets the definition of qualifying asset.

b) There are 14 months between the start of the construction of the warehouse and its completion. However, the construction of the warehouse was suspended for 2 months due to the workers' strike. Due to this suspension, financing expenses should be capitalized over 12 months, not 14 months.

c) The entity used general and specific borrowings to finance the warehouse construction. While general borrowings are valid for both years, specific borrowings are only made for 2021. The capitalisation rate of general borrowings will be valid in both years.

Calculation of capitalisation rate

Loans	Outstanding from January 1, 2020 to December 2021	Weighted Average Loan	Rate	Borrowing Cost (Interest Expense)
14% Loan	CU12,000,000	CU12,000,000	14%	12,000,000*0.14=1,680,000
11% Loan	CU8,000,000	CU8,000,000	11%	8,000,000*0.11=880,000
TOTAL		CU20,000,000		CU2,560,000

Annual interest expense of these borrowings are CU 2,560,000. If there is no capitalisation of interest all amount will be reported as interest expense in 2020 profit or loss statement.

$$Capitalisation\ Rate = \frac{2{,}560{,}000}{20{,}000{,}000} x100 = 12.8\%$$

For expenditures financed by general borrowing, the interest amount to be capitalized will be calculated at a rate of 12.8%.

Expenditure made in 2020	Nominal Amount	Expenditure funded by the special borrowing	Expenditure funded by general borrowings	Months till the year end after expenditure	Weighted average amount of expenditure
November 1	120,000	0	120,000	2	120,000*2/12=20,000
December 1	30,000	0	30,000	1	30,000*1/12=2,500
	CU150,000	0	CU150,000		CU22,500

Weighted amount of expenditures funded by general borrowings is CU 22,500. The capitalised interest for the year 2020 is:

Borrowing Cost eligible for capitalisation from general borrowings: CU 22,500 * 12,8 % = 2,880

Expenditure made in 2021	Nominal Amount	Expenditure funded by the special borrowing	Expenditure funded by general borrowings	Months till the year end after expenditure	Weighted average amount of expenditure
January 1	40,000	40,000	0	12	0*12/12=0
April 1	210,000	160,000	50,000	9	50,000*9/12=37,500
June 1	90,000		90,000	7	90,000*7/12=52,500
August 1	150,000	-	150,000	5	150,000*5/12=62,500
November 1	60,000	-	60,000	2	60,000*2/12=10,000
	CU550,000	CU200,000	CU350,000		CU162,500

Borrowing Cost eligible for capitalisation from general borrowings: CU162,500 * 12,8 % = 20,800

Borrowing Cost eligible for capitalisation from specific borrowings:

CU200,000 * 10 % = 20,000 Annual interest

Under normal circumstances, the interest expense that the entity would capitalize would be CU40,800, which is the sum of CU20,800 and CU20,000. However, there are two situations here. First, CU2,000, the investment income from the specific borrowing, must be offset against the interest expense of the specific borrowing. Second, the capitalization of interest expenses during the suspension period should be stopped. The interest expense of this period is (this period is financed by specific borrowing);

$$= \frac{20,000}{12} x2\ months = CU\ 3,333\ (rounded)$$

Then the net interest expense should be capitalised from specific borrowing is;

Annual interest expense from specific borrowing	20,000
Investment income	(2,000)
Suspension period	(3,333)
Borrowing cost to be capitalised from specific borrowing	14,667

Values of the warehouse in the statement of financial position dated December 31, 2020 and December 31, 2021

	31.12.2020	31.12.2021
Beginning value		152,880
Total expenditure	150,000	550,000
Capitalised interest from general borrowings	2,880	20,800
Capitalised interest from specific borrowings	-	14,667
Final Value	**152,880**	**738,347**

CASE STUDY - IAS 24 RELATED PARTY DISCLOSURES

Yasemin Ertan*

Introduction

An entity can become partners with other entities in its business life. Entities can engage in commercial activities with their partner. These activities may be non-arm's length transactions. The commercial activities carried out in this way affect the financial position and performance of one of the entities positively and the other negatively. Even if related entities do not carry out commercial activities with each other, an entity that has control or significant influence can affect other entities' financial and operational policies. Due to the existence of these possibilities, users of financial statements should be informed about the related parties of the enterprises while making their decisions.

The aim of this case study is to discuss who the related parties are, what related party transaction is, and which information about related parties and related party transactions should be disclosed in financial statements.

The Case Information

Stylish Company was founded in Istanbul in 1985. It is a ready-to-wear manufacturer. Thanks to a high-quality brand image, the Stylish Company has grown rapidly. The stylish company has many offices and showrooms and has been publicly traded since 2015.

Alfred Stylish owns 55% shares of the Stylish Company. Alfred Stylish is the founder of Stylish Company. He is the head of the Stylish Company board of directors. Alfred Stylish has 80% of Fabloth Company. Fabloth Company manufactures fabric.

* Assoc. Prof., Bursa Uludag University, yasertan@uludag.edu.tr, ORCID: 0000-0002-9193-3396

25% of the Stylish Company’s shares has owned by Moon Stylish. Moon Stylish is the daughter of Alfred Stylish. Despite his father's intense insistence, she did not want to be a part of the family business and got a bachelor's degree in art history. She founded her entity, Moonstyle, in 2010 and provides consultancy services to private collections, galleries, and artists.

The Stylish Company’s board of directors consists of 5 members. Three of these members are independent. One of the independent board members, Alicia Shine, is an independent director of Tyger Company.

The Stylish Company has two subsidiaries and an associate. The name of these companies and the ownership rate of the Stylish Company can be seen below.

Name of the company	Ownership rate of the Stylish Company
Stylish-holl Company	65%
Stylish-ing Company	57%
Carnagy Company	30%

The Stylish Company has bought fabric from the Fabloth Company since 2017. In 202X, a total of CU100,000 of fabric were purchased from the Fabloth Company. At the end of the 202X, the Stylish Company owes CU20,000 to Fabloth Company.

The Stylish Company has sold a total of CU250.000 goods to Stylish-holl Company in 202X. At the year-end, Stylish-holl Company still owes The Stylish Company CU25,000 for the goods. The Stylish Company is doubtful to realize this amount because due to the worsening financial situation of Stylish-holl Company.

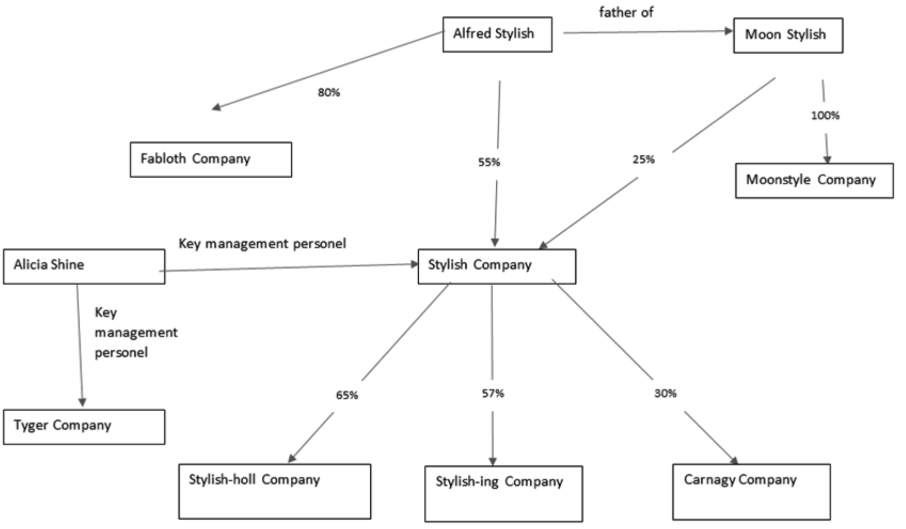
Discussion Questions

Please explain

1. The related parties
2. The related party transaction

that should be disclosed in the Stylish Company’s financial report.

SOLUTION OF CASE STUDY – IAS 24 RELATED PARTY DISCLOSURES



1- Related parties

Alfred Stylish, the founder of the Stylish Company, has 55% of the Stylish Company. He has control of the Stylish Company. Thus, he is a related party of the Stylish Company.

Moon Stylish, who is the daughter of Alfred Stylish, has 25% of the Stylish Company. She has significant influence over the Stylish Company. Thus she is the related party of the company. Moon Stylish would be a related party, even if she did not have significant influence over the Stylish Company. Because she is a close family member of Alfred Stylish who has control of the Stylish Company.

Alfred Stylish controls both the Stylish Company and the Fabloth Company. Thus The Stylish Company and Fabloth Company are related parties.

Moonstyle Company and the Stylish Company are related parties. Because Moon Stylish has significant influence over the Stylish Company and has control of the Moonstyle Company. And also Moon Stylish is the daughter (close family member) of Alfred Stylish who has control over the Stylish Company.

Alicia Shine is a related party of the Stylish Company because she is the key management personnel of the Stylish Company. She is key management personnel of the Tyger Company at the same time. Tyger Company and Stylish Company are not related parties because they have only key management personnel in common.

Stylish Company has 65% of Stylish-holl Company and 57% Stylish-ing Company. They are subsidiaries of the Stylish Company. Thus, the Stylish-holl and the Stylish-ing Companies are related parties of the Stylish Company.

Stylish Company has 30% of Carnagy Company. The Carnagy Company is an associate of the Stylish Company. So, The Carnagy Company and the Stylish Company are related parties.

In the financial reports of the Stylish Company, all related parties who are mentioned above should be disclosed. And, the total compensation paid to key management personnel should be disclosed. Moreover, entities should also provide information about related party transactions in their financial reports.

2. Related Party Transaction

Disclosure of information regarding transactions between the Stylish Company and the Fabloth Company:

Transaction amount: CU100,000

The outstanding balance: CU20,000

Disclosure of information regarding transactions between the Stylish Company and the Stylish-holl Company:

The transaction amount: CU250,000

The outstanding credit balance: CU25,000

Provision for doubtful debts: CU25,000

CASE STUDY - IAS 26 ACCOUNTING AND REPORTING BY RETIREMENT BENEFIT PLANS

Elif Yücel*

Introduction

Retirement benefit plans provide for the establishment of a fund. Employees can make to various organisations such as a mutual aid institution or a solidarity fund during their working period payments in the form of monthly payments or as a lump sum after retirement. On the other hand, the organisation tries to create resources for the payments it will make to the employees after their working life by converting these payments into investments. For this reason, it is very important to inform the employees who makes the payments in order to benefit themself in their retirement.

The aim of this case study is to clarify how to create a retirement benefit plan and how to make the necessary calculations under the IAS 26 standard.

The Case Information

AR-DE company was established in 1950 in Istanbul. The company, which started its activities as a weaving workshop, has turned into a textile and apparel company operating globally with more than 70 years of experience. As of 2022, a total of 350 people works in the company. In AR-DE Company which adopts a company policy that cares about its employees, many employees continue to work until their retirement. Therefore, "AR-DE Pension Fund Foundation" was established in 2000 to meet the retirement and social assistance obligations of employees. Through this foundation, retirement benefit plans are created within the framework of IAS 26, with deductions from employees' salaries, optional payments and employer contributions. This foundation is responsible for the management of fund assets and benefits.

The actuarial present value of the accumulated retirement benefit plans belonging to the AR-DE Pension Fund Foundation is calculated based on current salaries

* Assoc. Prof., Bursa Uludag University, emugal@uludag.edu.tr, ORCID: 0000-0002-2708-6778

within the scope of IAS 26. AR-DE Pension Fund Foundation plans contributions to the employees by calculating a percentage of their current annual salary, which varies according to seniority. Accordingly, the contributions paid according to the working hours and the average monthly salaries of the employees are as follows:

Seniority	Number of Employee	Average Monthly Salary	Employee Contribution	Employer Contribution
5-15 Years	200	CU1,500	5%	8%
15 Years >	100	CU2,500	1%0	8%

Additionally, 80% of the contributions are invested in government bonds at an annual interest rate of 10% and 20% is invested in various stocks. The average return on stocks is estimated at 15%. The company has prepared a plan to ensure that an employee's annual retirement benefit is equal to 3% of years of service multiplied by the final average salary (FAS). FAS is determined by the average of the 3 highest consecutive salaries.

Investments within the scope of AR-DE Pension Fund Foundation pension benefit plan are shown at their fair values in the financial statements. While the foundation prefers low-risk financial instruments such as government bonds and treasury bills, it also invests in stocks and other securities. The company generates significant income from its investments. As of 2022, the investments of the company under the pension benefit plan are as follows:

Investment of AR-DE Pension Fund Foundation (at fair value)

Equities	CU2,100,480
Bonds and Debentures	CU11,514,880
Other Investment Instruments	CU300,340

The retirement benefit plan includes payments in the form of a lump sum or pension to those who retire from the company, a lump sum payment to his heirs in case of death of employees, and payment in case of incapacity of employee due to an accident. Other assets and liabilities of the business are as follows:

Debt for brokerage commission	CU14,400
Accrued benefits	CU82,260
Total of Benefits Paid to Participants in 2022	CU385,280
Administrative expenses	CU264,400
Net assets available for benefits at the beginning of the period	CU14,151,800

Discussion Questions

1. Prepare the defined contribution plan of the AR-DE company by making the necessary calculations.
2. Arrange the statements of net assets available for benefits and the changes in net assets available for benefits by making the defined contribution plan of the AR-DE company.

SOLUTION OF CASE STUDY - IAS 26 ACCOUNTING AND REPORTING BY RETIREMENT BENEFIT PLANS

The Company plans contributions to its employees by calculating a percentage of their current annual salary, which varies according to seniority. So the percentages applied are as follows:

There are 100 employees working in the company for more than 15 years and also there are 200 employees working in the company between 5 and 15 years. The average annual salary of the employees can be calculated as follows:

5-15 Years →1,500 (average monthly salary) x 12 x 200(number of employees) = CU3,600,000

15 Years Above → 2,500 (average monthly salary) x 12 x 100 (number of employees) =

CU 3,000,000

According these salaries the contributions of employees and employer will be calculated as follows:

5-15 Years → CU 3,600,000 x 0,05 = 180,000 (by employee) and

CU 3,600,000 x 0,08 = 288,000 (by employer)

15 Years Above → CU 3,000,000 x 0,10 = 300,000 (by employee) and

CU 3,000,000 x 0,08 = 240,000 (by employer)

So we can calculate the investment returns as follows:

For 5-15 Years:

$$\left.\begin{array}{l}(180{,}000 + 288{,}000) \times 0.8 = 374{,}400 \rightarrow 374{,}400 \times 0.1 = 37{,}440 \\ (180{,}000 + 288{,}000) \times 0.2 = 93{,}600 \rightarrow 93{,}600 \times 0.15 = 14{,}040\end{array}\right\} 51{,}480$$

For 15 Years Above:

$$\left.\begin{array}{l}(300{,}000 + 240{,}000) \times 0.8 = 432{,}000 \rightarrow 432{,}000 \times 0.1 = 43{,}200 \\ (300{,}000 + 240{,}000) \times 0.2 = 108{,}000 \rightarrow 108{,}000 \times 0.15 = 16{,}200\end{array}\right\} 59{,}400$$

Based on these calculations, AR-DE Company prepares a defined contribution plan as follows

Seniority	Average Annual Salary	Employee Contribution	Employer Contribution	Total Contribution	Investment Return
5-15 Years	CU 3,600,000	CU 180,000	CU 288,000	CU 468,000	CU 51,480
15 Years >	CU 3,000,000	CU 300,000	CU 240,000	CU 540,000	CU 59,400
TOTAL	CU 6,600,000	CU 480,000	CU 528,000	CU 1,008,000	CU 110,880

Other data in the case are as follows:

Investment of AR-DE Pension Fund Foundation (at fair value)

Equities: 2,100,480

Bonds and Debentures: 11,514,880

Other Investment Instruments: 300,340

The company's debt for brokerage commission is CU14,400.

The accrued benefits total is CU 82,260.

The total of Benefits Paid to Participants in 2022 is CU 385,280.

The administrative expenses of CU 264,400 were incurred.

At the beginning of 2022, the net assets available for benefits of the company is CU 14,151,800.

Accordingly, the statements of net assets available for benefits and the changes in net assets available for benefits are prepared as follows.

THE STATEMENT OF NET ASSETS AVAILABLE FOR BENEFITS DECEMBER 31, 2022	
	2022(CU)
ASSETS	
Investment in the AR-DE Pension Fund Foundation (at fair value)	
Equities	2,100,480
Bonds and Debentures	11,514,880
Other Investment Instruments	300,340
Total Investments	***13,915,700***
Receivables	
Company Contributions	528,000
Accrued income	80,640
Total Receivables	***608,640***
Total Assets	**14,524,340**
LIABILITIES	
Liabilities for Brokerage Commissions	14,400
Benefits Payable	82,260
Total Liabilities	**96,660**
NET ASSETS AVAILABLE FOR BENEFITS	**14,621,000**

THE STATEMENT OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS DECEMBER 31, 2022	
	2022(CU)
ADDITIONS TO NET ASSETS	
Investment Income (Including changes in fair value)	110,880
Contributions:	
Employee	480,000
Employer	528,000
Total Addition	***1,118,880***
DEDUCTIONS FROM NET ASSETS:	
Benefits Paid to Participants	385,280
Administrative Expenses	264,400
Total Deduction	***649,680***
Net Increase in Net Assets	***469,200***
Net Assets Available for Benefits (Beginning of Year)	14,151,800
NET ASSETS AVAILABLE FOR BENEFITS (END OF YEAR)	**14,621,000**

CASE STUDY - IAS 27 SEPARATE FINANCIAL STATEMENTS

Tuba Bora Kılınçarslan*

Introduction

IAS 27 is applied in accounting for investments in subsidiaries, joint ventures, and associates when an entity prefers or is required by local regulations, to present separate (non-consolidated) financial statements.

When an entity prepares separate financial statements; investments in subsidiaries, associates, and jointly controlled entities are accounted for cost, fair value or using equity method.

The entity is required to apply the same accounting method for each category of investments. If an entity elects measurement of its associates and joint ventures at fair value; it shall apply the same method while presenting separate financial statements. If an entity elects to use the equity method for its associates and joint ventures; it shall apply the same method while presenting separate financial statements.

As for the subsidiaries, the parent company can choose to present its subsidiaries (as an investment) at cost, fair value, or by using the equity method in its separate financial statements. However, using the equity method while preparing separate financial statements and using consolidation procedures while preparing consolidated financial statements seems complicated. Presentation of investments in subsidiaries in a separate financial statement either at cost or fair value will be more practical.

The aim of this case study is to enable separate financial statements to be prepared.

The Case Information

Founded in Berlin in 1925, WhiteHouse Company operates in the field of durable consumer goods with its R&D, production, marketing and after-sales support services with its more than 10,000 employees.

On January 1, 2022, WhiteHouse Company acquired 25% share in Colourful-House Company, which established in the Istanbul by Colourful Global Inc., for CU 75,000 with the aim of producing and selling "Colourful" branded home appliances, including refrigerators, washing machines, and vacuum cleaners around the world, excluding the Chinese market, and rendering after-sales service for these products in line with the growth strategy of the emerging markets. Colourful-House Company's retained earnings amount to CU 50,000 on acquisition date.

WhiteHouse Company has significant influence over the Colourful-House Company. In addition, WhiteHouse Company has chosen to recognize for its investments in the Colorful-House Company at cost in its separate financial statements in accordance with IAS 27.

On December 31, 2022, the Colourful-House Company paid dividends in total amount of CU 15,000. Dividend payment is only reflected in the financial statements of Colourful-House Company, not reflected in the financial statements of WhiteHouse Company.

According to local regulations, WhiteHouse Company prepare separate financial statements in addition to the consolidated financial statements. The separate statement of financial position of WhiteHouse Company and Colourful-House Company as of December 31, 2022 are as follows:

The separate statement of financial position of WhiteHouse Company and Colourful-House Company (31.12.2022, CU)

	WhiteHouse Company, CU	**Colourful-House Company, CU**
Current Assets	***290,000***	***90,000***
Cash and cash equivalents	220,000	80,000
Trade receivables (Colourful-House Company)	30,000	-
Inventories	40,000	10,000
Non-Current Assets	***210,000***	***130,000***
Property, Plant and Equipment (PPE)	135,000	130,000
Investment (Colourful-House Company)	75,000	-
TOTAL ASSETS	**500,000**	**220,000**
Current Liabilities	***-***	***30,000***
Trade Payables (WhiteHouse Company)	-	30,000
Equity	***500,000***	***190,000***
Shares Capital	400,000	120,000
Retained Earnings	100,000	70,000
TOTAL LIABILITIES AND EQUITY	**500,000**	**220,000**

Discussion Questions

1. Show which journal entries WhiteHouse Company should make in its separate financial statements,
2. Reflect the dividend payment on the WhiteHouse Company's financial statements.

SOLUTION OF CASE STUDY - IAS 27 SEPARATE FINANCIAL STATEMENTS

WhiteHouse Company acquired 25% share in Colourful-House Company for CU 75,000. WhiteHouse Company has significant influence over the Colourful-House Company. Therefore, it has been recognized for as an associate. WhiteHouse Company has chosen to recognize for its investments in the Colorful-House Company at cost in its separate financial statements in accordance with IAS 27.

Initial recognition of an associate

Dr. Investment in an associate CU75,000

Cr. Bank CU75,000

On December 31, 2022, the Colourful-House Company paid dividends in total amount of CU 15,000. Dividend payment is only reflected in the financial statements of Colourful-House Company, not reflected in the financial statements of WhiteHouse Company. So, WhiteHouse Company's cash and cash equivalents and retained earnings accounts are increased CU 3,750 (15,000*25%).

	WhiteHouse Company	
	Dividend from Colourful-House Company, CU	**Separate Statement of Financial Position, CU**
Current Assets		***293,750***
Cash and cash equivalents	3,750	223,750
Trade receivables (Colourful-House Company)		30,000
Inventories		40,000
Non-Current Assets		***210,000***
Property, Plant and Equipment (PPE)		135,000
Investment (Colourful-House Company)		75,000
TOTAL ASSETS		**503,750**
Current Liabilities		***-***
Trade Payables (WhiteHouse Company)		-
Equity		***503,750***
Shares Capital		400,000
Retained Earnings	3,750	103,750
TOTAL LIABILITIES AND EQUITY		**503,750**

The dividends received will be recorded in the profit or loss.

Dr. Cash CU3,750

Cr. Profit or loss (retained earnings) CU3,750

CASE STUDY - IAS 28 INVESTMENT IN ASSOCIATES AND JOINT VENTURES

Alp Aytaç*

Introduction

Companies generally invest in other companies to stay competitive and expand in the market. Different types of investments are explained in the International Accounting/Financial Reporting Standards. When making investments, recognition of this in the financial statements is crucial to present relevant and faithful information. IAS 28 Investment in Associates and Joint Ventures specifically focuses on associates and the equity method. To recognise an investment as an associate, significant influence and other indicators must exist.

This case illustrates how a company invests in other companies and how to recognize different investment types, including associates with which value.

The Case Information

FasText Company operates in the textile sector. FasText was founded in 1940 as a family business in a small factory. The founder of FasText, Mr. Chad Fox, greatly emphasizes quality and customer and retailer satisfaction. Even though a short time has passed since its foundation, FasText has gained a significant market share. Along with the development of digitalization and expansion in the sector, FasText has been looking for ways to expand its market share and profitability since 2012 and they decided to accomplish this aim via investments at the national and international levels.

To expand FasText's share, the first step was to invest in companies operating in the same sector. In 2012, Iron Company operated in the textile sector, and they were new in the sector. But Iron Company brought a new point of view by using automated tools and techniques in the production process with their young core. FasText saw the Iron Company as a threat to its operations and bought %65 of its share with CU900,000.

* Assist. Prof., Bursa Uludag University, alpaytac@uludag.edu.tr, ORCID: 0000-0003-4949-4884

Over the years, FasText made some changes to the board of directors who are talented in the information sector, keeps up with the development in information technology and believes in the information sector's rapid growth. They saw this as an opportunity. In the board meeting, to increase profitability, it was argued that WinTech Company which operated in the software sector, was showing significant signs of development. The decision-makers of FasText decided to buy %25 of WinTech's shares with CU850,000 in 2015. When FasText acquired WinTech’s shares, WinTech's net assets' fair value was worth CU750,000. In 2018, WinTech reported CU150,000 profits and paid CU80,000 dividends.

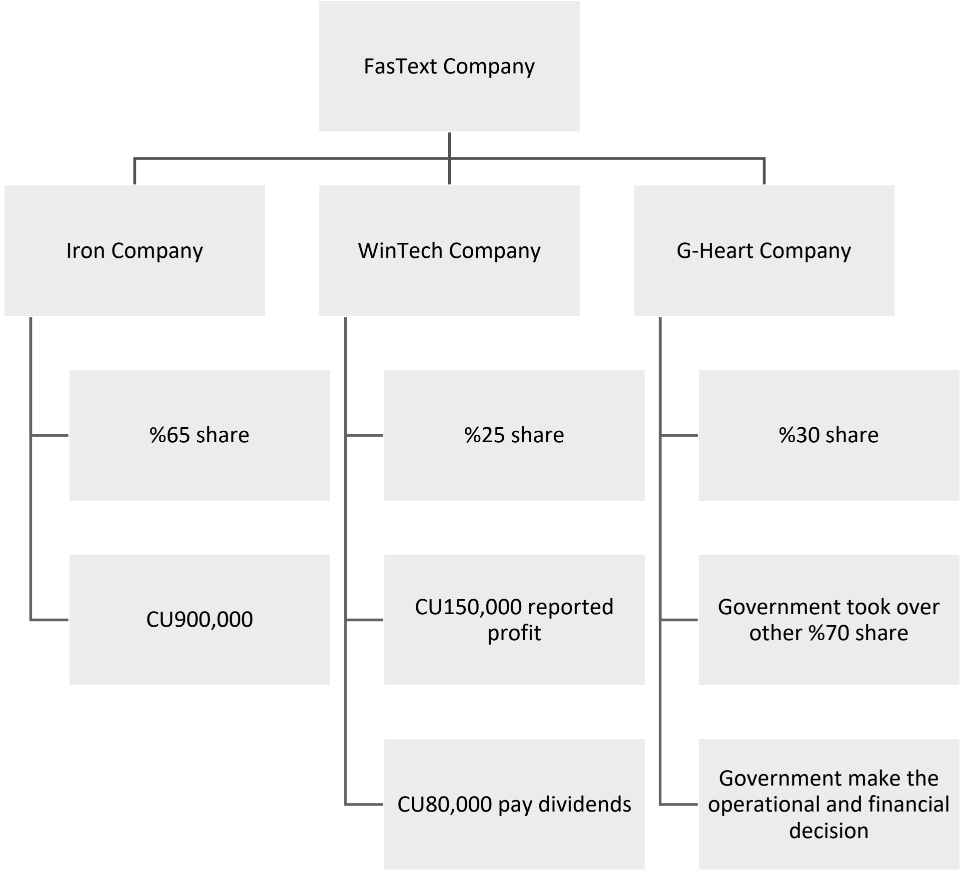
In 2020, FasText was looking for an opportunity overseas. FasText's board of directors discussed that to expand the Company's customer portfolio and make it international, and they should invest overseas. In 2020, FasText attended the International Textile Expo. On the 3rd day of the expo, FasText's representatives visited G-Heart Company's booth area. G-Heart was located in India. At that meeting, representatives of FasText were impressed by G-Heart's management farsightedness. After detailed research, they discovered that G-Heart Company has a broad customer and retailer network. By getting in touch with G-Heart Company in detail, FasText aimed to enter the Indian market, increase its total profitability, and benefit from the Indian market's advantages. To accomplish this aim, after months of discussions, FasText and G-Heart Company agreed that, FasText bought %30 shares with CU1,000,000. Three months after the agreement, there were newsbreaks heard around the world. The National Government of India announced that from now on, the Government took control of companies' Indian shares, but they will not intervene in the shares of foreign-based companies. But the Government will be in charge of all operational and financial activities of companies in India. Along with this sudden and unexpected development, FasText had a %30 share of G-Heart Company, whereas the Government had the other %70 shares. In addition, the Government was in charge of daily activities and made the critical decisions related to G-Heart Company.

Discussion Questions

1. Interpret the FasText Company’s acquisition of Iron Company and make the journal entry.
2. Interpret the FasText Company’s acquisition of WinTech Company and make the journal entries of acquisition, profit reporting, and paying dividend process under the equity method.
3. Interpret the FasText Company’s acquisition of G-Heart Company and make the journal entry of the acquisition. In addition, interpret the development of government interference and how FasText recognizes its investment in G-Heart Company along with this development.

SOLUTION OF CASE STUDY - IAS 28 INVESTMENT IN ASSOCIATES AND JOINT VENTURES

Figure 1: Summary of The Case



1. Acquisition of Iron Company's share and interpretation of this transaction

Dr. Subsidiary	900,000	
(Investment in Iron Company)		
Cr. Bank Account		900,000

Interpretation of investment in Iron Company: IAS 28 defines four types of investments: Subsidiaries, Associates, Joint Ventures/Joint Operations, and Financial assets. To record an investment as an Associate, an investor should have shares between 20-50%, which means significant influence occurred. Other indicators should be considered if this criterion has not been met. If the investor has more than 50% shares upon the investee, then the investor has control power; therefore, the investment should be recorded as a subsidiary. In the acquisition of Iron Company, FasText has 65% shares and control power. That's why investment in Iron Company is recorded as a "Subsidiary."

2. Acquisition of WinTech Company and interpretation of this transaction

Dr. Associates	850,000	
(Investment in WinTech)		
Cr. Bank Account		850,000

Interpretation of investment in WinTech Company: According to IAS 28, if an investor has shares between 20-50% over an investee, which means significant influence, then the investee should be considered an Associate unless otherwise. At the time of acquisition, to calculate whether there is goodwill or not, the fair value of the investee's assets should be compared with the transferred amount. If the transferred amount is bigger than the fair value of assets, goodwill occurs. Goodwill does not record as a separate item in the financial statement and is included in an acquisition cost. This is why the FasText record associates with the amount of CU850,000.

Net Fair Value of WinTech Company's assets	750,000	
Transferred Amount		850,000
Goodwill		100,000

In the case of associates, they recognized with the equity method. In the equity method, the carrying amount of the investment is increased in case an investee reports profit. If an investee pays dividends, the investor decreases the investment's carrying amount.

Dr. Associates	37,500	
(Investment in WinTech)		
Cr. Profit of associates		37,500

Measured with the equity method

Dr. Cash	20,000	
Cr. Associates		20,000
(Investment in WinTech)		

3. Acquisition of G-Heart Company and interpretation of this transaction

Dr. Associates 1,000,000

(Investment in G-Heart)

Cr. Bank Account 1,000,000

Interpretation of investment in G-Heart Company: According to IAS 28, if an investor has shares between 20-50% over an investee, which means significant influence, then the investee should be considered as an Associate unless otherwise. At the time of acquisition, significant influence occurred, then the investment in G-Heart should be recorded as an associate. Three months later, Government took control of share companies' Indian shares. Therefore, in G-Heart Company, Government holds the 70% of the shares and makes all the relevant operational and financial decisions. According to IAS 28, significant influence disappears when the investor loses its participation power in the associate's operating and financial decisions and, in case of a change in absolute or relative ownership levels such as Government, court, administrator, or regulator becomes the controller of an associate. In the G-Heart case, this is the situation. Even though FasText holds 30% shares, it will not be included in the financial and operational activities, therefore not ensuring significant influence. In this case, significant influence disappeared, turning this investment into a financial asset.

Dr. Financial Asset 1,000,000

(Investment in G-Heart)

Cr. Associates 1,000,000

CASE STUDY - IAS 29 FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES

Erika Besuspariene*

Introduction

One of most important indicators in a market economy is inflation. Prices for goods and services always change, the total price level increases, and you can buy less for the same amount of currency than before. In some countries, these changes are significant and indicate hyperinflation.

The aim of this case study is to encourage students to think about the issues of preparation of the financial statements, if entity operates in a country with the hyperinflation economy. The case study addresses the following issues:

- First, it seeks to provide the ability to understand that financial statements without adjustment do not disclose the purchasing power of money, and financial data cannot be used to make financial decisions in hyperinflation economy countries.
- Second, its aim is to provide the ability to identify the methods used in different elements of accounting and make decisions about the elements of accounting adjustment, if it is needed in hyperinflation economy countries.

The Case Information

Global Consultation (GC) operates in a hyperinflationary economy country. The main activity of the company is the provision of services; the cost of services consists of the services of subcontractors. Revenue and expenses have incurred evenly during the current year. Company "GC applies the historical cost method. The financial statements below of the company GC are presented in the functional currency.

* Assoc. Prof., Vytautas Magnus University, erika.besuspariene@vdu.lt, ORCID: 0000-0001-5111-1307

Statement of Financial Position		
Item	**Current year, CU**	**Previous year, CU**
Receivables amount	20,000	15,000
Cash	30,000	40,000
Total:	50,000	55,000
Share capital	10,000	10,000
Profit (loss)	40,000	45,000
Total:	50,000	55,000

Statement of Profit or Loss and Other Comprehensive Income		
Item	**Current year, CU**	**Previous year, CU**
Sales revenue	100,000	120,000
Costs of sales	(65,000)	(78,000)
Gross profit	35,000	42,000
Administrative expenses	(40,000)	(38,000)
Net profit	(5,000)	4,000

The price indexes were:

Current year		Previous year	
January 1 – 220	December 31 – 180	January 1 – 200	December 31 – 220

Discussion Questions

1. Can these financial statements of GC be presented to users of the financial statements? Explain.
2. What changes should be introduced in the financial statements of GC so they can be presented to the user and reveal the true and fair financial face of GC? Explain.
3. Prepare GC financial statements, provide calculations.

SOLUTION OF CASE STUDY – IAS 29 FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES

If GC is operating in a country with a hyperinflationary economy, unspecified financial statements cannot be presented to users, since without the recalculation by price index level, the financial statements do not reveal GC's true financial situation. In this case, the data in the financial statements must be adjusted to reflect the change in the level of the price index.

The amounts in the Statement of Financial Position should be recalculated as follows:

Statement of Financial Position						
Item	**Current year**			**Previous year**		
	CU	**Index level**	**CCU***	**CU**	**Index level**	**CCU***
Receivables amount	20,000	-	20,000	15,000	180/220	12,273
Cash	30,000	-	30,000	40,000	180/220	32,727
Total:	**50,000**		**50,000**	**55,000**		**45,000**
Share capital	10,000	180/220	8,182	10,000	180/220	8,182
Profit (loss)	40,000	50,000-8,182	41,818	45,000	45,000-8,182	36,818
Total:	**50,000**		**50,000**	**55,000**		**45,000**
Gain (loss) on the net monetary position	*Formed as a result of the following recalculation:* *Share capital 8,182 – 10,000 = -CU1,818 (expenses)* *Profit (loss) 40,000x180/220 – 40,000 = -CU7,273 (expenses)* *Total: -CU9,091 (loss)*			*Formed as a result of the following recalculation:* *Receivables amount 12,273 – 15,000 = -CU2,727 (expenses)* *Cash 32,727 – 40,000 = -CU7,273 (expenses)* *Share capital 8,182 – 10,000 = -CU1,818 (expenses)* *Profit (loss) 45,000x180/220 – 45,000 = -CU8,182 (expenses)* *Total: -CU20,000 (loss)*		

***Converted currency unit**

Data about the previous period (regardless of the historical cost method or the current cost method used) is recalculated using the current price index for the current reporting period. Receivables amount and cash are not recalculated for the current year, because they are already presented in the measuring unit current at the end of the period. The earnings retained (profit/loss) are calculated as the difference between the value of the assets and the value of the shares. The resulting gain (loss) on the net monetary position will be presented in the statement of profit or loss and other comprehensive income.

If income and expenses have incurred evenly over the year, the average change in the price index can be applied in recalculating the statement of profit or loss and other comprehensive income:

Current year		Previous year	
Average price index	January 1 – 220 December 31 – 180 (220+180)/2=200	**Average price index**	January 1– 200 December 31– 220 (200+220)/2=210

Recalculation of the income statement amounts:

Statement of Profit or Loss and Other Comprehensive Income						
Item	**Current year**			**Previous year**		
	CU	**Index level**	**CCU***	**CU**	**Index level**	**CCU***
Sales revenue	100,000	180/200	90,000	120,000	180/210	102,587
Costs of sales	(65,000)	180/200	(58,500)	(78,000)	180/210	(66,857)
Gross profit	35,000		31,500	42,000		35,730
Administrative expenses	(40,000)	180/200	(36,000)	(38,000)	180/210	(32,571)
Gain (loss) on the net monetary position			8,590			11,071
Net profit	(5,000)		4,090	4,000		14,230
Gain (loss) on the net monetary position	*Formed as a result of the following recalculation:* *Sales revenue 90,000 – 100,000 = -CU10,000 (loss)* *Costs of sales -58,500 – (-65,000) = CU6,500 (Gain)* *Administrative expenses -36,000 – (-40,000) = CU4,000 (Gain)* *Total: CU500 (gain from profit (loss) statement) – CU9,091 (loss from financial positions statement) = -CU8,591 (loss)*			*Formed as a result of the following recalculation:* *Sales revenue 102,857 – 120,000 = -CU17,143 (loss)* *Costs of sales -66,857 – (-78,000) = CU11,143 (gain)* *Administrative expenses -32,571 – (-38,000) = CU5,429 (gain)* *Total: 571 CU (gain from profit (loss) statement) – CU20,000 (loss from financial positions statement) = -CU19,429(loss)*		

***Converted currency unit**

The following financial statements will be available to users of financial statements:

Statement of Financial Position		
Item	**Current year, CU**	**Previous year, CU**
Receivables amount	20,000	12,273
Cash	30,000	32,727
Total:	**50,000**	**45,000**
Share capital	8,182	8,182
Profit (loss)	41,818	36,818
Total:	**50,000**	**45,000**

Statement of Profit or Loss and Other Comprehensive Income		
Item	**Current year, CCU**	**Previous year, CCU**
Sales revenue	90,000	102,587
Costs of sales	(58,500)	(66,857)
Gross profit	**31,500**	**35,730**
Administrative expenses	(36,000)	(32,571)
Gain (loss) on the net monetary position	(8,591)	(19,429)
Net profit	**(13,091)**	**(16,270)**

CASE STUDY - IAS 32 FINANCIAL INSTRUMENTS: PRESENTATION

Turgay Sakin*

Introduction

Financial instruments used in today's economies can be quite complex and difficult to understand. Accounting, valuation, classification of financial instruments and making explanations about financial instruments is a very comprehensive subject. This comprehensive subject has been addressed with 3 different accounting standards. Classification of financial instruments in financial statements is within the scope of IAS 32.

In this case, it is aimed to explain how to classify financial instruments according to their characteristics under certain conditions.

The Case Information

Troy Company is a toy company founded in 1998. The company has become an important player in the market in a short time with its quality toys that are loved by children. In order to grow in this period, Troy company has taken care to establish strategic partnerships both on the supply side and on the sales and distribution side. Troy Enterprise signed an agreement with Rapid Plastics Company, a small chemical company, in 2016 as part of this strategic cooperation plan. Under this agreement, the Troy company would provide her with financing to support the growth of Rapid Plastics company. In this agreement, Troy Company presented two alternatives to Rapid Plastics Company.

In the first alternative, Troy Company would purchase some shares of Rapid Plastic Company for CU 200,000. Rapid Plastic Company would pay an annual dividend of CU10,000 over 10 years in exchange for these purchased shares. Ten years later, Troy Company would sell the shares it had bought back to Rapid Plastic Company for CU250,000.

* Assoc. Prof., İstanbul University, tsakin@istanbul.edu.tr, ORCID: 0000-0001-6953-3516

In the second alternative, the Troy company would also lend CU200,000 to Rapid Plastic. According to the agreement, Rapid Plastic Company would be able to pay off this debt in two different ways after 5 years. In the first, Rapid Plastics Company would be able to pay off the debt by paying CU400,000 in cash. The second was that Rapid Plastic company would give 2,000 shares to Troy Company to cover the debt. However, the decision of which of these alternatives to be applied would be determined by the management of Troy Company.

Rapid Plastic Company executives, after the evaluations, decided that the first option would be more suitable for the entity. After the approval of both parties, an agreement was signed on December 29, 2016, and the sale of shares was realized. At the end of 2016, Troy Company classified the purchased shares as financial asset investments to be reported at Fair Value Through Profit and Loss. On the other hand, Rapid Plastic Company recognized this agreement as a share sale.

Discussion Questions

a. Is the way of the presentation of this agreement in the statement of financial position appropriate for both companies? Even if the business has legally sold shares, can it report it as a different transaction in its financial statements?
b. If the businesses had chosen the second alternative, how would this agreement affect the financial statements of the entities?

SOLUTION OF CASE STUDY - IAS 32 FINANCIAL INSTRUMENTS: PRESENTATION

a. There are two parties in this case: Troy Company and Rapid Plastic Company. For Troy Company, shares purchased under the given agreement are financial assets. According to IAS 32, an equity instrument of another entity is a financial asset. The classification of this financial asset will be determined according to the business model test and cash flow characteristics test specified in IFRS 9.

Rapid Plastic Co, on the other hand, needs to decide whether this financial instrument is a financial debt or an equity instrument. Considering the legal framework of the agreement, the stocks to be given should be classified as equity instruments. The first critical question for classification is whether the relevant financial instrument contains contractual obligations. Analysing the deal, we understand that Rapid Plastic Company is issuing shares and sending them to Troy Company. However, Rapid Plastic Company is obliged to pay a fixed dividend to Troy Company for 10 years and undertakes to repurchase the shares at the end of 10 years by paying a predetermined price. This is a contractual obligation. Due to that Rapid Plastic should classify this as a financial liability.

b. The second alternative looks like a liability from a legal perspective. Troy Company extends a CU200,000 loan to Rapid Plastic Company and obliges Rapid Plastic Company to pay CU450,000 at the end of the fifth year, even though it does not charge periodic interest payments for 5 years. Up to this point, this transaction seems to be a financial liability in terms of IAS 32.

However, in the agreement, Troy Company has the right to purchase 2,000 Rapid Plastic Company shares instead of receiving the CU450,000 repayment. The agreement includes a contractual obligation as well as an equity component. In this case, it should be considered as a compound instrument. Rapid Plastic Company management should first calculate the value of the portion to be classified as financial liability in relation to this compound instrument. Afterwards, it should find the equity instrument value by subtracting the financial liability amount from the total amount.

CASE STUDY - IAS 33 EARNINGS PER SHARE

Yasemin Ertan*

Introduction

Earnings per share (EPS) is the most commonly used ratio to evaluate the financial performance of an entity over different periods and compare various entities' financial performance. In IAS 33, two definitions of EPS, namely basic EPS and diluted EPS, are discussed.

The aim of this case study is to discuss the calculation of basic and diluted EPS and disclosures that should be done in the scope of IAS 33 in financial statements.

The Case Information

Agro-Int Company was founded in 1942 in Türkiye. The Company's main activity is producing and marketing agricultural fertilisers. The Company's mission is to provide the highest benefit to the agricultural sector with sustainable growth. As an extension of this mission, it was decided to establish a new organization in Uzbekistan. After long research, a manager who can speak English, Turkish, and Uzbek languages was hired. The manager lives in Kazakhstan, CEO of the Agro-Int wanted the manager to move to Uzbekistan. The manager received 15,000 share options at CU3 on April 1, 2022.

Agro-Int company's equity was CU1,000,000 on December 31, 2021. And the company had 1,000,000 shares on December 31, 2021. On March 1, 2022 total of 200,000 new bonus share was issued. The company's equity and profit on December 31, 2021, and December 31, 2022, are as follows (all amounts in CU):

Items	31.12.2021	31.12.2022
Equity	1,000,000	1,200,000
Net profit	450,000	550,000

* Assoc. Prof., Bursa Uludag University, yasertan@uludag.edu.tr, ORCID: 0000-0002-9193-3396

Agro-Int Company has had a contingent share agreement since 2020. According to this agreement, 1% of the net profit will be distributed to the managers as shares if the net profit exceeds CU500,000.

The entity sold 3,000 convertible bonds on August 1, 2021. A bond can be convertible into three ordinary shares. In 2022, CU2,400 was paid for convertible bond interest. Interest that was paid to convertible bond holders in 2021 was 1,000. The corporate tax rate in 2021 and 2022 is 20%.

The company's shares market price can be seen in the following table (all amounts in CU):

Year	Minimum market price	Maximum market price	Average market price
2021	1	3	2
2022	1	5	4

Discussion Questions

1. Please discuss the meaning and importance of basic EPS and diluted EPS for financial statement users.
2. Please calculate the basic EPS and diluted EPS of Agro-Int Company for 2021 and 2022.

SOLUTION OF CASE STUDY - IAS33 EARNINGS PER SHARE

1. Basic EPS expresses how much the company actually earns per share. Whereas diluted EPS enables financial statement users to see the entity's future. The existence of potential ordinary shares of the entity indicates the probability of an increase in the number of shares in the future. The realization of this possibility will lead to a decrease in the partnership rate of those holding the shares in the current period. Diluted earnings per share provide information on how much earnings per share would have been if potential ordinary shares had been converted to ordinary shares.

Basic EPS

In IAS 33, two different definitions of EPS, namely basic EPS and diluted EPS, are discussed. The profit figure calculated by considering the number of outstanding ordinary shares of the entity is called the basic EPS. When a bonus share is issued, the total resources of the entity do not change, but the total number of shares does change. In this condition, to make it possible to compare periods, earnings per share must be adjusted to the beginning of the earliest period presented, regardless of the actual issue date. When Agro-Int Company's basic EPS for 2021 is calculated, the effect of bonus shares that were issued in 2022 should be taken into account.

31.12.2021	**31.12.2022**
In 2021, the company had CU1,000,000 equity, 1,000,000 shares, and CU450,000 net profit. In 2022, the company issued 200,000 new bonus shares. To make a comparison between periods, new bonus shares that were issued in 2022 should be taken into account when the basic EPS of 2021 is calculated. $Basic\ EPS = \frac{450{,}000}{1{,}000{,}000 + 200{,}000}$ $Basic\ EPS = CU0{,}375$	In 2021, the company had CU1,000,000 equity, 1,200,000 shares, and CU550,000 net profit. $Basic\ EPS = \frac{550{,}000}{1{,}200{,}000}$ $Basic\ EPS = CU0{,}4583$

iluted EPS

Diluted EPS is also calculated by dividing the profit or loss attributable to ordinary shares by the number of ordinary shares. But in this calculation, both the numerator and denominator should be adjusted by considering the effect of potential ordinary shares. Share options, contingent share agreements, and convertible bonds are potential ordinary shares.

<table>
<tr><td colspan="2">SHARE OPTION
Options issued in the current period are deemed to have been exercised at the beginning of the period.</td></tr>
<tr><td>31.12.2021</td><td>31.12.2022</td></tr>
<tr><td>The manager was given 15,000 share options at CU3 on April 1, 2022. Thus they don’t affect the diluted EPS of 2021.</td><td>The manager received 15,000 share options at CU3 on April 1, 2022. Thus they should be received into account.
Income from the exercise of the options is $15{,}000 x\ 3 = CU45{,}000$.

The number of ordinary shares that can be purchased from the market at the average market price is $45{,}000/4\ =\ 11{,}250$.

These shares are antidilutive. Shares that have dilutive effects are $15{,}000 - 11{,}250 = 3{,}750$.

These shares can have a dilutive effect and should be taken into account when EPS is calculated. Thus diluted EPS is $\frac{550{,}000}{1{,}200{,}000+3{,}750}\ =\ CU0{,}4569$.

The options should be taken into consideration when the diluted EPS is calculated. In order to basic EPS (0,4583) is higher than the diluted EPS (0,4569).</td></tr>
<tr><td colspan="2">CONTINGENT SHARE AGREEMENT
Contingently issuable ordinary shares are included in the calculation if the condition is met in the current period, even if it is related to future periods. If the contingently issuable ordinary shares agreement is made in the prior period, the contingently ordinary shares are considered to have existed since the beginning of the current period when calculating the current period's diluted earnings per share.</td></tr>
<tr><td>In 2021, the company’s net profit was CU450,000. As the net profit did not exceed CU500.000, the relevant condition was not fulfilled. So contingent share agreement was not taken into account.</td><td>In 2022, the company’s net profit was CU550,000. As the net profit did not exceed CU500.000, the relevant condition was fulfilled. So contingent share agreement should be taken into account.
The number of shares to be distributed to the managers is as follows:

$$\frac{550{,}000\ x\ 0{,}01}{4} = 1{,}375$$
Diluted EPS = $\frac{550{,}000}{1{,}203{,}750+1{,}375} = CU0{,}4564$

When the contingently issuable shares were taken into account, the diluted EPS decreased to 0,4564 from 0,4569. Thus contingently issuable shares should be taken into account when the diluted EPS is calculated.</td></tr>
</table>

<table>
<tr><td colspan="2">CONVERTIBLE BONDS
When the number of ordinary shares emerging from the conversion of convertible instruments is calculated, time-weighting factor are considered.</td></tr>
<tr><td>The entity sold 3,000 convertible bonds on August 1, 2021. In 2021, the company paid CU1,000 in interest to convertible bond holders. The corporate tax rate in 2021 is 20%.
The after-tax value of the interest paid for the bonds is as follows:
$1000x\ (1-0{,}20)=800$

The weighted average number of potential shares is calculated as follows:
$3{,}000x\ 3x\ \frac{5}{12}=3{,}750$

Diluted EPS = $\frac{450{,}000+800}{1{,}200{,}000+3{,}750}=CU0{,}3745$.
With the issuance of the convertible bonds, the diluted EPS decreased to 0,3745 from 0,375. Thus convertible bonds should be taken into account when the diluted EPS is calculated.
$Basic\ EPS=\frac{450{,}000}{1{,}000{,}000+200{,}000}$
$Basic\ EPS=CU0{,}375$</td><td>In 2021, the company paid CU2,400 in interest to convertible bond holders. The corporate tax rate in 2021 is 20%.

The after-tax value of the interest paid for the bonds is:
$2{,}400x\ (1-0{,}20)=1{,}920$

The weighted average number of potential shares is calculated as follows:
$3{,}000x\ 3x\ \frac{12}{12}=9{,}000$

Diluted EPS is $\frac{550{,}000+1{,}920}{1{,}205{,}125+9{,}000}=CU0{,}4566$.
When the convertible bonds are taken into account, diluted EPS increases to 0,4566 from 0,4564. Thus convertible bonds should not be taken into account when the diluted EPS is calculated.</td></tr>
</table>

CASE STUDY - IAS 34 INTERIM FINANCIAL REPORTING

Emre Selçuk Sarı*

Introduction

The main purpose of financial statements is to provide reliable and timely information to financial statement users. Financial statement users will be able to make decisions using this information. Another source of information for decision makers is interim financial statements. Interim financial statements are statements that provide users with financial information covering a period of less than one year. The IAS 34 standard defines the minimum content and recognition and measurement criteria that interim financial reports should have. In addition to these, the notes that should be included in the interim financial reports are also included in the standard. In addition, the standard also addresses how seasonal, cyclical and occasional revenues and unevenly costs should be accounted for. In the case, the problems that a company that uses IFRS for the first time may encounter while preparing its interim financial reports and their solutions are discussed.

The Case Information

Lightning Company is a company engaged in the production of electronic home appliances. The company started to use International Financial Reporting Standards (IFRS) for the first time in 2021 and will therefore prepare interim financial reports for the first time. The company wishes to prepare interim financial statements on a quarterly (quarterly) basis. The manager of the accounting department of the company has faced such a situation for the first time and he has conflicts about how interim financial reports should be prepared. The information obtained for the preparation of interim financial reports is as follows.

- Sales

* Assoc. Prof., İstanbul University, emresari@istanbul.edu.tr, ORCID: 0000-0001-6675-3214

Quarter	Sales
1	CU 1,000,000
2	CU 900,000
3	CU 1,200,000
4	CU 1,100,000
Total	**CU 4,200,000**

- Only at the end of the second quarter and at the end of the year physical inventory count is carried out in the company. The gross profit margin of the company is usually at the level of 25% of the gross sales. The gross profit realized at the end of the second quarter is 27%. At the end of the year, the gross profit was 26%.
- The company's largest customer placed orders that will result in sales revenue of CU 400,000 in the first quarter, CU 300,000 in the second quarter, CU 420,000 in the third quarter and CU 250,000 in the fourth quarter. The company gives a 5% discount to its customer if it exceeds the annual purchase worth CU 1,000,000 of goods. The customer exceeded this amount last year and is expected to exceed it this year.
- At the end of the second quarter, a net realizable value adjustment of CU 120,000 is required for inventories due to market conditions. This market-driven situation disappeared at the end of the year.
- At the end of the third quarter, the market value of inventories decreased by CU 55,000. This inventories value increases by CU 60,000 at the end of the fourth quarter.
- CU 50,000 was paid in the 2nd quarter for a promotional event to take place in the 3rd quarter.
- At the beginning of the first quarter, factory annual maintenance and necessary replacements (such as factory chimney air filter) were carried out and CU 90,000 was paid.
- If the targeted sales figures are reached, the company gives a bonus to the managers. Target sales figures are CU 4,000,000 per year and expected sales targets are expected to be met from Q1. The amount of bonus to be distributed to managers at the end of the year is CU 100,000.

Discussion Questions

The manager of the accounting department of Lightning Company thinks that you are one of the brightest and most knowledgeable employees in the company, and has asked for your help in the preparation of interim financial reports. How do you think the effect of the above information should be on the interim financial reports to be prepared for each quarter?

SOLUTION OF CASE STUDY - IAS 34 INTERIM FINANCIAL REPORTING

	Quarter 1 (CU)	Quarter 2 (CU)	Quarter 3 (CU)	Quarter 4 (CU)	Yearly (CU)
Sales Revenue	1,000,000	900,000	1,200,000	1,100,000	**4,200,000**
Sales Discounts *	-50,000	-45,000	-60,000	-55,000	**-210,000**
Cost of Goods Sold (Gross Profit Method)[β]	-750,000		-900,000		**-1,650,000**
Cost of Goods Sold (Based on Actual Physical Count)[β]		-637,000		-821,000	**-1,458,000**
Temporary Net Reliaziable Value Change[℧]		-120,000		120,000	**0**
Decline in Inventory Value With Subsequent Increase[α]			-55,000	55,000	**0**
Promotion Expense[ϕ]			-50,000		**-50,000**
Maintenance and Replacement Expense[€]	-22,500	-22,500	-22,500	-22,500	**-90,000**
Bonus Expense[∞]	-23,809.5	-21,428.6	-28,571.4	-26,190.5	**-100,000**

* The customer has reached the purchase amount required for the discount in the last quarter. However, since firm orders will exceed CU 1,000,000, the obligation to the customer is likely to be fulfilled. A discount of 5% from sales revenue is required of the customer's purchases each quarter.

1.Quarter: CU 1,000,000 * 5% = CU 50,000

2.Quarter: CU 900,000 * 5% = CU 45,000

3.Quarter: CU 1,200,000 * 5% = CU 60,000

4.Quarter: CU 1,100,000 * 5% = CU 55,000

β Cost of Goods Sold

Cost of Goods Sold (Gross Profit Method is calculated by multiplying Q1 and Q3 sales (1-Expected Profit Margin).

Cost of Goods Sold (Based on Actual Physical Count): Total sales in Q2 and Q4 are multiplied by actual gross profit margin. It is calculated by subtracting the cost of goods sold in the Q1 and Q3 from the results obtained.

Q1 and Q2 Total Cost of Goods Sold: (CU 1,000,000 + CU 900,000) * (1 – 0.27) = CU 1,387,000

Q1 Cost of Goods Sold = CU 1,000,000 - (1 – 0.25) = CU 750,000

Q2 Cost of Goods Sold = CU 1,387,000 – CU 750,000 = CU 637,000

Total Cost of Goods Sold: CU 4,200,000 * (1 – 0.26) = CU 3,108,000

Q3 Cost of Goods Sold = CU 1,200,000 - (1 – 0.25) = CU 900,000

Q4 Cost of Goods Sold = CU 3,108,000 - (CU 1,387,000 + CU 900,000) = CU 821,000

Ʊ Temporary Net Realizable Value Change: Although the net realizable change in value will disappear at the end of the year, it should be reported in the financial reports in the period when it occurs.

α Decline in Inventory Value with Subsequent Increase: The decrease in the value of inventories is reported in the interim financial reports in the relevant quarter. The increase in value is also included in the interim financial reports in the quarter in which it occurs, but the portion exceeding the previous decrease in value is not reported in the interim financial statements.

ϕ Promotion Expense: Prepaid expense is recognized as an expense in the quarter in which it accrued.

€ Maintenance and Replacement Expense: Even if it was done in the Q1, it should be distributed evenly throughout the year.

Maintenance and Replacement Expense (Quarterly) = CU 90,000 / 4 = CU 22,500

∞ Bonus Expense: It should be distributed proportionally to the sales revenues for each quarter.

Q1: (CU 100,000/CU 4,200,000)* CU 1,000,000 = CU 23,809.52

Q2: (CU 100,000/CU 4,200,000)* CU 900,000 = CU 21,428.57

Q3: (CU 100,000/CU 4,200,000)* CU 1,200,000 = CU 28,571.43

Q4: (CU 100,000/CU 4,200,000)* CU 1,100,000 = CU 26,190.48

CASE STUDY - IAS 36 IMPAIRMENT OF ASSETS

Catalin Albu* - Nadia Albu**

Introduction

Faithfully reflecting the value of financial statement elements contributes to providing relevant information to users, who can make informed decisions based on these reports. To this end, entities are supposed to recognize any impairment for their assets. Asset impairment requires management to exercise their judgment on the best way to proceed, and this process is based on and results in making estimates that should accurately reflect the value entities expect to obtain from their assets over the coming period. Since this process may result in losses being recognized in the entities' financial statements, management may be inclined not to recognize them in a timely manner. Nevertheless, the resulting reported information is biased (not free from errors), not neutral (overestimates assets) and not faithfully representing a relevant phenomenon (that the benefits expected to be realized by the entity from their assets are not as high as it was previously anticipated).

This case study is designed to underline the importance of accurately performing the necessary impairment testing of assets, when conditions require so, and of accurately reporting the consequences of such tests in the entities' financial statements.

The Case Information

You are a junior accountant working with the accounting department of Brown Toy Ltd., a small, listed entity producing toys for small children. Management is concerned about the impact of the recent economic crisis on the financial statements of the entity.

Brown Toy Ltd. produces two types of toys – wooden toys and plastic toys. The entity is organized around the two types of toys, each of these being set up as a department. Mr. Brown, the founder, started his business 30 years ago by producing wooden toys, being initially inspired by his children. Some years later, the company grew by the acquisition of another small producer, focused on plastic toys.

* Prof., ASE Bucharest, catalin.albu@cig.ase.ro, ORCID: 0000-0002-3282-8414
** Prof., ASE Bucharest, nadia.albu@cig.ase.ro, ORCID: 0000-0003-2953-9619

The end of the financial year 20X1is fast approaching (we are now at the end of December 20X1) and management is concerned about the implications of the recent economic crisis that affects Happyland, the country where the entity is based. The demand for toys has abruptly decreased, and it is forecasted to decrease over the following years even more than the initial prospects.

A management meeting will take place soon to discuss the consequences of these events on the financial statements prepared by the entity for the year 20X1. You receive the following excerpts from the preliminary data to be used for the 20X1 financial statements.

Assets	Wooden toys departments (carrying amount, in CU)	Plastic toys department (carrying amount, in CU)	Total
Production line	55,000	35,000	90,000
Other property, plant and equipment	15,000	15,000	30,000
Goodwill		20,000	20,000
Building			20,000
Total	70,000	70,000	160,000

The budgeted data for the two lines of activity are as follows:

Budgeted data	Wooden toys department	Plastic toys department
Units of yearly sales estimated in 20X0 for the next years	20,000 units	12,000 units
Units of yearly sales estimated in 20X1 for the next years	17,000 units	10,000 units
Discounted cash flows for the next 5 years	CU65,340	CU64,000

If the departments would be sold as a whole, their fair value less costs to sell would be CU68,000 for the Wooden toys department, and CU70,000 for the Plastic toys department.

The general manager of Brown Toy Ltd. is concerned that the market decrease might negatively impact how the entity's assets are measured and that losses might have to be reported. However, the manager of the Plastic toys department believes that his department is not affected, and that an impairment test should not be carried out, since this department might be sold at a value that is equal to the carrying amount of the assets.

Discussion Questions

You are asked to prepare a report to the management, addressing the following issues:

1. Does an impairment test need to be conducted, and if so, for which department?
2. What are the consequences of the impairment test and what values need to be reported in the financial statements for the year 20X1?

SOLUTION OF CASE STUDY- IAS 36 IMPAIRMENT OF ASSETS

To: Management of Brown Toy Ltd.

From: Junior accountant

About: Impact of the economic crisis on the value of the entity's assets

1. I assessed the need to conduct an impairment test for the entity's assets. This test would indicate if these assets have lost part of their value, and if losses must be recognized. An impairment test is needed:
   a) For the Wooden toys department – because there are external indications (the market has decreased from 20,000 units to 17,000 units) that the value of its assets might have decreased.
   b) For the Plastic toys department – this department has allocated goodwill, and a yearly impairment test is needed.

Therefore, the impairment test needs to be conducted at the department level (as independent cash generating units – CGU), for both departments.

2. To conduct the impairment test, the value of the building (corporate asset) must be first allocated to the two departments. Since the assets of the two departments have the same carrying amount, and there are no differences in how these assets are used, we will split evenly the value of the building between the two departments. Then, the carrying amount of the department is compared to its recoverable amount, which is the higher of its value in use (discounted cash flows) and its fair value less costs to sell.

Assets	Wooden toys department (in CU)	Plastic toy department (in CU)
Original carrying amount	70,000	70,000
Building (corporate asset)	10,000	10,000
Total carrying amount	**80,000**	**80,000**
Value in use	65,340	64,000
Fair value less costs to sell	68,000	70,000
Recoverable amount	**68,000**	**70,000**
Loss for the cash generating unit	**12,000**	**10,000**

The loss is allocated first to goodwill, if the cash generating unit has any, and any remaining loss amount is allocated to the assets forming the cash generating unit, pro-rated based on the carrying amount of each asset in the unit.

The Wooden toys department does not have any goodwill. Therefore, the computations related to the impairment loss for this department are the following:

Assets	Original amounts (in CU)	Allocated loss (in CU)	Final amounts (in CU)
Production line	55,000	12,000*55,000/80,000 = 8,250	46,750
Other property, plant and equipment	15,000	12,000*15,000/80,000 = 2,250	12,750
Building	10,000	12,000*10,000/80,000 = 1,500	8,500
Total	80,000	12,000	68,000

The Plastic Toys department has allocated goodwill. Therefore, the computations for this department are the following:

Assets	Original amounts (in CU)	Allocated loss (in CU)	Final amounts (in CU)
Production line	35,000		35,000
Other property, plant and equipment	15,000		15,000
Goodwill	20,000	10,000	10,000
Building	10,000		10,000
Total	80,000	10,000	70,000

The overall impact on the statement of financial position is the following:

Assets	Amount before the impairment test (in CU)	Amount after the impairment test (in CU)
Production line	90,000	81,750
Other property, plant and equipment	30,000	27,750
Goodwill	20,000	10,000
Building	20,000	18,500
Total	160,000	138,000

The statement of profit or loss is impacted by an impairment loss of CU22,000.

CASE STUDY - IAS 37 PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

Catalin Albu* - Nadia Albu**

Introduction

Many entities have liabilities that are characterised by uncertainty in terms of timing, probability of occurrence, and value. Estimates and professional judgement are employed to determine if and when these are recognized as liabilities in the statement of financial position, or disclosures made in the notes to the financial statements suffice for offering useful information to users.

The aim of this case study is to discuss the consequences of liabilities that are characterised by uncertainty in terms of timing, probability of occurrence, and value, on the entities' financial position. You are an accountant working with Oil Terminal Ltd., a multinational corporation active in the oil and gas industry. Despite its best efforts, it is inevitable for the entity to avoid polluting the environment, given its activity. However, it is not always obvious if and to what extent the entity must ensure that the sites are restored. This also depends on the laws in place in various jurisdictions.

The Case Information

Oil Terminal Ltd. is based in and listed on the stock exchange of Developedland, a well-developed country, and it operates two sites in this jurisdiction. Developedland has strong laws in place demanding entities to restore the damaged environment. Moreover, the entity's slogan is: "We care for and protect Developedland's environment". It is expected that the restoration costs of the environment after the production ends amount to CU25,000. A provision of CU15,000 has been recognized in prior years in this respect.

Moreover, Oil Terminal Ltd. has subsidiaries and operates extraction sites in three developing countries, i.e., Eastland, Southland and Northland. Eastland has no law

* Prof., ASE Bucharest, catalin.albu@cig.ase.ro, ORCID: 0000-0002-3282-8414
** Prof., ASE Bucharest, nadia.albu@cig.ase.ro, ORCID: 0000-0003-2953-9619

obliging companies to restore the sites once they were polluted. However, it is virtually certain that a law will be passed early next year obliging companies to restore their sites. The estimated costs to restore the sites are CU6,000.

Southland has no law in place requiring companies to protect the environment, but several NGOs push entities to be more responsible. Having a good image in this respect helps attract more clients in this country. Therefore, the subsidiary in Southland publicly announced that it will restore the environment. The estimated costs are between CU8,000 and CU10,000.

The subsidiary in Northland has just started its activity. It is the first operation of the Oil Terminal entity in that region. Northland has a law in place requiring entities to restore the environment. However, the managers of the Northland's subsidiary claim that they cannot estimate the future costs of restoring the environment, given that they just started the operations there.

The forecast duration of the operations is between 10 and 15 years in all sites. The indicated amounts of the costs are not discounted.

Discussion Questions

1) Discuss if a provision should be recognised in each country, and for what amount.
2) What is the time value of money implication for the provisions to be recognised?

SOLUTION OF CASE STUDY - IAS 37 PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

1) In accordance with IAS 37, provisions are recognised when:

a) an entity has a present obligation (legal or constructive) as a result of a past event;
b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
c) a reliable estimate can be made of the amount of the obligation.

If all or any of these conditions are not met, no provision shall be recognised. The value of the provision reflects the liability at the end of the year.

Oil Terminal has both a legal and a constructive obligation to restore the environment in Developedland. Given that its activities pollute the environment, it is probable to incur an outflow of resources to settle the obligation. The liability was estimated at CU25,000. This is the amount to be reported in the statement of financial position at the end of the period. Given that a provision of CU15,000 is already recognised, an adjustment (increase in provisions) will be recorded for CU10,000.

Eastland will certainly have a law; therefore, Oil Terminal's subsidiary is under the legal obligation to restore the environment. Given that its activities pollute the environment, it is probable to incur an outflow of resources to settle the obligation. The liability was estimated at CU6,000. This is the amount to be reported in the statement of financial position at the end of the period (therefore, at the end of the year an expense and a provision of CU6,000 are recognised).

The subsidiary in Southland does not have any legal obligation to restore the environment, but it has a constructive one, given its public statement to that effect. Given that its activities pollute the environment, it is probable to incur an outflow of resources to settle the obligation. The liability was estimated between CU8,000 and CU10,000. The liability needs to be measured at the most likely outcome. Based on the experts' opinion, an amount between CU8,000 and CU10,000, reflecting the most likely outcome, will be reported in the statement of financial position at the end of the period (and an expense with the same amount will be reported in the statement of profit or loss).

The subsidiary in Northland has a legal obligation and a probability of outflows of resources. However, given that it just started its activity, managers claim that they do not have enough data to reliably estimate the value of the provision. Therefore, a provision cannot be recognised, but the entity must disclose (in the notes) a contingent liability.

2) When the time value of money differs significantly, provisions must be measured at discounted values. This is particularly the case when the liabilities will be settled after a long period (of several years), which is the case here. Therefore, each of the provisions recognised must be discounted, taking into consideration the appropriate discount rate for each country. Discounting provisions will result in lower amounts reported in liabilities at first, and in a yearly increase in liability and a yearly financial expense to recognise the yearly financial cost in the statement of profit or loss.

CASE STUDY - IAS 38 INTANGIBLE ASSETS

Cătălin Albu* - Nadia Albu**

Introduction

Intangible items represent a significant portion of entities' investments, and they are crucial to their functioning and development. However, not all intangible items may be recognized as assets. It is therefore important to understand how investments in intangible items impact the financial statements of an entity.

The aim of this case study is to assess and examine if and when expenditures made for intangible items are recognized as intangible assets in, and to discuss the consequences on, the statement of financial position and on the statement of profit or loss.

The Case Information

You work with the accounting department of Prepare for the future Ltd., an entity operating in the automotive industry, spending impressive budgets on innovation and development activities. The entity's strategy is conceived around quality and innovation. Most of the activities carried out in relation to this strategy are organised in the Development Department. The Department is in charge of preparing staff to be innovative and to produce high quality products, to run campaigns to promote and display the innovative spirit of the entity, and to establish projects to develop new products, or new components that improve existing products. When such a project is focused on a specific component or product, it receives a project number, and it starts to be followed separately.

The expenditures of the Development Department for the year 20X1 are the following (all amounts in CU):

* Prof., ASE Bucharest, Romania, catalin.albu@cig.ase.ro, ORCID: 0000-0002-3282-8414
** Prof., ASE Bucharest, Romania, nadia.albu@cig.ase.ro, ORCID: 0000-0003-2953-9619

Expenditures	Project X3206	Project X3207	General	Total
Materials	500	1,200	800	2,500
Services	300	2,000	8,300	10,600
Salaries	1,200	2,400	4,700	8,300
Others (rent, utilities etc.)	480	680	3,720	4,880
Total	2,480	6,280	17,520	26,280

This Department is managed as a cost centre, and even if management is highly supportive of investments in innovation, the department manager has a yearly budget of CU20,000 for expenses that she must meet. With this expense budget, the general manager intends to stimulate the department to engage in rewarding projects (which are mainly those resulting in assets; amortisation of assets is not allocated to the department).

The Development Department manager asks you to investigate the expenditures of the year 20X1 and to determine the amount recognized as expenses for the year. She provides you with the following details regarding the activity of the Department:

“20X1 was a very good year for the department, and I hope that most of our work results in assets. I am sure that we will meet our budget for the year.

We worked on two projects: Project X3206 is aimed at improving the mechanism of closing the door of the AlfaJ3 car model. The project was started last year and proved to be successful on March 1. Materials and services were consumed in January, and salaries and other expenses were consumed evenly throughout the year.

Project X3207 started on March 1, and it concerns a new prototype for an electric car. The technical feasibility, intention, and ability to finalise the project were certain on August 1. All expenditures were made evenly throughout the year.

A major training course has been organised for employees, to reduce the number of errors in production. Its amount was of CU3,000 and it is included in the services line for General expenditures.

A major campaign to promote the innovative spirit of the entity has been organised; the cost was of CU2,500 and it is included in the services line for General expenditures.

I believe that these two projects will bring significant benefits to the entity.

My salary (included in the salaries line for General expenditures) was CU200/month. I spent about 10% of my time supervising Project X3206 and about 20% supervising Project X3207."

Discussion Questions

1. What are the recognition criteria for an intangible asset?
2. Determine the value of intangible assets and that of expenses resulting from the expenditures of the Development Department for the year 20x1.

SOLUTION OF CASE STUDY - IAS 38 INTANGIBLE ASSETS

1. An intangible asset is an identifiable, non-monetary asset without physical substance. An asset is recognized when it meets the definition of an asset (a present economic resource controlled by the entity as a result of past events (CFFR.4.3). An economic resource is a right that has the potential to produce economic benefits (CFFR.4.4)). Moreover, IAS 38 outlines three critical features of an intangible asset: identifiability; control (power to obtain benefits from the asset); future economic benefits (such as revenues or reduced future costs).
2. The activity of the Development Department comprises the following activities:
   - training activities – the expenditures cannot be recognized as an asset – control over employees and over the future benefits expected from the skilled staff is not ensured.
   - marketing activities – the expenditures cannot be recognized as an asset as there is uncertainty regarding the future benefits.
   - research and development activities – research (general documentation, analysis of the market, of competitors' products) is included under the General category, and these expenditures are all expensed. Development activities are carried out for specific projects and are identified as such. However, not all development costs are recognized as assets. Feasibility criteria must be met, and the entity must prove both the intention and the ability to finalise the projects. Capitalization (recognition of an asset) starts when these criteria are met.

Criteria for asset recognition are met for Project X3206 on March 1; therefore, capitalization starts on this date.

The value of intangible assets and of expenses resulting from Project X3206 (all amounts in CU):

Expenditures	Total expenditures	Intangible asset	Expenses
Materials	500 – consumed in January		500
Services	300 – consumed in January		300
Salaries	1,200 – consumed evenly	1,200*10/12 = 1,000	1,200 * 2/12 = 200
Others (rent, utilities etc.)	480 - consumed evenly	480 * 10/12 = 400	480*2/12 = 80
Salary of the manager	200*10%*12 = 240 - consumed evenly	240 * 10/12 = 200	240*2/12 = 40
Total		1,600	1,120

Project X3207 starts on March 1, therefore the work done for this project covers 10 months. Feasibility is proved on August 1, 5 months after inception. Therefore, only half of the period consists in activities that contribute to an asset.

The value of the asset and of expenses is resulting from Project X3207 (all amounts in CU):

Expenditures	Total expenditures	Intangible asset	Expenses
Materials	1,200	600	600
Services	2,000	1,000	1,000
Salaries	2,400	1,200	1,200
Others (rent, utilities etc.)	680	340	340
Salary of the manager	200 * 20% * 10 = 400 - consumed evenly	200	200
Total		3,340	3,340

Concluding, the value of the intangible assets recognized for the period, resulting from the two Projects (as development costs) is: CU1,600 + CU3,340 = CU4,940. The total expenditures of the department are CU26,280. Therefore, of this amount CU4,940 is capitalised as an asset and the rest of CU21,340 are expensed. This amount marginally exceeds the yearly expense budget of CU20,000 that is under the manager's responsibility. Better control in the future should assist the manager in achieving her target.

CASE STUDY - IAS 39 FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

Turgay Sakin[*]

Introduction

Entities face many different risks in the current economic system. It has been one of the duties of the managers to identify the possible negative effects of these risks on the financial performance of the entities and to control this effect. The effects of these risks on financial transactions and the control of the negative consequences of this effect with financial instruments are within the scope of IAS 39.

Certain conditions must be met for the application of hedge accounting. For hedge accounting, the characteristics of the hedged item and the related financial instrument must match within certain conditions. In this case, it is aimed to explain the relationship between hedged item and derivative instrument and to explain how hedge accounting is applied.

The Case Information

Babylon Company has been providing national and international transportation services. Although the entity has grown strongly since its foundation, it has always needed good management in a sector where there is a very strong competition. The transportation sector was one of the sectors that had significant operational risks and that these risks need to be managed continuously. However, despite all its risks, the transportation sector has been pleasing its investors as it transforms the successful financial performances of well-managed companies into high profitability figures.

At the beginning of 2022, the financial manager of the Babylon Company stated that they should pay attention to the rising risks in energy prices and that they should take precautions accordingly. However, upper management and executives in charge of operations stated that economic activity in the world is increasing

[*] Assoc. Prof., İstanbul University, Türkiye, tsakin@istanbul.edu.tr, ORCID: 0000-0001-6953-3516

slowly and that the increase in fuel prices will be limited in this environment. Top managers stated that the storage costs of the fuel to be purchased would be high. The finance manager then decided to buy an option to at least make money from the increase in fuel prices.

After short research, the finance manager decided that it would be appropriate to invest in crude oil futures contracts. Shortly after the finance manager bought the futures contract, the negative news that affected the whole world caused the fuel prices to rise rapidly. The finance manager has made a substantial profit by realizing his futures investment.

But the news from the operation side is not good at all. Rising fuel prices had negative consequences on costs. As a precaution against the increase in fuel prices, taking and storing fuel from the front caused a significant storage cost. However, before these extra fuels were used from the tanks, the world's fuel prices fell again and reached the old level, which increased the fuel and storage losses of the enterprise to significant levels. At the end of the year, the fuel cost of the Babylon Co. in 2022 was CU5,000,000, while the fuel cost in the warehouses was CU4,000,000. This change in fuel prices negatively affected the profitability trend of the enterprise. And next year would be even worse due to fuel purchased at a high price in 2022 and most of it not yet used.

While considering ways to reduce the possible impact of the increase in fuel costs on the financial statements, the finance manager thought of applying hedge accounting. In their meeting with the finance manager, accounting and operations managers, they calculated that they had purchased an additional CU6 million fuel due to the increase in fuel prices. The finance manager stated that he made a profit of CU5.5 million with the futures contract. And he stated that profits from futures investment and cost increase can be hedged. The accounting manager also stated that this could happen. He added that 2.5 million CU's of the additional cost in fuel is transferred to the cost of service account and the remaining amount is kept in ending inventory.

Discussion Questions

a. Show how the financial statements of Babylon Company will be affected in case of using or not using hedge accounting.
b. Is it appropriate for the entity to use hedge accounting?

SOLUTION OF CASE STUDY - IAS 39 FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

a. If hedge accounting will be applied, this will be cash flow hedge. In this case, the hedge item is the fuel price. In case of cash flow hedge, gains and losses arising from hedged item and hedge instrument must be measured and recognized separately. In this case, Babel Co calculated that it had spent CU6 million more due to the increase in fuel prices. As CU2.5 million of this additional expenditure is used, it has been transferred to the cost of service. The remaining CU3.5 million are in the ending inventory and when used next year it will be transferred to the cost of service.

The profit from the futures transaction is CU5.5 million. For hedge accounting, this gain should not be directly transferred to profit and loss but should be recognized in other comprehensive income. Gains from the futures transactions should transferred to profit and loss in the same period as gains and losses arising from the fuel price. Then some portion of futures gain should be used to offset the cost of service in 2022. The remaining amount will be used to offset cost of service of 2023 due to the usage of the high-priced fuel. Calculations and 2022 cost of service offset record are as follows.

	Total	**2022**	**2023**
Fuel	(6,000,000)	%40 (2,400,000)	%60 (3,600,000)
Futures	5,500,000	2,200,000	3,300,000
Total	(500,000)	200,000	300,000

Dr. Unrealized Gain from Futures (OCI) 2,200,000

Cr. Cost of Service 2,200,000

With this entry, a portion of the increased cost of service due to the increase in the fuel price will be offset by a portion of the profit from the futures transaction determined as a hedge item.

b. Simply NO. To apply hedge accounting, the transaction must provide hedge qualification. For hedge qualifications there are some conditions:
   1) Formal designation and documentation of the hedging relationship, entity's risk management strategy, and strategy for undertaking the hedge at its inception.
   2) High hedge effectiveness.

3) For cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect profit or loss.
4) Reliable measurement of hedge effectiveness.
5) The hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.

In this case, we see that the hedging relationship at the initial stage is not documented. More importantly, it is understood that the risk of increase in fuel prices was not determined as a significant risk by the management at the very beginning. For this reason, the hedge accounting applied above has not been made in accordance with the rules specified in IAS 39.

CASE STUDY - IAS 40 INVESTMENT PROPERTY

Cătălin Albu* - Nadia Albu**

Introduction

Many entities hold land or buildings to earn rentals or for capital appreciation. These assets represent investment property and different measurement principles apply to them than to items of property, plant and equipment, the category in which land and buildings used in production or for administrative purposes are included.

Aim of this case study is to discuss the consequences of the measurement of assets classified as investment property on the financial statements.

The Case Information

You work for NiceHotels Co., an entity managing several hotels. Some buildings are used as hotels by NiceHotels, while others are rented out, usually on the short term, to entities that are expected to use the building for similar purposes. Therefore, it is not costly for NiceHotels to change the use of the buildings. This flexibility (enhanced by the flexibility of the staff to move from one location to another) provides management with the opportunity to make decisions in line with the market evolution. Decisions are made based on the prospects for sales (resulting from the use as hotels) and on the expected impact of the measurement of the building on the financial statements.

You are asked to assess each of the following cases (all amounts in CU):

Property	20X1 Carrying amount	20X1 Fair value	Estimated amount for the end of 20X2	Estimated amount for the end of 20X3
Sea Sun	120,000	130,000	125,000	128,000
Mountain View	85,000	80,000	78,000	81,000
Central	65,000	67,000	64,000	68,000

* Prof., ASE Bucharest, Romania, catalin.albu@cig.ase.ro, ORCID: 0000-0002-3282-8414
** Prof., ASE Bucharest, Romania, nadia.albu@cig.ase.ro, ORCID: 0000-0003-2953-9619

- The Sea Sun is used by NiceHotels as a hotel and is located at the seaside. The building was purchased 10 years ago, and is depreciated annually for CU10,000. The rainy summer of 20X1 shortened the summer season and the hotel generated losses. Thus, NiceHotels considers renting the Sea Sun to a large car manufacturer that is in search of a location to organise regular in-house team building sessions.
- The Mountain View hotel has been rented out until this year. NiceHotels considers using it again as a hotel, given the good prospects of attracting tourists in the near future. The estimated remaining useful life of the building is 20 years.
- The Central is a former hotel that NiceHotels owns in the city centre. The building is rented out and management intends to keep it rented for at least 3 years.
- The accounting policies of NiceHotels are to use the cost model and the straight-line depreciation method for its property, plant and equipment assets, and the fair value model for investment properties.

Discussion Questions

Calculate and discuss the implications on the financial statements of NiceHotels Co. of the scenarios considered by the management for each asset. In doing so, you must also assess the implications of the transfer from one category to another that would take place at the end of 20X1, should management decide to make the transfer.

SOLUTION OF CASE STUDY - IAS 40 INVESTMENT PROPERTY

The Sea Sun is used as an asset by NiceHotels in the sale of accommodation services, and is therefore classified as property, plant and equipment. Being used for 10 years by the end of 20X1, it was depreciated for CU10,000 * 10 years = CU100,000. Therefore, the initial cost of the building was CU220,000 (the current carrying amount of CU120,000 + CU100,000 of accumulated depreciation). The asset will be measured as follows under the two scenarios that are considered by management for it (all amounts are in CU):

Scenario	**Use the Sea Sun as a hotel**	**Rent the Sea Sun out**
Type of asset	Owner-occupied property (Property, plant, and equipment)	Investment property
Measurement	Cost (depreciated amount)	Fair value
20X1	120,000	The building is transferred from property, plant and equipment to investment property. The asset should be measured at fair value before the transfer; hence it is revalued at its fair value (of 130,000) and a revaluation reserve of 10,000 is therefore recognized.
20X2	120,000 – 10,000 (depreciation) = 110,000	125,000 (a loss of 5,000 is recognized from fair valuing the investment property)
20X3	110,000 – 10,000 (depreciation) = 100,000	128,000 (a gain of 3,000 is recognized from fair valuing the investment property)

The Mountain View has been rented out; therefore, it is currently treated as investment property. If it is kept as investment property, it will continue to be measured at fair value. If it is transferred to owner-occupied property, the fair value at that date becomes the cost that will be depreciated thereafter. The asset will be measured as follows under the two scenarios that are considered by management for it (all amounts are in CU):

Scenario	Rent the Mountain View out	Use the Mountain View as a hotel
Type of asset	Investment property	Owner-occupied property (Property, plant, and equipment)
Measurement	Fair value	Cost (depreciated amount)
20X1	80,000 (a loss of 5,000 is recognized from fair valuing the investment property)	The building is transferred from investment property to property, plant and equipment, at its fair value (of 80,000) (a loss of 5,000 is recognized during this transfer). Starting 20X2, the building will be depreciated over 20 years.
20X2	78,000 (a further loss of 2,000 is recognized from fair valuing the investment property)	80,000 – 4,000 (depreciation; 80,000/20 years) = 76,000
20X3	81,000 (a gain of 3,000 is recognized from fair valuing the investment property)	76,000 – 4,000 (depreciation) = 72,000

In terms of the decisions that NiceHotels' management considers for these two buildings, management must assess the prospects of each of them to generate sales revenue and cash inflows, and compare them to the forecast expenses and expenditures, under the 'owner-occupied' scenario. The prospective profit and cash figures that result from this option should thereafter be compared to the profit or loss impact of fair valuing investment properties in the alternative scenarios.

The Central is rented out and therefore it is classified as investment property. It is therefore measured at fair value. There are no other scenarios for this asset. Therefore:

- At the end of 20X1: the asset is measured at CU67,000 (a gain of CU2,000 is recognized from fair valuing the investment property)
- At the end of 20X2: the asset measured is at CU64,000 (a loss of CU3,000 is recognized from fair valuing the investment property)
- At the end of 20X3: the asset is measured at CU68,000 (a gain of CU4,000 is recognized from fair valuing the investment property).

CASE STUDY - IAS 41 AGRICULTURE

Erika Besusparienė*

Introduction

In entities of agricultural activities, the accounting of biological assets and agricultural production (outputs) has specifics regarding the transformation of biological assets and the conversion of agricultural products. Cost accounting becomes complicated, and costs do not always reflect the value of biological assets as a result of transformation. Irrespectively, users of financial statements must receive relevant information. Therefore, IAS Standard 41 Agriculture determines the application of fair value for biological assets and agricultural production.

Aim of this case study is to encourage students to think about the issues of the preparation of financial statements if an entity's activity is agriculture. The case study addresses the following issues:

- First, it seeks to provide the ability to understand the methods of fair value measure, its meaning and impact on the financial position and performance of the entity.
- Second, it is to provide the ability to make a decision in measuring the fair value of biological assets and agricultural production (output), and make the necessary changes in financial statements.

The Case Information

Green Farm (GF) is an agricultural entity. GF operates in the protected area of the region and is valued for the preservation of rare local animal species. The majority of the management of the GF belongs to the X family, which has managed the entity for 3 generations. The activity of GF is mixed – crop and livestock farming:

- GF had 2 cows and 3 goats at the beginning of the year, the fair values less sales costs were set at CU4,000 for the cows and CU300 for the goats. The number of animals did not change during the period. Accumulated cost of animal husbandry was CU500.

* Assoc. Prof., Vytautas Magnus University, Lithuania, erika.besuspariene@vdu.lt, ORCID: 0000-0001-5111-1307

- Crop production was harvested at the end of July of the reporting year – 5 tons of wheat grain and 2 tons of barley grain. The accumulated cost of crop production was CU600 for growing and CU200 for growing barley.

GF operates only in the local market, i.e. agricultural products and livestock are not exported to foreign markets.

GF investors requested to present the financial statements on the 31st of July of the reporting year. The GF must measure the fair value of harvested grain and of livestock on the 31st of July. The accounting manager and the finance director collected the following information:

Information for fair value assessment of livestock	**Information for fair value assessment of agricultural production**
Taking into account the age, weight and other physiological characteristics of the animals, the following was determined: ● In July of the reporting year, the prices between the participants for the transactions were – CU3,800 for the cows and CU420 for the goats in the local market. ● In July of the reporting year, the prices among the participants for the transactions were – CU4,500 for the cows and CU410 for the goats in the foreign market.	● In order to manage the risks of price change in the market, a contract was concluded with the buyer in March of the reporting year. It stipulated that the following selling price will be applied in July – CU150 per tonne of wheat; CU110 per tonne of barley. ● In July of the reporting year, the prices were as follows: CU140 per tonne of wheat; CU130 per tonne of barley in the local grain exchange market. ● In July of the reporting year, the prices were CU130 per tonne of wheat; CU125 per tonne of barley in the foreign grain exchange market. ● The part of the grain was sold to another buyer on 2 August of the reporting year: ✔ 1.5 tonnes of wheat sold for CU135 per tonne; and ✔ 0.5 tonnes of barley sold for CU120 per tonne.

Discussion Questions

1. Based on the information collected by the accounting manager and the finance director, explain which information should be used to determine the fair value of grain and livestock?
2. Estimate what changes will be accounted in the financial accounting due to changes of the fair value of grain and livestock. Explain how this affects the financial statements on July 31? Determine what value of grain and livestock the investors will see in the financial statements?

SOLUTION OF CASE STUDY - IAS 41 AGRICULTURE

Even though GF accounting manager and finance director has collected a variety of information in different markets or under different contracts, not all information will be suitable for determining the fair value of livestock and grain.

Object	**Information for fair value assessment**	**Explanation**
Livestock	Taking into account the age, weight and other physiological characteristics of the animals, it was determined: ● In July of the reporting year, the prices between the participants for the transactions were – CU3,800 for the cows and CU420 for the goats in the local market. ● In July of the reporting year, the prices between the participants for the transactions were – CU4,500 for the cows and CU410 for the goats in the foreign market.	Considering that the animals are traded in the local market, the information in the foreign market will not be relevant. ***The fair value determined for animals will be – CU3,800 for the cows and CU420 for the goats***.
Agricultural production	● In order to manage the risks of price change in the market, a contract was concluded with the buyer in March of the reporting year. It stipulated that the following selling price will be applied in July – CU150 per tonne of wheat; CU110 per tonne of barley. ● In July of the reporting year, the prices were as follows: CU140 per tonne of wheat; CU130 per tonne of barley in the local grain exchange market. ● In July of the reporting year, the prices were CU130 per tonne of wheat; CU125 per tonne of barley in the foreign grain exchange market. ● The part of the grain was sold to another buyer on 2 August of the reporting year: ✔ 1.5 tonnes of wheat sold for CU135 per tonne; and ✔ 0.5 tonnes of barley sold for CU120 per tonne.	IAS41 defines that the contract concluded to sell grain on a future date cannot be used to determine fair value, because the value in the contract does not reflect the current market conditions. Considering that the grain is traded in the local market, the information in the foreign market will not be relevant. **Alternative 1.** The fair value determined for grain will be –CU140 per tonne of wheat; CU130 per tonne of barley. **Alternative 2.** If the sales transaction (contract) that took place was not an onerous contract, in this case, the sales prices can be considered the fair value. The fair value determined for grain will be – CU135 per tonne of wheat; CU120 per tonne of barley.

Below is an explanation of the changes that will occur after determining the fair value of livestock and agricultural production (grains). An extract from the statement of the financial position is presented:

Item	**On July 31st (until the adjustment), CU**	**Alternative 1** **On July 31st (after the adjustment), CU**	**Alternative 2** **On July 31st (after the adjustment), CU**
Biological assets	4,300	4,220	4,220
Agricultural production	-	960	915
Work in process	1,300	-	-
TOTAL	5,600	5,180	5,135

As seen in the statement of the financial position, the value of the biological assets decreased and will be reported as CU4,220 instead of CU4,300. Taking into account the cost of livestock (work in process), GF will incur a loss of CU580 and reduce the profit on the profit (loss) statement. The record for these assessments will be as follows:

Record for the subsequent measurement of the biological assets is as follows:

Dr. Loss in change of fair value 580

Cr. Biological assets (CU4,300 – CU4,220) 80

Cr. Work in process (livestock costs) 500

For assessing agricultural production (grain), we analyse two alternatives. In this case, both alternatives set the harvested grain at fair value, which is higher as compared to the accrued costs (work in process). In the statement of the financial position, the value of the inventories will increase because of the grain harvest assessed at fair value. Taking into account that the fair value is higher than the accumulated costs (work in process), the profit will increase in the profit (loss) statement. The record for these assessments will be as follows:

Record for the subsequent measurement of the agricultural production is as follows:

Alternative 1:

Dr. Inventories (agricultural production) 960

Cr. Work in process (crop production costs CU600 + CU200) 800

Cr. Gain in change of fair value (CU960 – CU800) 160

Alternative 2:

Dr. Inventories (agricultural production) 915

Cr. Work in process (crop production costs CU600 + CU200) 800

Cr. Gain in change of fair value (CU915 – CU800) 115

It should be noted that in the statement of financial position, the total value of inventory after these records will decrease due to the work in process. This is mainly influenced by animal husbandry. In addition, in this example, we have not discussed sales (in August), because it falls in a different accounting period than the financial statements analysed do.

CASE STUDY - IFRS 1 FIRST-TIME ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

Silva Katutyte*

Introduction

Transition of the financial reporting from national accounting standards to IFRS standards is a complicated procedure, in which recognition and measurement of each article of assets and liabilities needs to be addressed. IFRS 1 Standard provides guidelines for entities adopting IFRS for the first time in order for the transition to be as smooth as possible, and for the result of it to comply with the requirements of users of financial statement information regarding its reliability and relevance.

Aim of this case study is to provide understanding of the essence of the requirements for entities once they decide to prepare their financial statements according to IFRS Standards. The case study addresses the following issues and clarifies the following:

- first, how to identify, when an entity should be treated as the first-time adopter of IFRS Standards;
- second, to get familiar with the requirements for application and for disclosure.

The Case Information

In year 20X9, entity A decided to start trading its shares at the stock exchange. It used to prepare its financial statements in accordance with the national accounting standards. In order to be able to join the stock exchange, it needs to start reporting in accordance with the IFRS Standards. Entity A took a decision to start applying IFRS Standards to its financial reporting starting year 20X9. Its reporting year coincides with the calendar year. Entity A used to comparative on a year-to-year information in its previous reporting.

* Lecturer., Vytautas Magnus University, Lithuania, silva.katutyte@vdu.lt,
ORCID: 0000-0002-3913-5944

Later, it is revealed that from year 20X1 to 20X4, entity A used to report in accordance with IFRS Standards and made an explicit and unreserved statement confirming this fact. In year 20X5, after the change of the shareholders, the decision was to return to reporting under the national accounting standards. In year 20X9, the shareholders of entity A decided to start reporting according IFRS Standards with the financial statements starting with 20X9.

It is known that other companies operating in the market apply different accounting standards. Entity B used to prepare financial reports according to the national standards. In year 20X9, it decided to start reporting in accordance with the IFRS Standards and declaring the compliance with the IFRS Standards. Entity C used to prepare financial statements according to IFRS Standards, but only for internal use without confirmation that they comply with the IFRS Standards. In year 20X9, it decided start declaring that its financial statements comply with the IFRS Standards. Entity D was just established in year 20X9 and is going to prepare its first financial statements ever. It had decided that these statements should be prepared according to IFRS Standards.

Discussion Questions

1. Please identify the date of transition to IFRS Standards, first reporting period as well as the comparative period and explain the importance of identification of all listed dates in the case of entity A.
2. Please identify which of entities (A, B, C, D) should be treated as the first-time adopters of IFRS Standards in 20x9. Explain why this identification is important.
3. The general rule is the retrospective application of the accounting in accordance with IFRS Standards in the opening statement of the financial position. However, there are some exceptions for application prospectively. Please discuss why retrospective application is better than prospective. What kind of exceptions there could be, and why they are important.
4. What specific requirements for disclosures are stated in IFRS 1 Standards and why are they important?

SOLUTION OF CASE STUDY - IFRS 1 FIRST-TIME ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

1. IFRS 1 requires for the first time adopters to prepare the opening balance sheet at the date of transition. In this standard, **date of transition to IFRS Standards** refers to the first day of the earliest period for which the entity presents the full comparative information under the IFRS Standards in its first IFRS Standard financial reports. So, in the case of entity A, as it used reporting according to IFRS Standards for financial statements from 20X1 to 20x4 with an explicit and unreserved statement confirming this fact, the date of transition to IFRS Standards would be 01.01.20X0.

The first IFRS reporting period is the first reporting period, for which the entity prepares the financial reports in accordance with IFRS Standards. Since entity A made the decision to start applying IFRS Standards to its financial reporting starting year 20X1 and its reporting year coincides with the calendar year, therefore, the first IFRS reporting period will be the financial reporting period for the calendar year 20X1.

IFRS Standards do not require more than one year of comparative information and entity A also used to prepare comparative on a year-to-year information in its previous reporting. Since the first IFRS reporting period for entity A is year 20X1, the comparative period shall be year 20X0.

All these dates are important for the further application of procedures established in IFRS 1. For example, the first-time adopter is required to recognize assets and liabilities with the provisions of IFRS and derecognize assets and liabilities that do not comply with IFRS in the opening balance sheet at the date of transition.

2. Entity A is not the first-time adopter of IFRS Standards in year 20X9 as it had reported previously according to the IFRS Standards. All other entities listed are first-time adopters of IFRS Standards because the entity is treated as the first-time adopter of IFRS Standards in cases when:
   - it's most recent financial reports have been prepared according to the national standards (this is the case of entity B);
   - it's most recent financial reports have been prepared according to the IFRS Standards, but without confirmation that they complied with the IFRS Standards (this is the case of entity C);
   - it has not prepared any financial statements at all (this is the case of entity D).

The identification whether an entity is the first-time adopter of IFRS Standards is important as this determines if requirements of IFRS 1 Standard would be applied. The first-time adopter must comply with all IFRS Standards effective at the reporting date. However, specific transitional provisions of separate standards are not applied to a first-time adopter. Therefore, first-time adopter of IFRS Standards prepares its opening balance sheet in accordance to the provisions set in IFRS 1 Standard.

3. The retrospective application of the accounting in accordance with IFRS Standards allows presenting information of the previous reporting period, as if an entity has always presented its financial statements in accordance with IFRS. This allows users of the financial information compare the results and financial position of the entity with the previous reporting period. However, in some areas, it is difficult to make changes retrospectively. For example, measuring fair value of financial assets at their initial recognition. In addition, there could be situations when the costs of retrospective application would exceed the benefits to the users of the information of financial statements. Therefore, these areas are identified in IFRS 1 Standard with certain optional and mandatory exceptions to the general principle of retrospective application. These exceptions serve as guidelines for entities when identifying areas, in which retrospective application is obligatory. In addition, they provide the entities with the right to apply the optional exceptions only in part, fully or not at all, in cases when it is possible to calculate the effect of transitions to the IFRS reporting reliably.
4. In cases of most entities that are recognised as first-time adopters of IFRS Standards, new areas of disclosure will be added or broadened, as there might be differences between the requirements of IFRS and national accounting standards. However, besides the requirements for disclosures according to specific IFRS Standards requirements, when submitting its first financial statement according to IFRS Standards, a first-time adopter will have to explain how the transition from the national reporting standards to IFRS Standards affect its financial position, financial performance and cash flows.

CASE STUDY - IFRS 2 SHARE-BASED PAYMENT

Cătălin Albu* - Nadia Albu**

Introduction

Sometimes entities purchase goods or services for which payment is made in equity instruments, or in cash, to the extent the cash payment depends on the value of the equity instruments. This is particularly useful to design plans to stimulate employees or other parties to contribute to the entity's performance. A particular case here is represented by the compensation schemes designed for employees.

Aim of this case study is to discuss the impact of such schemes intended to motivate employees on the entities' financial statements.

The Case Information

You are part of the accounting department of Car of the Future Ltd., an entity that designs cars that incorporate the latest technological developments. The management of the entity would like to implement a plan to reward its employees and to increase the staff retention rate. Management is interested in understanding the impact of several types of rewards proposed by the Human Resources Department on its financial statements.

Car of the Future Ltd. is a small car manufacturer, focused on innovation and on responding to clients' expectations. The entity is quite successful in attracting talented and skilful employees, which is critical for this industry and for implementing a strategy that is focused on innovation. However, internal reports indicate that an increasing number of employees leave the entity over the last few years. Consequently, management has requested the Human Resources Department to suggest a plan to motivate staff, in the hope of increasing the staff retention rate.

The Human Resources Department proposed the following plans, and with the following expected consequences on employee retention:

* Prof., ASE Bucharest, Romania, catalin.albu@cig.ase.ro, ORCID: 0000-0002-3282-8414
** Prof., ASE Bucharest, Romania, nadia.albu@cig.ase.ro, ORCID: 0000-0003-2953-9619

Plans	Details	Number of employees included	Expectations
1	Grant 10 share options to each employee who has a role in innovation and who stays in service for 5 years; the fair value of such an option is CU10.	100	10% of employees were leaving annually until now. This plan is expected to result in retaining more people and having 90 employees at the end of the 5-year period.
2	Grant share appreciation rights (SAR) to department managers if they remain employed for 3 years. SARs give them the right to receive a cash payment equal to the increase of the share price above CU20.	3	It is expected that the 3 managers will remain employed for the 3-year duration. The fair value of SARs that are expected to vest is CU6,000.
3	Grant share options to each employee from the sales department who remains employed for 3 years and contributes to an increase in sales. Each employee will receive 8 share options if the average yearly growth rate is between 5 and 8%; and each employee will receive 10 shares if the average yearly growth rate exceeds 8%. The fair value of an option is CU12.	10	Sales are expected to increase by more than 8% each year, and 9 employees are expected to remain in service for 3 years. However, there are some chances that in year 2, the 3-year average sales increase is estimated between 5% and 8%.

Discussion Questions

What are the implications of these plans on the entity's financial statements, as they were designed? What are the implications of a less optimistic outcome (without providing supporting calculations)?

SOLUTION OF CASE STUDY - IFRS 2 SHARE-BASED PAYMENT

The plans proposed by the Human Resources Department imply concluding an agreement between the entity and its employees. This agreement entitles the employees to receive cash for amounts that are based on the price (or value) of equity instruments (including shares or share options) of the entity, or to receive equity instruments (including shares or share options), provided that the specified conditions are met. Given that the plans remunerate a service, an expense should be recognised in each period. If the payment is made in cash, the entity should recognise a liability, and if the payment is made in equity instruments, the transaction impacts equity.

The implications of each plan are indicated below:

Plan 1 is an equity-settled share-based payment transaction, resulting in a yearly expense and an increase in equity.

10 options * 90 employees * CU10 = CU9,000

The yearly expense and increase in equity are CU9,000/5 = CU1,800

So, the yearly impact of this plan on the entity's financial statements is reflected as follows:

Dr. Expense	1,800
Cr. Equity	1,800

If the plan would not yield such an optimistic outcome, it implies that fewer employees will benefit from the plan. This implies a smaller expense and a smaller increase in equity in the year when the outcome is worse than expected and the following ones.

Plan 2 is a cash-settled share-based payment transaction, resulting in a liability being recognised at its fair value.

Based on this plan, the yearly expense and increase in liability is CU2,000 (CU6,000/3).

So, the yearly impact of this plan on the entity's financial statements is reflected as follows:

Dr. Expense	2,000
Cr. Liability	2,000

Until the liability is settled, the entity shall remeasure its fair value at the end of each reporting period and at the date of the settlement, with any changes in fair value being recognised in profit or loss for the period. If employees leave, or the prospects of having the desired increase in share price decrease, the liability is remeasured (and it results in a lower expense and a lower liability being recognised in that year and the following ones).

Plan 3 is an equity-settled share-based payment transaction, resulting in a yearly expense and an increase in equity. The computations for the expected outcome are:

9 employees * 10 share options * CU12 = CU1,080

An expense of CU360 (CU1,080/3) will thus be recognized each year.

So, the yearly impact of this plan on the entity's financial statements is reflected as follows:

Dr. Expense	360
Cr. Equity	360

If the plan would be less successful, the expected value of the settlement will be impacted, resulting in lower expenses and equity increases. For example, if the 3-year average sales increase is estimated between 5% and 8% in year 2, the computations are as follows:

Total value: 9 employees * 8 share options * CU12 = CU864

Cumulative expense that is needed at the end of year 2: CU864/3 * 2 = CU576

CU360 were already recognised as an expense in year 1

Expense to be recognised in year 2 = CU576-CU360 = CU216

CASE STUDY - IFRS 3 BUSINESS COMBINATION

Erika Besusparienė*

Introduction

Business combinations occur for a variety of reasons, including resources, production processes or human capital required by the business. First of all, it needs to be determined whether a contract could be identified as a business combination. Second, it needs to be identified whether the IFRS 3 should be applied and whether a business combination transaction is covered by the scope of IFRS 3.

Aim of this case study is to familiarize the students with the issues of business combination transitions and how they affect the financial statements. Thus, this case study introduces the following issues:

- How to identify the differences between the purchase of assets and business combination?
- Why it is important to identify the acquirer and the acquisition date?
- How to evaluate the acquired assets and liabilities, what effect will there be in the acquirer's financial statements?

The Case Information

Company "Delicious Food" (DF) produces frozen food that complies with the standards of high nutritional standards and uses only the highest quality ingredients. The main range of DF products includes daily lunch meals (e.g.: meatballs, soups, etc.). DF has decided to expand its range to include exotic dishes such as frozen clam chowder, octopus and more. This resulted in an agreement to make a business combination with company "Queen's Sea Food" (QSF) with all of its managed equipment and the business model.

* Assoc. Prof., Vytautas Magnus University, Lithuania, erika.besuspariene@vdu.lt, ORCID: 0000-0001-5111-1307

On 31 December 20x0, company DF acquires all assets and liabilities of company QSF by issuing 40,000 units of shares of company DF. Before this agreement, company DF owned 160,000 units of shares and after the transaction, it will have 200,000 shares in total. According to the agreement, 20% of the shares will be owned by company QSF. In the example below, the balance sheets of both companies are presented:

Items	Company DF 31 December 20x0, CU	Company QSF 31 December 20x0, CU
Cash	1,000,000	50,000
Receivables	2,000,000	150,000
Inventory	200,000	50,000
Land	1,000,’000	300,000
Buildings and equipment	3,000,000	500,000
Accumulated deprecation	(1,200,000)	(150,000)
TOTAL ASSETS:	**6,000,000**	**900,000**
Non-current liabilities	1,000,000	100,000
Current liabilities	400,000	-
Equity (shares)	2,600,000	200,000
Profit (Loss)	2,000,000	600,000
TOTAL EQUITY AND ASSETS	**6,000,000**	**900,000**

When acquiring the business, company DF measured the fair value of the assets acquired and liabilities assumed from company QSF. The estimated fair value is set out below:

Article	Fair value 31 December 20x0, CU
Cash	50,000
Receivables	150,000
Inventory	50,000
Land	400,000
Buildings and equipment	550,000
Non-current liabilities	(100,000)
TOTAL NET ASSETS:	**1,100,000**

Taking into the account that the market value of the shares of company DF is CU30, the total acquisition price of the new shares shall be 1.2 million CU (400,000 shares x CU30).

Discussion Questions

1. Explain whether the situation presented can be considered a business combination. Identify the steps Company DF will take after acquiring Company QSF.
2. Measure the goodwill in Company DF after taking the assets and acquiring liabilities of Company QSF.
3. Identify whether the company acquired QSF will receive gain or loss after the business combination?
4. Please present the entry record which will be made in the accounts of the acquiring company DF on the acquisition date. Prepare the statement of financial position after the business combination.
5. Please present the entry record which will be made in the accounts of the acquiree company QSF on the acquisition date. Prepare the statement of financial position after the business combination.

SOLUTION OF CASE STUDY - IFRS 3 BUSINESS COMBINATION

Given that Company DF does not invest in Company QSF or does not purchase the assets of Company QSF, under the situation presented, Company DF acquired the assets and liabilities of Company QSF. Therefore, this case study will be treated as that of a business combination under the given situation. In case of a business combination, Company DF must (1) identify the acquisition date; (2) assess the fair value of the assets and liabilities to be acquired; (3) make a record of the assets and liabilities acquired; and (4) prepare financial statements.

Taking into consideration the value of the shares, the value of the assets taken, and the liabilities acquired, goodwill can be measured, and a transaction entry can be recorded in the accounts. Goodwill is measured as the difference between the cost of the business and the fair value of the net assets acquired:

Goodwill = Cost of acquisition – The net asset fair value of the acquiree
Cost of acquisition is new shares amounting to 1.2 million CU (400,000 shares x CU30). The net asset fair value of the acquiree is 1.1 million CU. Goodwill = 1,200,000 – 1,100,000 = CU100,000

An entry will be made in the accounts of the acquiring company DF for the date of the business combination:

Dr. Cash	50,000
Dr. Receivables	150,000
Dr. Inventory	50,000
Dr. Land	400,000
Dr. Buildings and equipment	550,000
Dr. Goodwill	100,000
Cr. Shares	1,200,000
Cr. Cr. Non-current liabilities	100,000

Meanwhile, the company QSF selling the business will record the transaction by writing off all of its assets and liabilities and introducing the acquisition of new shares and recognizing the gain on the transaction. It should be noted that after the transfer of assets and liabilities, the only remaining assets are the shares acquired.

This transaction is not considered an investment between the respective companies, as company DF acquires assets and liabilities directly rather than by purchasing target shares. Company QSF is not considered a subsidiary of Company DF. Based on these facts, company QSF will calculate the gain and record the entry. Gain would be calculated as the difference between the values of the consideration (shares) received and the value of the assets and liabilities transferred:

Gain = Cost of acquisition – The net asset balance value
Cost of acquisition is new shares is 1.2 million CU (400,000 shares x CU30). The net asset balance value is CU0.8 million. Gain = 1,200,000 – 800,000 = CU400,000

An entry will be made in the accounts of the acquiree company QSF for the date of the business combination:

Dr. Financial assets (shares)	1,200,000
Dr. Non-current liabilities	100,000
Dr. Accumulated Depreciation	150,000
Cr. Cash	50,000
Cr. Receivables	150,000
Cr. Inventory	50,000
Cr. Land	300,000
Cr. Buildings and equipment	500,000
Cr. Gain	400,000

The financial statements of both companies have changed since the transaction.

Item	Company DF 31 December 20x0, CU			Company QSF 31 December 20x0, CU		
	Before transaction	Changes	After transaction	Before transaction	Changes	After transaction
Cash	1,000,000	+50,000	1,050,000	50,000	-50,000	
Receivables	2,000,000	+150,000	2,150,000	150,000	-150,000	
Inventory	200,000	+50,000	250,000	50,000	-50,000	
Land	1,000,000	+400,000	1,400,000	300,000	-300,000	
Buildings and equipment	3,000,000	+550,000	3,550000	500,000	-500,000	
Accumulated deprecation	(1,200,000)		(1,200,000)	(150,000)	+150,000	
Financial assets					+1,200,000	1,200,000
Goodwill		+100,000	100,000			
TOTAL ASSETS:	**6,000,000**		**7,300,000**	**900,000**		**1,200,000**
Non-current liabilities	1,000,000	+100,000	1,100,000	100,000	-100,000	
Current liabilities	400’000		400,000	-		
Equity (shares)	2,600,000	+1,200,000	3,800,000	200,000		200,000
Profit (Loss)	2,000,000		2,000,000	600,000	+400,000	1,000,000
TOTAL EQUITY AND ASSETS	**6,000,000**		**7,300,000**	**900,000**		**1,200,000**

Depending on the nature of the transaction, company QSF could continue its activities or be liquidated.

CASE STUDY - IFRS 5 NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

Cătălin Albu* - Nadia Albu**

Introduction

Entities sometimes decide to discontinue (part of) their operations and to sell some of their non-current assets. This decision influences how and the extent to which entities generate future cash flows. This decision must be appropriately reflected in the financial statements of the entity. Particularly, it is important to understand how the non-current assets held for sale are measured and presented in the financial statements.

Aim of this case study is to discuss and evaluate the consequences on the financial statements of a decision to hold for sale some non-current assets. You are an accountant with Choco Biscuit Ltd., and you are required to assess these consequences for some of the assets of the entity.

The Case Information

Choco Biscuit Ltd. is a small, family-owned entity, producing gourmet cookies. The sales of the entity steadily increased over the last few years, but the demand for gourmet cookies began to decrease at the beginning of the year 20X3, given the deterioration of the general economic context. Management thus considers downsizing the activity and selling some of its non-current assets. This is the case for the production lines PLX07 and PLX09 employed to produce the gourmet cookies with white and black chocolate ganache fillings. Producing these cookies requires significant internal resources, and clients consider their price as being too high.

* Prof., ASE Bucharest, Romania, catalin.albu@cig.ase.ro, ORCID: 0000-0002-3282-8414
** Prof., ASE Bucharest, Romania, nadia.albu@cig.ase.ro, ORCID: 0000-0003-2953-9619

The following information is available about the two production lines:

	PLX07	PLX09
Date of acquisition	1 Jan. 20X0	1 July 20X1
Cost of acquisition (CU)	120,000	180,000
Useful life	10 years	10 years
Depreciation	Straight line	Straight line
Fair value on March 1 20X3 (CU)	83,000	142,000
Fair value on July 1 20X3 (CU)	82,500	141,500
Fair value on December 31 20X3 (CU)	82,000	142,000
Estimated cost to sell	3,000	2,000

The management decides on March 1 20X3 to sell the two production lines, and an active programme to locate a buyer is initiated. Production line PLX07 will continue to be used until a buyer is found, but it is available for immediate sale. Production line PLX09 will be used to finalise an existing big order received. This is estimated to take place at the end of June 20X3. The two production lines are not sold until the end of 20X3. While management is still committed to selling the two lines, it is also interested in understanding the consequences on the financial statements if the selling plans are abandoned.

Discussion Questions

1) What are the consequences on the financial statements of the plan to sell the two production lines, compared to their continuous use?
2) What will be the consequences on the financial statements if the plan to sell the two production lines is abandoned?

SOLUTION OF CASE STUDY - IFRS 5 NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS

1) The two production lines are treated as property, plant and equipment (IAS 16) as long as they are in continuous use. Therefore, they are measured at cost minus any accumulated depreciation and impairment. They are reclassified as non-current assets held for sale when the conditions for such a classification are met (management has committed to sell the assets, an active search for a buyer has begun, the asset available for sale etc.). At the date when these criteria are met, the assets are measured at the lower of their carrying amount and fair value less costs to sell.

If the assets are classified as held for sale, the consequences for the two production lines are the following:

	PLX07	PLX09
Date of acquisition	Jan. 1 20X0	July 1 20X1
Cost of acquisition (CU)	120,000	180,000
Useful life	10 years	10 years
Depreciation	Straight line	Straight line
Annual depreciation (CU)	120,000/10 = 12,000	180,000/10 = 18,000
Date when criteria to reclassify assets as held for sale are met (when the asset is available for immediate sale)	March 1 20X3	July 1 20X3
Period of continuous use	Jan. 1 20X0 – March 1 20X3	July 1 20X1 – July 1 20X3
Accumulated depreciation (CU)	12,000 * 3 + 12,000 * 2/12 = 38,000	18,000 * 2 = 36,000
Carrying amount at the reclassification date (CU)	120,000 – 38,000 = 82,000	180,000 – 36,000 = 144,000
Fair value less costs to sell at the classification date (CU)	83,000 – 3,000 = 80,000	141,500 – 2,000 = 139,500
Impairment loss recognised upon reclassification (CU)	2,000	4,500
Fair value less costs to sell at the end of 20X3 (CU)	82,000 – 3,000 = 79,000	142,000 – 2,000 = 140,000
Adjustment of the impairment loss at the end of 20X3 (CU)	Additional loss of 1,000 is recognised	Reversal of the impairment loss for 500

The impact on the financial statements of 20X3 is the following:

		PLX07 (in CU)	PLX09 (in CU)
If the asset is classified as held for sale	Statement of financial position	79,000	140,000
	Statement of profit or loss	expense of 5,000 (depreciation of 2,000 and impairment losses of 3,000)	expense of 13,000 (depreciation of 9,000 and impairment of 4,000)
If the asset is used as property, plant and equipment	Statement of financial position	72,000 (82,000 – 10,000 for another 10 months of depreciation)	135,000 (144,000 – 9,000 for another 6 months of depreciation)
	Statement of profit or loss	12,000 (a full year of depreciation)	18,000 (a full year of depreciation)

2) If at the end of the year the management decides to terminate the selling plan and to continue to use the assets, these are reclassified as property, plant and equipment. At the date of reclassification, they should be measured at the lower of carrying amount before the classification as held for sale, adjusted for any depreciation that would have been recognised, had the asset not been classified as held for sale, and the recoverable amount. The carrying amount is lower than the fair value less costs to sell, therefore this would be the value of the assets (irrespective of the estimated value in use).

CASE STUDY - IFRS 6 EXPLORATION FOR AND EVALUATION OF MINERAL RESOURCES

Silva Katutyte*

Introduction

Exploration for and extraction of mineral resources is an activity that involves significant financial and time recourses. Moreover, entities involved in this activity face high risks that the projects will not be as profitable as initially planned or even fail. Therefore, the accounting policies related to exploring for and extracting mineral resources require very specific attitude on the setting of accounting rules in such a manner that financial information would be relevant and reliable.

Aim of this case study is to provide an understanding of the essence and methods of treating the expenditures incurred by an entity in connection with the search for mineral resources. This case study addresses the following issues:

- Identification of expenses which are treated as exploration and evaluation expenditures and how they are measured.
- Familiarization with the procedures that should be applied and what are the requirements for disclosure.

The Case Information

Entity A is involved in oil refinery. Taking into account that the process of oil extraction is complicated, and the balance of recoverable oil resources in the wells is limited, entity A is looking for a new area for exploration. Entity A received permission from African country X to conduct research and explore opportunities for oil production in N's area. The following expenditure has incurred related to the exploration of area N:

- In May 20x3, entity A incurred CU5,000 of prospecting expenditures for evaluation of the potential to find some oil in area N.

* Lecturer., Vytautas Magnus University, Lithuania, silva.katutyte@vdu.lt, ORCID: 0000-0002-3913-5944

- In July 20x3, entity A received the legal rights to start the exploration. The license for exploration of area N has cost CU15,000, and is valid for 3 years.
- In August 20x3, entity A purchased the necessary exploitation equipment for CU70,000. The depreciation period for equipment is 5 years.
- In August 20x3, entity A hired a team of employees to work on the exploration and evaluation project for an annual labour cost of CU40,000.
- In December 20X3, entity A purchased additional exploration works from contractors at the cost of CU5,000.
- In December 20X4, the evidence of successful exploration has been obtained, proving that sufficiently large quantities of oil can be extracted from the wells explored. Therefore, in February 20X5, the company has additionally purchased equipment for extracting the oil for a price of CU100,000.

Discussion Questions

1. Which expenditures incurred by entity A may be treated as exploration and evaluation expenditures. Explain.
2. Calculate what will be the value of exploration and evaluation assets by 31.12.20X3, if entity capitalized the exploration and evaluation expenditures as exploration and evaluation assets?
3. What entity A was obliged to do, if during the exploration period, the situation in the market of minerals would change dramatically, resulting in a significant plunge in oil prices?

SOLUTION OF CASE STUDY - IFRS 6 EXPLORATION FOR AND EVALUATION OF MINERAL RESOURCES

1. IFRS 6 is not applicable to expenditure incurred **before** the entity receives the legal rights to explore a specific area and **after** it is proved that it is technically and commercially viable to execute the mining works.

Therefore, the prospecting expenditures for evaluation of potentially finding some oil in area N that incurred in May 20x3 are not related to the exploration and evaluation expenditures as they were incurred before the legal rights to start the exploration were obtained.

The equipment for extracting oil purchased in February 20X5 does not qualify as exploration and evaluation expenditures as well, since this equipment is purchased for the extraction of oil from successfully detected wells.

All other expenditures should be treated as exploration and evaluation expenditures.

2. The expenditures related to exploration and evaluation include obtaining license, the exploitation equipment, labour costs of employees and additional exploration works.

Since the license and exploiting equipment are non-current tangible assets, the part of amortization and depreciation of year 20X3 should be capitalized as exploration and evaluation assets.

Amortization of license for year 20X3 is CU15,000/3 years/12 months x 5 months =CU2,083

Depreciation of exploiting equipment for year 20X3 is CU70,000/5 years/ 12 months x 4 months = CU4,667

Labour costs of employees is capitalized at the amount paid for the period from August to December 20X3 which would be CU40,000/12 months x 5 months = CU16,667

Exploration works are capitalized at all its amount of CU5,000, as these expenses have incurred at once in December 20X3.

Capitalized costs	July – December 20x3, CU
License amortization	2,083
Equipment depreciation	4,667
Labour	16,667
Exploring works	5,000
Total value of exploration and evaluation assets	**28,417**

3. In situations when market conditions are changing significantly, the business results of entities involved in the exploration for and extracting of mineral resources may be affected. At the same time, there may occur a situation when the booked value of exploration and evaluation asset may become much higher than its recoverable amount. Therefore, in such cases, the impairment test must be performed, so that the entity would evaluate the impact of the change on the value of its exploration and evaluation assets. Such entity should measure, present and disclose any impairment loss in its financial statements.

CASE STUDY - IFRS 7 FINANCIAL INSTRUMENTS: DISCLOSURES

Emre Selçuk Sarl*

Introduction

Today, financial instruments are of great importance for businesses. As a result of the increasing importance of financial instruments, IASB changed the existing standards regarding financial instruments and also published new standards. IFRS 7 regulates the disclosures that businesses should make regarding the risks of financial instruments and users should be aware of.

Aim of this case is to discuss how businesses should make disclosures about their financial instruments under different classifications and how they can provide the most benefit to users of financial statements.

The Case Information

Tornado Company was established in the early 2000s and is a business that buys and sells electronic goods. The entity has started to use International Financial Reporting Standards (IFRS) as of 2021. The debt and equity instruments held by Tornado Enterprise at the end of 2021 and the amounts reported in the statement of financial position of these assets are as follows.

Financial Assets	**Book Value**
Governmet Bonds	CU 1,500,000
Tresury Bills	CU 700,000
Share Investments (No Significant Influence and Control)	CU 580,000

Since Tornado Company has not used IFRS before, it is required to classify and measure the above financial assets in accordance with IFRS. Until the end of 2021, all financial assets were measured at cost.

* Assoc. Prof., Istanbul University, Türkiye, emresari@istanbul.edu.tr, ORCID: 0000-0001-6675-3214

The manager of Tornado Company's accounting department knew that the financial assets owned by the business needed to be classified and measured in accordance with IFRS and the necessary financial statement footnotes had to be prepared. For this reason, he has appointed an employee he knows to have worked in companies that previously reported in accordance with IFRS.

The accounting manager of the enterprise also gave the following information to the employee she assigned to report financial assets in accordance with IFRS:

- Government bonds and treasury bills will be classified as financial assets at fair value through profit or loss.
- At 31 December 2021 the fair value (FV) of government bonds is CU 1,800,000 and the FV of treasury bills is CU 750,000.
- Shares will be classified as financial assets at fair value through other comprehensive income. The shares' fair value at 31 December 2021 is CU 650,000.

Receiving the above information from the manager, the employee classified the financial assets owned by the enterprise as follows.

Financial Assets	**Book Value**
Fair Value Through Profit & Loss	CU 2,550,000
Fair Value Through Other Comprehensive Income	CU 650,000

The employee responsible for this job knew how to present financial asset investments in the statement of financial position within the framework of this information. However, he was also aware that this information would not be sufficient when it came to preparing financial statement notes for financial assets.

Discussion Question

What information other than the information provided by the accounting manager does the business employee need to prepare the necessary notes on financial assets?

SOLUTION OF CASE STUDY - IFRS 7 FINANCIAL INSTRUMENTS: DISCLOSURES

It is not sufficient for an entity reporting in accordance with IFRS to make an appropriate classification of financial asset investments and present financial assets with their fair values.

The Tornado Company is required to present the following disclosures in its financial statements for its financial assets measured at fair value through profit or loss:

- Since comparative financial statements are required to be prepared, the fair values of these financial assets as of 1 December 2021 should be presented.
- Maximum credit risk exposure for government bonds and treasury bills held at 31 December 2021.
- The amount that occurs at fair value and is attributable to the change in credit risk.

The Tornado Entity is required to present the following disclosures in its financial statements for its financial assets measured at fair value through other comprehensive income:

- Fair values of financial assets as of 1 December 2021, as comparative financial statements are required to be prepared.
- Which equity instrument investments are measured at fair value through other comprehensive income.
- The reason for using this alternative presentation option.
- The fair value of these investments at the reporting date.
- Dividends recognized related to these investments during the period.
- Transfers of total gains and losses in equity (with reasons for transfers).
- If there are financial assets disposed of during the period:
  - Reasons for their disposal.
  - The fair values of the investments at the recognition date.
  - Gain or loss as a result of disposal.

In addition, disclosures should be made about the accounting policies for the measurement of these financial assets. These explanations:

- Criteria for such classification on initial recognition of financial assets measured at fair value through profit or loss.
- How net gain and loss are determined for each financial asset class.

In addition, disclosures about income, expenses, gains and losses are required. These explanations:

- Interest income on financial assets measured in FV.
- Income or expenses related to transaction fees.
- Fair value changes for financial assets measured at fair value through profit or loss.
- Investments in equity instruments measured at fair value through profit or loss.

CASE STUDY - IFRS 8 OPERATING SEGMENTS

Kristina Geseviciene*

Introduction

Businesses often diversify their operations in order to manage business risks in the changing market and earn more profit. It might extend to entity's geographical area it operates in, a business division, or services/products. It is important for an entity to follow the results of such operating segments and at the same time, to disclose information on operating segments to the users of financial statements.

Aim of this case study is to familiarize students with the requirements for reportable operating segments selection. The following issues are addressed in this case study:

- Examination and application of the measurement procedures established by the standard when determining operating segments;
- Getting acquainted with reportable operating segments selection in practice and finding a suitable alternative for solving the selection problem for ensuring a sufficient income threshold.

The Case Information

Local Store Inc. (LS) sells various types of footwear in one geographical region. The LS is one of the most popular stores in region, standing out for its well-selected suppliers, ensuring shoe quality and comfort at an affordable price. The range of products is wide: from casual shoes to sports shoes for men, women and children.

For the assessment of better revenue components and profitability, the LS follows operating segments based on its product types. In a table below, there is information provided on the entity's operating segments.

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* Lecturer, Vytautas Magnus University, Lithuania, kristina.geseviciene@vdu.lt, ORCID: 0000-0002-1547-858X

Segments	Men's shoes	Men's sports shoes	Women's shoes	Women's sports shoes	Kids' shoes	Kids' sports shoes	Total
Revenue, CU	149,000	40,000	168,000	39,000	35,000	15,000	446,000
Profit (loss), CU	58,110	9,500	67,200	5,500	2,000	-1,700	140,610
Assets, CU	61,000	20,000	95,000	12,500	7,500	22,500	218,500

It is known that:

- entity LS has got an external customer Axes Wear Inc. (AW) which buys 27% per cent of men's shoes and men's sports shoes;
- the entity is considering to stop trading sports footwear in the future.

Discussion Questions

1. Perform the necessary tests and determine LS entity's reportable operating segments; present the results in a table;
2. If not all conditions of the revenue test are met, offer an alternative to reach the revenue test threshold;
3. Explain and present how the information in the financial statements is affected by the fact that LS has a buyer whose purchases make up 27 per cent of product revenue in one segment?

SOLUTION OF CASE STUDY - IFRS 8 OPERATING SEGMENTS

Information about operating segments must be disclosed in financial statements if those segments are in line with the criteria's set with the standard IFRS 8. There are 3 quantitative thresholds set for measuring operating segments that will be performed in the table below.

Table with quantitative thresholds performed:

Segments	Revenue test		Profit (loss) test				Asset test	
	Amount, CU	%	Profit		Loss		Amount, CU	%
			Amount, CU	%	Amount, CU	%		
Men's shoes	149,000	**<u>33.41</u>**	58,110	**<u>40.83</u>**			61,000	**<u>27.92</u>**
Men's sports shoes	40,000	8.97	9,500	6.68			20,000	9.15
Women's shoes	168,000	**<u>37.67</u>**	67,200	**<u>47.22</u>**			95,000	**<u>43.48</u>**
Women's sports shoes	39,000	8.74	5,500	3.86			12,500	5.72
Kids' shoes	35,000	7.85	2000	1.41			7,500	3.43
Kids' sports shoes	15,000	3.36			-1,700	100.00	22,500	**<u>10.30</u>**
Total	446,000	100.00	142,310	100.00	-1,700	100.00	218,500	100.00

According to the revenue test, the revenue of an operating segment should comprise ≥ 10% of the revenue of all operating segments. The table suggests that the operating segments Men Shoes and Women shoes are selected.

According to the profit (loss) test, the profit of an operating segment should comprise ≥ 10% of the profit of all profitable operating segments, and the loss should be evaluated separately – the loss of an operating segment shall comprise ≥ 10% of the loss of all unprofitable operating segments. The segments of Men Shoes and Women Shoes are selected as profitable, but no additional segments are added to them. The operating segment Kids sports shoes is selected as unprofitable.

Based on the asset test, the assets of an operating segment must be ≥ 10% of combined assets of all operating segments. No additional segments have been selected after the asset test.

After performing all three tests, the reportable operating segments selected include Men's Shoes, Women's shoes and Kids' sports shoes. Then we have to check, if the revenue of these segments comprises 75% of the total of the entity's revenue.

CU149,000 (Men's Shoes) + CU168,000 (Women's shoes) + CU15,000 (Kids' sports shoes) = CU332,000

CU332,000 (revenue from selected segments) / CU446,000 (total revenue) x 100 = 74.44%

The check shows that the revenue of selected operating segments is less than 75% of the total revenue. The entity must add additional segments to fulfil the condition.

Alternative:

Since entity LS plans to quit the sales of sports footwear, it allows merging certain product groups, i.e. Men's shoes + Men's sports shoes; Women's shoes + Women's sports shoes; Kids' shoes + Kids' sports shoes.

Segments	**Revenue test**		**Profit (loss) test**				**Asset test**	
	Amount, CU	**%**	**Profit**		**Loss**		**Amount, CU**	**%**
			Amount, CU	**%**	**Amount, CU**	**%**		
Men shoes	189,000	**42.38**	67,610	**48.08**			81,000	**37.07**
Women shoes	207,000	**46.41**	72,700	**51.70**			107,500	**49.20**
Kids shoes	50,000	**11.21**	300	0.21			30,000	**13.73**
Total	446,000	100.00	140,610	100.00			218,500	100.00

After merging the segments, all three segments now – Men's shoes, Women's shoes and Kids' shoes become reportable operating segments and will be presented in the financial statements.

Information disclosure requirements also state that dependency on major customers should be reported in the financial statements. Therefore, entity LS should disclose the facts about customer Axes Wear Inc. (AW) as sales to this customer comprise 27 per cent of revenue from the men's shoes segment.

Information disclosure:

The total revenue amount of customer AW: CU189,000 x 27% = CU51,030, segment identification – Men's shoes.

CASE STUDY - IFRS 9 FINANCIAL INSTRUMENTS

Turgay Sakin*

Introduction

Accounting for financial instruments is a complex and comprehensive issue. IFRS 9 sets the framework for the recognition, derecognition, and valuation of financial instruments. There are two income elements related to financial instruments. The first is income items such as interest and dividends arising from financial instruments. The second is the fair value differences of the financial instrument.

In this case, it is aimed to explain how the value of the financial instrument will be determined in the statement of financial position and how the value differences will be reported depending on the classification of financial instruments.

The Case Informatıon

2020 has been a very successful year for River Company. The business had significantly increased its profitability in 2020. As a result of this financial performance, the cash flows of the business from its operations increased significantly. And that resulted in the business's cash and cash equivalents tripling and having a significant cash surplus in 2021. River Company management decided to use this surplus cash by investing in financial instruments. As a result of their evaluation, the management has decided to make an investment that will generate interest income with a part of the excess cash and an equity investment with the remaining part.

River Company purchased three different shares (Purple Company, Turquoise Company and Mandarin Company) from the stock market in March 2021. The total cost of the purchased shares is as follows.

Purple Company	CU25,600
Turquoise Company	CU68,800
Mandarin Company	CU47,300

* Assoc. Prof., İstanbul University, Türkiye, tsakin@istanbul.edu.tr, ORCID: 0000-0001-6953-3516

River Company management classified these equity investments as Financial Asset at Fair Value Through Other Comprehensive Income (FAFVTOCI).

River Company also purchased some bonds of an entity from its initial public offering on 1 July 2021 for CU 96,139. The bond has a nominal value of CU 100,000 and a nominal interest rate of 9%. The interest payments are made semi-annually on June 30 and December 31. The bond provides 10% interest for the investors. River management has determined that the business model for this type of investments is to hold to earn interest income.

The following data are available on the value of River Company's investments at the end of 2021.

Purple Company	CU35,400
Turquoise Company	CU65,000
Mandarin Company	CU50,700
Bond value	CU92,000

In 2021, River Co earned CU4,807 interest on its bond investment and collected CU4,500 interest.

At the end of 2022, information on River Co investments is as follows.

Purple Company	CU38,400
Turquoise Company	CU67,500
Mandarin Company	CU40,700
Bond value	CU98,000

In 2022, River Company earned CU 9,661 interest on its bond investment and collected CU 9,000 interest. At the end of 2022, River management has decided that the business model for both investments has changed and that the new business model is a business model for these investments is to profit from trading on price changes. Therefore, they stated that all investments will now be reclassified as Financial Asset Measured at Fair value through profit or loss (FAFVTPL).

Discussion Questions

a. How should River Company financial instrument investments be presented in the statement of financial position as of December 31, 2021? What should be reported about these investments in the profit and loss statement for 2021?
b. Can River Company reclassify its financial instruments by the end of 2022?
c. What should be the accounts and amounts to be reported in the 2022 financial statements?

SOLUTION OF CASE STUDY - IFRS 9 FINANCIAL INSTRUMENTS

a. River management has decided to classify their share investments as Financial Asset at Fair Value Through Other Comprehensive Income (FAFVTOCI) in initial recognition. River management will report the change in the total value of their equity investment portfolios as part of their other comprehensive income.

River management, on the other hand, decides to keep its bond investments for the sole purpose of earning interest income. Therefore, these investments should be classified as financial assets valued at amortized cost. Equity and debt instrument investments will be shown in the statement of financial position dated 31 December 2021 and in the profit and loss statement for 2021 as follows.

31 December 2021	Carrying Value, CU	Fair Value, CU	Unrealized Gain (Loss), CU
Purple Company	25,600	35,400	9,800
Turquoise Company	68,800	65,000	(3,800)
Mandarin Company	47,300	50,700	3,400
Total			**CU9,400**

Dr. Financial Assets (FAFVTOCI) 9,400

Cr. Unrealized Holding Gain (OCI) 9,400

A bond amortization table should be prepared in order to determine the interest income from the bond investment and the end-of-period bond value. The entity will periodically earn 5% on its bond investment and will charge interest of CU4500 at the end of each six months. Amounts are rounded in the table.

Periods	Beginning balance, CU	Interest Income, CU	Interest Receivable, CU	Ending Balance, CU
2021/2	96.139	4.807	4.500	96.446
2022/1	96.446	4.822	4.500	96.768
2022/2	96.768	4.838	4.500	97.107

Dr. Financial Assets (FAAC) 307

Dr. Cash 4,500

Cr. Interest Income 4,807

At the end of 2021, these investments will appear in the financial statements as follows.

River Company Statement of Financial Position as of 31.12.2021			
ASSETS		**LIABILITIES**	
Equity Investments	151,100		
Debt Investments	96,446	**EQUITY**	
		Unrealized Holding Gain	9,400

River Company Profit/Loss and Other Comprehensive Income Statement for the year 2021	
PROFIT/LOSS	
Interest Income	4,807
OTHER COMPREHENSIVE INCOME	
Unrealized Holding Gain	9,400

b. River Management may change the classification of financial instruments subject to a change in business models. However, for equity instruments, it can be determined irreversibly as Financial Asset at Fair Value Through Other Comprehensive Income (FAFVTOCI) at the initial recognition.

c. Equity instruments are irreversibly classified as Financial Asset at Fair Value Through Other Comprehensive Income (FAFVTOCI) and no change will be made to them. Thus, their values on 31 December 2022 will be as follows.

31 December 2021	Carrying Value, CU	Fair Value, CU	Unrealized Gain (Loss), CU
Purple Company	35,400	38,400	3,000
Turquoise Company	65,000	67,500	2,500
Mandarin Company	50,700	40,700	(10,000)
Total			**CU(4,500)**

Dr. Unrealized Holding Loss (OCI) 4,500

Cr. Financial Assets (FAFVTOCI) 4,500

For bonds, the interest income and interest collection records for 30 June and 31 December should be made first.

30 June 2022

Dr. Financial Assets (FAAC)	322
Dr. Cash	4,500
Cr. Interest Income	4,822

31 December 2022

Dr. Financial Assets (FAAC)	338
Dr. Cash	4,500
Cr. Interest Income	4,838

After these entries, the carrying amount of the investment would be CU97,107. At the end of the year, the bond investment should also be reclassified. With the reclassification, the bond will be reported as Financial Asset Measured at Fair value through profit or loss (FAFVTPL). As a result of the reclassification, the value of the bond investment will be its fair value at 31 December 2022. And the valuation difference will be reported in profit and loss.

31 December 2022

Dr. Financial Assets (FAFVTPL)	98,000
Cr. Financial Assets (FAAC)	97,107
Cr. Fair Value Gain	893

Financial investments will be as follows in the year-end financial statements.

River Company Statement of Financial Position as of 31.12.2022			
ASSETS		**LIABILITIES**	
Equity Investments	146,600		
Debt Investments	98,000	**EQUITY**	
		Unrealized Holding Gain	4,900
River Company Profit/Loss and Other Comprehensive Income Statement for the year 2022			
PROFIT/LOSS			
Interest Income	8,661		
Fair Value Gain	893		
OTHER COMPREHENSIVE INCOME			
Unrealized Holding Loss	(4,500)		

CASE STUDY - IFRS 10 CONSOLIDATED FINANCIAL STATEMENTS

Tuba Bora Kılınçarslan*

Introduction

IFRS 10 requires a parent entity to present a consolidated financial statement that reflects the financial position and performance of both the parent and the subsidiaries as a whole. A consolidated financial statement involves a consolidation of the separate financial statements of the partner company and the separate financial statements of the subsidiary/subsidiaries, based on consolidation procedures under the accounting requirements of IFRS 10.

During the consolidation process, the financial statements of the parent and its subsidiaries are combined on a line-by-line basis. The parent entity and its subsidiaries must have uniform accounting policies and reporting dates.

The consolidation procedure includes:

- Combining items like assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries.
- Eliminating the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary and recognition of goodwill or bargain purchase.
- Eliminating intra group assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group in full.

The aim of this case study is to enable the consolidated financial statements to be prepared.

* Asst. Prof., Bursa Uludag University, Türkiye, tubabora@uludag.edu.tr,
ORCID: 0000-0001-9258-3829

The Case Information

In-Tech Company produces technological products and markets them all over the world. In-Tech Company offers its products to the market at a higher price than the products in the market with the advanced technology it uses, and therefore appeals to people with high income levels. On the other hand, Bay-Tech Company appeals to middle-income people with its technological products. In-Tech Company aims to be a world giant in the technological products market by producing technological products that can be used by both high-income and middle-income people with its new marketing strategy. Therefore, In-Tech Company acquired 70% of Bay-Tech Company on January 1, 2022. Bay-Tech Company's retained earnings amount to CU 40,000 on acquisition date. In-Tech Company has power over Bay-Tech Company. Also, In-Tech Company is exposed or rights to variable returns from its involvement with Bay-Tech Company. In-Tech Company can use its power over the Bay-Tech Company to affect the amount of investor’s returns.

The following financial events occurred during the period and these transactions are not included in the financial statements:

Bay-Tech Company purchased technological products from Toratex Company for CU 25,000 and sold them to In-Tech Company for CU 30,000. By the end of the year, In-Tech Company had only been able to sell 40% of the technological products it bought from Bay-Tech Company.

The property, plant and equipment of Bay-Tech Company consist of machines. The machines cost CU 150,000, their accumulated depreciation is CU 60,000 and their fair value is CU 120,000. Bay-Tech Company plans to use these machines for 3 more years. At the end of 3 years, the useful life of the machines will be exhausted.

30% of Bay-Tech Company is owned by non-controlling interests. In-Tech Company has decided to recognize for non-controlling interests using the proportionate share of net assets method.

The separate statement of financial position of In-Tech Company and Bay-Tech Company as of December 31, 2022 are as follows:

The separate statement of financial position of In-Tech Company and Bay-Tech Company (31.12.2022)

	In-Tech Company, CU	**Bay-Tech Company,** CU
Current Assets	***400,000***	***175,000***
Cash and cash equivalents	340,000	170,000
Trade receivables (Bay-Tech Company)	40,000	-
Inventories	20,000	5,000
Non-Current Assets	***430,000***	***100,000***
Property, Plant and Equipment (PPE)	250,000	100,000
Investment (Bay-Tech Company)	180,000	-
TOTAL ASSETS	**830,000**	**275,000**
Current Liabilities	***-***	***40,000***
Trade Payables (In-Tech Corporation)	-	40,000
Equity	***830,000***	***235,000***
Shares Capital	630,000	180,000
Retained Earnings	200,000	55,000
TOTAL LIABILITIES AND EQUITY	**830,000**	**275,000**

Discussion Questions

1. What is the relationship between In-Tech Company and Bay-Tech Company?
2. Should In-Tech Company prepare consolidated financial statements? Why?
3. If a consolidated financial statement is required, prepare the group's consolidated statement of financial position.

SOLUTION OF CASE STUDY - IFRS 10 CONSOLIDATED FINANCIAL STATEMENTS

1. In-Tech Company has power over Bay-Tech Company. Also, In-Tech Company is exposed or rights to variable returns from its involvement with Bay-Tech Company. In-Tech Company can use its power over the Bay-Tech Company to affect the amount of investor's returns. Therefore, In-Tech Company controls Bay-Tech Company. In-Tech Company is the parent and Bay-Tech Company is a subsidiary of In-Tech Company.
2. As In-Tech Company controls Bay-Tech Company, In-Tech Company presents consolidated financial statements.
3. Calculations.

Before we can calculate consolidated inventories, firstly we need to calculate total unrealized profit. Bay-Tech Company purchased technological products from Toratex Company for CU 25,000 and sold them to In-Tech Company for CU 30,000. In other words, In-Tech Company purchased technological products from Bay-Tech Company for CU 30,000.

By the end of the year, In-Tech Company had only been able to sell 40% of the technological products it bought from Bay-Tech Company. In other words, 60% of the technological products remained unsold.

Unsold inventory cost of In-Tech Company (CU30,000*60%)	CU18,000
Unsold inventory cost of Group (CU25,000*60%)	CU15,000
Total unrealized profit (CU18,000 – CU15,000)	CU3,000

Now we can calculate consolidated inventories.

(+) In-Tech Company's inventories	CU20,000
(+) Bay-Tech Company's inventories	CU5,000
(-) Total unrealized profit	CU(3,000)
= Consolidated inventories	**CU22,000**

Before we can calculate the consolidated property, plant and equipment, firstly we need to calculate the fair value adjustment at the end of the period.

Fair value adjustments:	
(+) Fair value	CU120,000
(-) Carrying amount *Carrying amount = Cost price – Accumulated depreciation* *Carrying amount = 150,000 – 60,000 = 90,000 PB*	CU (90,000)
= Fair value adjustment on 01.01.2022	CU30,000
(-) Depreciation of fair value adjustment *(The machine will be used for another three years. So, 30,000/3=10,000)*	CU10,000
= Fair value adjustment on 31.12.2022 (30,000-10,000)	CU20,000

Now we can calculate consolidated property, plant and equipment (PPE).

(+) In-Tech Company's property, plant and equipment	CU250,000
(+) Bay-Tech Company's property, plant and equipment	CU100,000
(+) Fair value adjustment on 31.12.2022	CU20,000
= Consolidated property, plant and equipment	**CU370,000**

Before we can calculate goodwill, firstly we need to calculate the Bay-Tech Company's net assets at the date of acquisition (01.01.2022).

(+) Bay-Tech Company's share capital	CU180,000
(+) Bay-Tech Company's retained earnings	CU40,000
(+) Fair value adjustment on 01.01.2022	CU 30,000
= Bay-Tech Company's net assets on 01.01.2022	CU**250,000**

Now we can calculate goodwill.

(+) Fair value of consideration	CU180,000
(+) Non-controlling interest at acquisition (01.01.2022) *(30% on Bay-Tech Company's net assets. So, 250,000*30%=75,000)*	CU75,000
(-) Bay-Tech Company's net assets on 01.01.2022	CU(250,000)
= Goodwill	CU**5,000**

Before we can calculate consolidated retained earnings, firstly we need to calculate Bay-Tech Company's post-acquisition retained earnings.

(+) Bay-Tech Company’s retained earnings of statement of financial position	CU55,000
(-) Bay-Tech Company’s retained earnings at acquisition (01.01.2022)	CU(40,000)
(-) Post-acquisition fair value adjustment	CU(10,000)
(-) Post-acquisition of total unrealized profit	CU(3,000)
(=) Bay-Tech Company’s post-acquisition retained earnings	CU**2,000**

Now we can calculate consolidated retained earnings.

(+) In-Tech Company’s retained earnings	CU200,000
(-) In-Tech Company’s share on post-acquisition retained earnings *(70% on Bay-Tech Company’s post acquisition retained earnings.* *So, 2.000*70%=1,400)*	CU1,400
(=) Consolidated retained earnings	CU**201,400**

Calculation of non-controlling interests using the proportionate share of net assets method:

(+) Non-controlling interest at acquisition	CU75,000
(+) Non-controlling interest on post-acquisition retained earnings *(30% on Bay-Tech Company’s post-acquisition retained earnings.* *So, 2,000*30%=600)*	CU600
(=) Non-controlling interest on 31.12.2022	CU**75,600**

Group Consolidated Statement of Financial Position (31.12.2022)

	Group Consolidated Statement of Financial Position, CU
Current Assets	***532,000***
Cash and cash equivalents	510,000
Trade receivables (Bay-Tech Company)	0
Inventories	22,000
Non-Current Assets	***375,000***
Property, Plant and Equipment (PPE)	370,000
Goodwill	5,000
Investment (Bay-Tech Company)	0
TOTAL ASSETS	**907,000**
Current Liabilities	***0***
Trade Payables (In-Tech Corporation)	0
Equity	***907,000***
Shares Capital	630,000
Retained Earnings	201,400
Non-controlling interest	75,600
TOTAL LIABILITIES AND EQUITY	**907,000**

CASE STUDY - IFRS 11 JOINT ARRANGEMENTS

Alp Aytaç*

Introduction

Though economic conditions sometimes force companies to look for alternative ways to be competitive in the market. One alternative way is to join forces with other companies. This joining could create a synergy effect, resulting in stronger results. In some instances, entities form a joint arrangement to share risks and rewards with other entities, combine complementary businesses of different entities, and to fund a business operation in an effective manner. IFRS 11 Joint Arrangements standard regulates reporting rules of entities which is a part of arrangements that are controlled jointly.

This case aims to showcase the strong outcomes of combining powers with other companies and the recognition rules of these transactions.

The Case Information

HuSoft Company was founded in 1989 in Brussels. Mrs. Rebecca Huisberg and her husband Mr. Jacque Pillion established HuSoft. Mrs. Huisberg has a solid educational background in software engineering and codification. After 30 years, HuSoft was considered one of the best software companies in the World. The Board of HuSoft also knows that to move to the elite level, sometimes they should share risk levels and combine with different entities. When the calendars pointed out May 2020, one of the World's leading luxury car producers, Rolls Royce, called to improve their production process. They were looking for partners to design and produce a robot for their operation.

HuSoft and R-Tech Robotics agreed to answer this call and they did it. To accomplish this call, they established another entity called H-Tech Company. On H-Tech, both sides have equal shares. In addition, they formed an agreement. This

* Asst. Prof., Bursa Uludag University, Türkiye, alpaytac@uludag.edu.tr, ORCID: 0000-0003-4949-4884

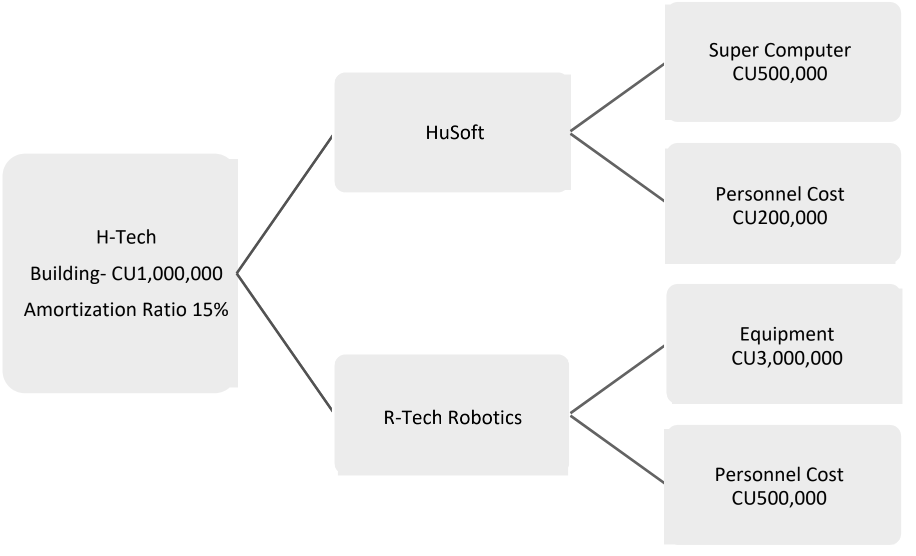
arrangement includes purpose, duration, and decision-making processes. HuSoft and R-Tech Robotics bought a building to create and codify Robot with CU1,000,000. The amortization ratio of the building is 15%. In addition, HuSoft purchased a supercomputer for the codification process with CU500,000 and made CU200,000 payments to coders. On the other side, R-Tech Robotics purchased designed equipment for creating the Robot with CU3,000,000 and paid CU500,000 to engineers.

Discussion Questions

1. Should the partnership of HuSoft and R-Tech Robotics be considered a joint arrangement? If it is a joint arrangement, then which type is it? Interpret it.
2. Make journal entries on HuSoft's and R-Tech Robotics' spending on H-Tech Company.

SOLUTION OF CASE STUDY - IFRS 11 JOINT ARRANGEMENTS

Summary of the Case



1. Interpretation: According to IFRS Standard 11 Joint Arrangements, a Joint arrangement is an arrangement in which two or more parties have joint control. In this case, HuSoft and R-Tech Robotics form an arrangement that gives both parties joint control. In this joint arrangement, purpose, duration, and decision-making processes are determined. There are two types of joint arrangements: joint operations and joint ventures. Joint ventures are usually structured in a separate vehicle. In this case, H-Tech is established, which is a separate vehicle. Therefore, this arrangement should be considered a Joint Venture. Both sides should equally record the purchasing and amortization of the building. On the other hand, they should record every transaction they do individually.
2. Based on this, journal entries of HuSoft and R-Tech Robotics should be as follows:
   - Journal Entries of HuSoft

Recognition of purchased building:

Dr. Property, Plant, Equipment (Building)	500,000	
Cr. Bank Account		500,000

Recognition of purchased supercomputer:

Dr. Property, Plant, Equipment (Super Computer)	500,000	
Cr. Bank Account		500,000

Recognition of personnel cost:

Dr. Service work-in-progress	200,000	
Cr. Wages Payable		200,000

Recognition of amortization:

Dr. Service work-in-progress	75,000	
Cr. Accumulated Depreciation		75,000

- Journal Entries of R-Tech Robotics

Recognition of purchased building:

Dr. Property, Plant, Equipment (Building)	500,000	
Cr. Bank Account		500,000

Recognition of purchased equipment:

Dr. Property, Plant, Equipment (Equipment)	3,000,000	
Cr. Bank Account		3,000,000

Recognition of personnel cost:

Dr. Service work-in-progress	500,000	
Cr. Wages Payable		500,000

Recognition of amortization:

Dr. Service work-in-progress	75,000	
Cr. Accumulated Depreciation		75,000

CASE STUDY - IFRS 12 DISCLOSURE OF INTEREST IN OTHER ENTITIES

Tuba Bora Kılınçarslan*

Introduction

The objective of IFRS 12 is to require an entity to disclose information about the nature of and risks associated with, its interests in other entities; and the effects of those interests on its financial position, financial performance and cash flows that enables users of its financial statements to evaluate.

IFRS 12 requires disclosure of the significant judgements and assumptions that an entity has made in determining the nature of its interest in another entity or arrangement. It also contains extensive disclosure requirements for subsidiaries, joint arrangements (joint operations or joint ventures), associates and unconsolidated structured entities.

The aim of this case study is to enable the understanding and evaluation of non-financial information about interest in other entities.

The Case Information

The Milcotton Company, which manufactures and sells silk fabric, is a successful and growing company operating in London. Milcotton Company established Linehome Company, which produces and sells linen fabric in Berlin on July 8, 2022, with a capital of CU 300,000. At this date, Milcotton Company owns 100% of Linehome Company. Milcotton Company has decided to go public on August 14, 2022, holding 45% of Linehome Company's equity (and related voting rights) to expand its operations and fund its investments. The remaining 55% equity and voting rights are distributed to 100 shareholders and each individually holding less than 1% of the voting rights. Milcotton Company entered into a contractual agreement with Linehome Company to direct the production process of Linehome Company while Linehome Company retained 45% voting rights.

* Asst. Prof., Bursa Uludag University, Türkiye, tubabora@uludag.edu.tr,
ORCID: 0000-0001-9258-3829

On the other hand, Softhome Company, which produces and sells velvet fabric, was established in Budapest on September 22, 2022, and Milcotton Company has 25% voting rights of Softhome Company. The reporting date of Softhome Company is November 30, and this date was determined when the company was founded. In Hungary, where Softhome Company operates, the reporting date cannot be changed because the government does not allow it. Appropriate adjustments have been made for the effects of significant transactions between Softhome Company's financial statements ended November 30, 2022, and Milcotton Company's financial statements ended December 31, 2022.

Discussion Question

1. Please consider the above case study within the scope of IFRS 12.

SOLUTION OF CASE STUDY - IFRS 12 DISCLOSURE OF INTEREST IN OTHER ENTITIES

IFRS 12 includes disclosure principles for both financial and non-financial information that enable users of its consolidated financial statements and/or financial statements to understand and evaluate all aspects of interests in other entities. These disclosures include disclosures of significant judgments made in determining that it has control over the investee and disclosures about non-controlling interests in the investee (for example, summary financial information about the investee). Although Milcotton Company does not hold a majority of the voting rights (45%), it is concluded that Milcotton Company controls Linehome Company given its ability to manage related activities in the production process based on contractual agreement. In other words, Milcotton Company has been determined to control Linehome Company even though it has less than half the voting rights over Linehome Company. Therefore, the Milcotton Company must consolidate the Linehome Company.

In addition, IFRS 12 requires an entity to disclose the end date of the reporting period of the joint venture or associate and the reason for using the different date or period if the financial statements of a joint venture or associate used to apply the equity method differ in the reporting date or period. Softhome Company is a subsidiary of Milcotton Company, and the equity method is applied, as Milcotton Company has 25% of the voting rights of Softhome Company. It was stated that the reporting date of Softhome Company is November 30, and the reporting date could not be changed because the Hungarian government did not give permission.

CASE STUDY - IFRS 13 FAIR VALUE MEASUREMENT

Kristina Gesevıcıene*

Introduction

There might be situations, in which users of financial statements would prefer information about accounting objects measured in fair value over acquisition price or production cost. According to IFRS 13, fair value refers to a value gained during the sale of an asset or paid when transferring liability in an orderly transaction between market participants at the measurement date. When measuring fair value of a particular asset or liability, their specific characteristics should be taken into account at the measurement date. Correct fair value measurement involves using appropriate valuation techniques and choosing the right type of the market when applicable.

Thus, in order to provide and deepen the knowledge and ability of students in applying fair value measurement, this case study has a twofold purpose:

- First, learn how to apply the market approach to evaluate the fair value of the goods when one trades the goods in several different markets, and to explain the results received based on the provisions of the standard;
- Second, to use the provisions of the standard applying fair value at the initial recognition of an asset and amend financial statements accordingly.

The Case Information

Novotex & Co is a group of economic entities that has been engaged in various economic activities for more than ten years. The individual activities of the group are concentrated in separate entities, it includes trade of wooden saunas, broker-trading, etc. However, all entities share the same accounting policy.

* Lecturer, Vytautas Magnus University, Lithuania, kristina.geseviciene@vdu.lt, ORCID: 0000-0002-1547-858X

One of the group entities – Uno Tree (UT) – sells one type of wooden saunas. Entity UT submitted one sauna for sale at different prices in two different markets. At the valuation date (e.g. the date of the financial statements), the entity has information about the possible selling prices in both markets and the related costs. In the table below, there is information provided on sauna's selling price, transaction and transportation costs in markets P and R.

Markets	**P**	**R**
Price, CU	2,600	2,500
Transaction costs, CU	300	100
Transportation costs, CU	200	200

Another group entity Zoe Zoe (ZZ) acts as broker-trader entity that buys goods and sells it quickly, earning from price changes, so such goods are measured at fair value. ZZ bought a truck for CU45,000 t the auction in December. The truck is ready for sale in the future. Under usual business conditions, a purchase price of a similar truck would be CU68,000. Entity ZZ ignored fair value adjustment requirements and recognized the full amount paid for the truck as inventory, which is reported under current assets in financial statements.

Subtracted financial statements of entity ZZ are provided in the table below.

Statement of financial position, CU		
Item	**Prepared statement**	**Corrected statement**
Non-current assets	1,200,000	
Current assets	800,000	
Inventories	631,000	
Cash	451,000	
Total assets	**3,082,000**	
Non-current liabilities	1,100,000	
Equity	500,000	
Other non-current liabilities	600,000	
Current liabilities	1,982,000	
Total liabilities	**3,082,000**	

Statement of Profit & Loss, CU		
Item	**Prepared statement**	**Corrected statement**
Revenue	5,063,000	
Costs of goods sold	(3,100,000)	
Gross profit	1,963,000	
Operating expenses	(1540,000)	
Operating profit	423,000	
Non-operating revenue & expenses	(10,000)	
Profit before income tax expense	413,000	
Income tax expense (20%)	(82,600)	
Net profit	**330,400**	

Discussion Questions

1. Determine the fair value of the goods for sale by entity UT using the market approach when:
   - the market P is the principal market;
   - the market R is the principal market;
   - neither P nor R are the principal markets; and explaining your answers.
2. Amend the Statement of Financial Position and Statement of Profit & Loss of entity ZZ taking into account that the truck has to be measured at fair value using journal entries to explain the changes.

SOLUTION OF CASE STUDY - IFRS 13 FAIR VALUE MEASUREMENT

Solution of question No.1

When it comes to using market approach for fair value measurement in accordance with IFRS 13, there are several assumptions are used. That is, if there is a principal market for an asset or a liability, the fair value determined corresponds to the price of the said asset or liability in that market, even if its price in another market could be more favourable on the valuation date. When the principal market is absent, then the fair value is measured in the most advantageous market.

<u>When market P is considered as the principal market</u>, the fair value of the sauna will be calculated as follows: price CU2,600 – transportation costs CU200 = CU2,400 fair value of the sauna.

<u>When the market R is considered as the principal market</u>, the fair value of the sauna will be calculated as follows: price CU2,500 – transportation costs CU200 = CU2,300 fair value of the sauna.

In a case where neither P nor R markets are principal markets, the most advantageous market is chosen. Then the net amount obtained for the sauna is considered in the market as follows:

Market P: price CU2,600 – transaction costs CU300 – transportation costs CU200 = CU2,100 net amount

Market R: price CU2,500 – transaction costs CU100 – transportation costs CU200 = CU2,200 net amount

<u>The most advantageous market for fair value determination will be market</u> R (CU2,200 > CU2,100). However, the fair value of the sauna in the most advantageous market R will be CU2,300, as the fair value is still determined by only deducting transportation costs from its price and not the transaction costs.

Solution for question No.2

When Zoe Zoe Co. bought a truck in an auction and did not apply fair value measurement at initial recognition, its journal records were as follows:

Dr. Inventories	45,000
Cr. Cash	45,000

Taking into consideration the provisions of IFRS 13, fair value may be applied at the initial recognition, while the transaction price differences from the fair value the resulting gain or loss the entity should be recognized as profit (loss). The journal records applying fair value measurement at initial recognition looks as follows:

Dr. Inventories 68,000

Cr. Cash 45,000

Cr. Revenue 23,000

Statement of financial position, CU		
Item	**Prepared statement**	**Corrected statement**
Non-current assets	1,200,000	1,200,000
Current assets	800,000	823,000
Inventories	631,000	654,000
Cash	169,000	169,000
Total assets	**2,000,000**	**2,023,000**
Non-current liabilities	1,100,000	1,118,400
Equity	500,000	518,400
Other non-current liabilities	600,000	600,000
Current liabilities	900,000	904,600
Total liabilities	**2,000,000**	**2,023,000**

Statement of Profit & Loss, CU		
Item	**Prepared statement**	**Corrected statement**
Revenue	5,063,000	5,086,000
Costs of goods sold	(3,100,000)	(3,100,000)
Gross profit	1,963,000	1,986,000
Operating expenses	(1,540,000)	(1,540,000)
Operating profit	423,000	446,000
Non-operating revenue & expenses	(10,000)	(10,000)
Profit before income tax expense	413,000	436,000
Income tax expense (20%)	(82,600)	(87,200)
Net profit	**330,400**	**348,800**

The fair value measurement applied at the initial recognition resulted in changes in ZZ entity's reports. Revenue increased by CU23,000 in the Statement of Profit & Loss, and thus resulted in bigger income tax expenses and bigger net profit of the entity as well. The changes in Statement of the financial position accrued in inventory value, which increased by CU23,000, equity by CU18,400 and current liabilities by CU4,600.

CASE STUDY - IFRS 14 REGULATORY DEFERRAL ACCOUNTS

Aslı Türel*

Introduction

The accounting impact of regulation by Governments on the supply and pricing of particular types of activity by private entities are addressed in IFRS Standard 14 Regulatory Deferral Accounts. Types of activity include utilities such as gas, electricity, and water.

The objective of the IFRS 14 is to specify the financial reporting requirements for regulatory deferral account balances that arise when an entity provides goods or services to customers at a price or rate that is subject to rate regulation (IFRS 14.1).

IFRS 14 is permitted, but not required, to be applied where an entity conducts rate-regulated activities and has recognized amounts that meet the definition of "regulatory deferral account balances" in its previous GAAP financial statements.

The Case Information

Hamburg Water Business (HSI) is operating in Germany, where the corporate tax is 15%. HSI is preparing its financial statements according to German Generally Accepted Accounting Principles (GERMAN GAAP). In order to reduce the volatility in the prices charged to customers, the regulator in Germany requires HSI to compensate for the differences between the actual and estimated costs over time. Under GERMAN GAAP, deferred water costs meet the asset recognition criteria and are presented as "Other assets and deferred costs" in HSI's statement of financial position as of December 31, 2021. Apart from these deferred costs, there are no other assets included in this item in the statement of financial position. The agency that regulates the tariffs allows HSI to recoup water supply costs to customers on a one-to-one pass-through basis. Under the price setting mechanism, the entity is required to depreciate the net over- or under-collection of water costs on a straight-line basis over three years.

* Prof., Istanbul University, Türkiye, gunduzay@istanbul.edu.tr, ORCID: 0000-0002-2658-4636

HSI has decided to apply International Financial Reporting Standards (IFRS) in its 2023 financial statements. At the date of adoption of IFRS (January 1, 2022), HSI's GERMAN GAAP statement of financial position has a carrying amount of CU120,000, which is shown as other assets and deferred costs related to the net under-collection of water costs to be deferred over the next three years. HSI has assessed that these deferred costs do not meet the requirements to be recognized as assets under IFRS.

The table below presents the effects of variations in the cost of water on HSI's rate-regulated activities over a three-year period, as of 31 December:

(In CU)	**2021**	**2022**	**2023**
Amount charged to customers based on regulated rates	950,000	1,250,000	1,090,000
Part of rate that recovers deficit/surplus in prior years	-	(40,000)	(30,000)
Net amount charged to customers in respect of current year	**950,000**	**1,210,000**	**1,060,000**
Actual water supply costs of current year	1,070,000	1,180,000	980,000
Net amount of (under)/over recovery of costs (i.e., regulatory deferral account (debit)/credit balance)	**(120,000)**	**30,000**	**80,000**

Discussion Questions

- What should be the accounts and amounts to be presented regarding deferred costs in the statement of financial position as of December 1, 2022, to be prepared in accordance with IFRS?
- Show the movements in the net regulatory deferral account balances over the three-year period, as of December 31.

SOLUTION OF CASE STUDY - IFRS 14 REGULATORY DEFERRAL ACCOUNTS

Presentation in the Statement of Financial Position as of January 1, 2022

Current Assets	XXX
Long Term Assets	XXX
Total Assets	**XXX**
Regulatory Deferral Accounts	120.000
Regulatory Deferral Accounts Deferred Tax Effect	18.000
Total Assets Including Regulatory Deferral Accounts	**XXX**

Consequently, the regulatory deferral account balances to be recognised under IFRS 14 amount to CU120,000, which is the difference between the deferred costs capitalised and recognised under GERMAN GAAP and what would have been recognised under IFRS without the adoption of IFRS 14 (i.e., CUNil). Amortisation expense of CU40,000 (CU120,000/3 years) will be recognised annually during the three-year recovery period.

Due to the under-recovery of water costs, a debit regulatory deferral balance of CU120,000 was recognised as of 1 January 2022 on application of IFRS 14. This regulatory deferral account debit balance will be amortised over three years, with an annual charge of CU40,000.

In the year 2022, the over-recovery of water costs of CU (30,000) results in a regulatory deferral credit balance which will also be amortised over three years, with an annual credit of CU (10,000).

The table below shows the movements in the net regulatory deferral account balances over the three-year period, as of 31 December:

Regulatory Deferral Account Balances, net (in CU)	**2021**	**2022**	**2023**
Beginning balance	**-**	**120,000**	**30,000**
Net under-recovery of water costs during the year	120,000	-	-
Net over-recovery of water costs during the year	**-**	**(30,000)**	**(80,000)**
Amortization of: • Under-recovery of water costs incurred in Year 20x1 • Over-recovery of water costs incurred in Year 20x2	 - -	 (40,000) -	 (40,000) 10,000
Net movement	**120,000**	**(70,000)**	**(110,000)**
Ending balance	**120,000**	**50,000**	**(60,000)**

Under IFRS 14, the net movement in the debit and credit balances will flow to the statement of profit or loss and other comprehensive income. A similar process would be applied when accounting for the activity in the regulatory deferral account balances for the subsequent years.

CASE STUDY - IFRS 15 REVENUE FROM CONTRACTS WITH CUSTOMERS

Jevgenija Furgase*

Introduction

The recognition of revenue in accounting is a significant and complex issue. With the development of new forms of business, the content of contracts signed with customers has changed due to new marketing tools, new pricing systems, new methods for the delivery of goods and the conditions of the provision of services as well as other factors. IFRS® Standard 15 Revenue from Contracts with Customers was introduced by the IASB to provide a single comprehensive revenue recognition model for all contracts with customers in order to reflect relevant changes and developments in the business world.

It is very important for the recognition of revenue and recording it in accounting to establish the elements and content of the contract. This recognition includes five stages: 1) contract identification; 2) combination of related contracts; 3) identification of existing contract modification; 4) identification of performance obligations; 5) fulfilment of the obligations. The composition of the transaction price can vary, so it is very important to identify different elements of prices set in contracts, namely variable and fixed price elements. Moreover, in order to allocate the transaction price for each obligation fulfilled, it is necessary to refer to the contract signed, and to assess whether separate prices were set for a specific good or service in the contract or whether a proportional calculation needs to be applied, i.e. adjusted market assessment, expected cost plus a margin or residual approaches.

Aim of this case study is to provide understanding of the principles and rules on how revenue received from the contracts signed with customers should be accounted, taking into account the size, nature, timing and other aspects of the cash flow and revenue.

* Lecturer, Vytautas Magnus University, Lithuania, jevgenija.furgase@vdu.lt,
ORCID: 0000-0001-6445-3314

The Case Information

Company "Beauty Goods" (BG) engages in wholesale trade and trades in beauty products. In order to maintain customer loyalty, BG concludes contracts with customers for the sale of goods and contracts related to the delivery of goods. Contracts cover a variety of aspects, from concessions to penalties for non-fulfilment.

One of such regular customers is the company "Beauty House" (BH). BG has concluded several contracts with BH for the supply of goods and services. The following information is known about these contracts and related events:

Data	Information
July 26, 20xx	A contract was concluded for a period of 12 months and covers: ✔ Selling goods without the full ready-to-use preparation service, CU1,000 per unit; ✔ A 9% discount will be applied for orders over CU50,000; ✔ The payment term will be 30 days; ✔ If the payment is made within 5 days after the completion of the order, an additional 1% discount will be applicable; ✔ The delayed payment fine is 0.2% per day.
August 1, 20xx	A contract was concluded for a period of 12 months and covers: ✔ Transportation of good shall cost CU500 per order; ✔ Transportation must be provided within 3 days of order confirmation; ✔ The delayed transportation fee is CU10 per day; ✔ The payment term will be 30 days; ✔ The delayed payment fine is 0.2% per day.
August 5, 20xx	The customer ordered 55 units of goods and transportation.
August 6, 20xx	The order of 5 August 20xx was completed.
August 9, 20xx	The customer has paid for the order.
September 5, 20xx	The customer ordered 25 units of goods and transportation.
September 10, 20xx	The order of 5 September was completed (there was a delay in transportation).
September 25, 20xx	The customer has paid for the order.
October 3, 20xx	An amendment to the 26 July 20xx contract was concluded, which provides: ✔ Selling goods with the full ready-to-use preparation, CU1,050 per unit; ✔ All other conditions remain valid under the original contract concluded on 26 July 20xx; ✔ The conditions of transportation remain valid under the contract concluded on 1 August 20xx.
October 5, 20xx	The customer ordered 50 units of goods and transportation.
October 6, 20xx	The order of 5 October was completed.
October 31, 20xx	The customer has paid for the order.

Discussion Questions

1. Analyse the case study according to the stages of revenue recognition from contracts with customers.
2. Discuss the elements of transaction price in this case study between BG and BH companies.
3. Identify the method that can be used to calculate the stand-alone selling price of a goods and services.

SOLUTION FOR CASE STUDY - IFRS 15 REVENUE FROM CONTRACTS WITH CUSTOMERS

It is known that the following transactions have taken place in relation to all contracts between BG and BH:

Month	**Goods**	**Delivery**	**Customer Payment**
August, 20xx	✔ On time ✔ Exceeds CU50,000	On time	✔ On time ✔ Payment is made within 5 days
September, 20xx	On time	Delayed	On time
October, 20xx	✔ On time ✔ Exceeds CU50,000	On time	On time

The following is the solution to decide how BG should apply the IFRS 15 for recognition of revenue from contracts with BH:

Stages	Identification of elements and content of a contract
1. Contract identification	Contract to sell goods.
2. Combination of related contracts	Related contract for the transportation of goods.
3. Identification of contract modification	Two months later, additional preparation service for goods has been ordered.
4. Identification of performance obligations	There are two obligations: ✔ To sell goods without and with the full ready-to-use preparation service; ✔ To provide the transportation service within 3 days after the order. The transaction price set for obligations consists of fixed and variable price elements. Fixed price elements for goods are as follows: ✔ without the full ready-to-use preparation service the price of goods is CU1,000; ✔ for goods with the full ready-to-use preparation service the price is CU1,050; Variable price elements for goods are as follows: ✔ 9% discount will be applicable for orders over CU50,000; ✔ additional 1% discount will be applicable, if the payment is made within 5 days; ✔ the delayed payment fine is 0.2% per day; Fixed price elements for transportation are as follows: ✔ for transportation of goods, the price is CU500 per order; Variable price elements for transportation:

	✔ the delayed transportation fee is CU10 per day; ✔ the delayed payment fine is 0.2% per day;
5. Fulfilment of the obligations	Throughout all the months, both obligations were fulfilled – goods were sold and transported. Revenue was recognized in accordance with the identification of obligation and the allocation of price. In August: *Goods sold 55 units x CU1000 = CU55,000* *Discount (goods) CU55000x 9% = CU4,950* *Discount (payment) CU55000x 1%= CU550* *Transportation service CU500 x 1 order = CU500* *Total revenue: CU55000– CU4950 - CU550+CU500= CU50,000* In September: *Goods sold 25 units x CU1000 = CU25,000* *Transportation service CU500 x 1 order = CU500* *Delayed transportation fee CU10*2=CU20* *Total revenue: CU25000+ CU500-CU20= CU25,480* In October: *Goods sold 50 units x CU1000 = CU50,000** *Full ready-to-use preparation service 50 units x CU50 = CU2,500* *Discount (goods) CU52500x 9% = CU4,725* *Transportation service CU500 x 1 order = CU500* *Total revenue: CU50000+ CU2500 - CU4725+CU500= CU48,275* **The entity has applied a separate selling price in reference to the total contract price minus the sum of the observed separate selling prices of other goods or services promised in the other contracts.*

CASE STUDY - IFRS 16 LEASES

Tuba Bora Kılınçarslan[*] - Emre Selçuk Sarı[**] - Agim Mamutı[***]

Introduction

In order for entities to carry out their activities, they need various assets such as machinery, equipment, vehicles. Today, many entities prefer to use these assets by leasing instead of meeting them with their own resources. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and ensures lessees and lessors to provide relevant information in a manner that faithfully represents those transactions.

The aim of this case study is to discuss how leases should be recognized under IFRS and to provide an understanding of its effects on financial statements.

The Case Information

Founded in 1987 in Sinop, Türkiye, Arena Logistics Company provides logistics services in road transport. The company, which started service with 3 trucks purchased on the date of its establishment and provides intercity road transportation services only in Türkiye, has taken firm steps forward without compromising service quality and customer satisfaction and has become one of the leading companies in the sector. In 2010, it started to provide logistics services in international road transport with 21 trucks it acquired. The company, whose business grew even more towards the end of 2020, decided to rent 10 trucks in order to meet the demands. Arena Logistics Company leased 10 trucks from Boras Company on January 1, 2021 to use in logistics activities. The following matters are included in the contract between Arena Logistics Company and Boras Company:

- The term of the lease contract is 5 years and the annual implicit interest rate is 6%.

[*] Assist. Prof., Bursa Uludag University, tubabora@uludag.edu.tr, ORCID: 0000-0001-9258-3829
[**] Assoc. Prof., İstanbul University, emresari@istanbul.edu.tr, ORCID: 0000-0001-6675-3214
[***] Prof., Mother Teresa University, agim.mamuti@unt.edu.mk, ORCID: 0000-0003-2499-0216

- Arena Logistics Company will pay CU300,000 on contract date (January 1, 2021) and CU1,000,000 at the end of each year (from December 31, 2021).
- The ownership of the trucks will pass to Arena Logistics Company at the end of the contract.
- The leased trucks have a useful life of 5 years and have no residual value.
- Arena Logistics Company will apply a straight-line depreciation method for these trucks.

Discussion Questions

1. How should Arena Logistics Company (lessee) and Boras Company (lessor) recognize leases in 2021?
2. How will this lease affect Arena Logistics Company's and Boras Company's statement of financial position and statement of profit or loss in 2021?

SOLUTION OF CASE STUDY - IFRS 16 LEASES

First of all, this lease needs to be classified for the lessee and the lessor. For the lessee, this contract is a long-term lease for which the underlying asset is not of low value. Therefore, it should be reported on the statement of financial position. For the lessor this is a finance lease because some of the finance lease conditions are met on this agreement. For example; leased assets ownership will be transferred at the end of the agreement.

Firstly, we must calculate the annuity factor (AF) and the present value (PV) of the payments to be made for the lease contract.

$$AF = \frac{1-(1+r)^{-n}}{r}$$

r: Interest rate, n: Number of periods

Since the term of the lease contract is 5 years and the implicit annual interest rate is 6%,

$$AF = \frac{1-(1+0.06)^{-5}}{0.06} = 4.212$$

Present Value (PV) = Cash Payment + (Annuity x $AF_{n=5,\ i=\%6}$)

Present Value (PV) = 300,000 + (1,000,000 x 4.212)

Present Value (PV) = CU4,512,000

Now, let's prepare the table of liability and interest payment.

Date	**Total Payment (CU)**	**Discount factor**	**Present value of payment (CU)**
01.01.2021	300,000	1	300,000
31.12.2021	1,000,000	0,943	943,000
31.12.2022	1,000,000	0,89	890,000
31.12.2023	1,000,000	0,84	840,000
31.12.2024	1,000,000	0,792	792,000
31.12.2025	1,000,000	0,747	747,000
TOTAL	**5,300,000**		**4,512,000**

Date	Principal Liability at the Beginning of the Period (CU)	Total Payment (CU)	Interest Payment (Liability*0.06) (CU)	Principal Payment (Total Payment-Interest Payment) (CU)	Principal Liability at the End of the Period (CU)
01.01.2021	4,512,000	300,000	0	300,000	4,212,000
31.12.2021	4,212,000	1,000,000	252,720	747,280	3,464,720
31.12.2022	3,464,720	1,000,000	207,883	792,117	2,672,603
31.12.2023	2,672,603	1,000,000	160,356	839,644	1,832,959
31.12.2024	1,832,959	1,000,000	109,978	890,022	942,937
31.12.2025	942,937	1,000,000	56,576	942,937	0
TOTAL		**5,300,000**	**787,513**	**4,512,000**	

Arena Logistics Company is the lessee and will recognize this lease on the statement of financial position.

Recognition of right-of-use asset in the statement of financial position

01.01.2021 Dr. Right-of-use Asset 4,512,000

Cr. Lease Liability 4,512,000

Payment on contract date

01.01.2021 Dr. Lease Liability 300,000

Cr. Bank 300,000

STATEMENT OF FINANCIAL POSITION, CU (01.01.2021)			
RIGHT-OF-USE ASSET	4,512,000	LEASE LIABILITY	4,212,000

Year-end interest expense

31.12.2021 Dr. Interest Expense 252,720

Cr. Lease Liability 252,720

Year-end payment (principal + interest)

31.12.2021 Dr. Lease Liability 1,000,000

Cr. Bank 1,000,000

Since the straight-line depreciation method is applied,

Depreciation expense = CU4,512,000 / 5 years = CU902,400

31.12.2021 Dr. Depreciation Expense 902,400

Cr. Accumulated Depreciation 902,400

STATEMENT OF FINANCIAL POSITION, CU (31.12.2021)			
RIGHT-OF-USE ASSET	4,512,000	LEASE LIABILITY	3,464,720
ACCUMULATED DEPRECIATION	(902,400)		

STATEMENT OF PROFIT OR LOSS, CU (01.01.2021 - 31.12.2021)	
OPERATING EXPENSES	
Depreciation Expense	(902,400)
FINANCE EXPENSES	
Interest Expense	(252,720)

Boras Company is the lessor and will recognize this lease as a finance lease.

Recognition of lease receivable in the statement of financial position

01.01.2021 Dr. Lease Receivables 4,512,000

Cr. PPE (underlying asset) 4,512,000

Collection on contract date

01.01.2021 Dr. Bank 300,000

Cr. Lease Receivables 300,000

STATEMENT OF FINANCIAL POSITION, CU (01.01.2021)		
LEASE RECEIVABLES	4,212,000	

Year-end interest income

31.12.2021 Dr. Lease Receivable 252,720

Cr. Finance Income 252,720

Year-end collection (principal + interest)

31.12.2021	Dr. Bank	1,000,000	
	Cr. Lease Receivables		1,000,000

STATEMENT OF FINANCIAL POSITION, CU (31.12.2021)		
LEASE RECEIVABLES	3,464,720	

STATEMENT OF PROFIT OR LOSS, CU (01.01.2021 - 31.12.2021)	
FINANCE INCOME	252,720

CASE STUDY - IFRS 17 INSURANCE CONTRACTS

Elif Yücel*

Introduction

The insurance industry has a very complex structure. The most important reason for this is that insurance contracts cover many risks and uncertainties. Moreover, it is very difficult to predict these uncertainties and calculate their results. So IFRS 17 Insurance Contracts Standard is a standard published to regulate the complex applications of the insurance industry, and includes comprehensive regulations regarding the accounting and reporting of insurance contracts.

With this case study, it is aimed to eliminate the uncertainties that arise in understanding and applying the IFRS 17 Insurance Contracts Standard.

The Case Information

URAS Insurance Company was established in Türkiye in 2020 and specialises only in life insurance. The company has started to apply the IFRS Standard 17 Insurance Contracts since 2022. URAS Insurance Company has written 50 - 2-years life insurance policies as of January 1st, 2022. These policies cover payments to be made in the event of death. All healthy individuals between the ages of 18-65 can benefit from this life insurance. Insurance contracts cover natural death and accidental death. Suicides are not covered by insurance contracts. Moreover, deaths due to epidemics (etc. COVID 19) were excluded from the policy since the company was established during the pandemic period and was ready for pandemic conditions. Within the scope of IFRS 17, the insurance company adopts the following assumptions:

- It is expected that a single premium of CU200 per policy will be received at the beginning of the contracts.

* Assoc. Prof., Bursa Uludag University, Türkiye, emugal@uludag.edu.tr,
ORCID: 0000-0002-2708-6778

- At the beginning of the contract, an acquisition cost of CU300 has been accrued (for brokerage, underwriting costs and medical expenses). All of these expenses will be distributed throughout the coverage period.
- The amount of coverage per policy is CU800.
- While estimating the cash outflows for each year, the company has assumed that it will repay 3 policies for each year by looking at the past statistics.
- During the contract period, the discount rate, including financial risk adjustment, is calculated as 4%.
- The risk adjustment ratio for non-financial risk has been determined as 6% of the estimated cash flows. The changes in the economic conditions of the country and therefore the living conditions of the society are effective in determining this risk.
- Contracts will not be terminated until the end of the guarantee period.
- At the end of the first year, the entity has not changed any assumptions about future periods, as all events occurred as expected.
- All contracts aren't expected to become onerous.
- The policyholder is obliged to inform the insurer about all important matters that should be known during the conclusion of the contract. If the issues that are not notified to the insurer, incomplete or incorrectly reported to the insurer are of a nature to affect the contract, incomplete or not receiving the compensation may occur.
- If the beneficiary of the insurance kills the insured or is complicit in his/her murder, he/she cannot receive the insurance compensation.
- Tax is neglected.

Discussion Questions

1. Explain which model should be selected and which transactions and calculations should be made, respectively, within the scope of IFRS 17.
2. Prepare the statement of profit or loss and other comprehensive income of the URAS Insurance Company by making the necessary calculations.

SOLUTION OF CASE STUDY - IFRS 17 INSURANCE CONTRACTS

At the beginning of the contract (January 1st, 2022):

Within the scope of IFRS 17, the company prefers the General Model Approach. According to this model, initially, the present value of future cash flows must be calculated. The insurance company estimated cash inflows of CU10,000 (CU200 x 50). The company calculated the cash outflows as CU2,400 based on the expected number of deaths (CU800 x 3). The net present value of the estimated cash outflows is calculated as CU 2,308 [CU2,400 / (1 + 0.04)] for the first year and CU2,219 [CU2,400 / $(1 + 0.04)^2$] at a 4% discount rate. Also, the net present value of the acquisition cost is calculated as CU288 [CU300 / (1 + 0.04)] for the first year and CU277 [CU300 / $(1 + 0.04)^2$] at a 4% discount rate. Thus, the Present Value of Future Cash Flows has been estimated at CU4,908 [CU10,000 – (CU2,308 + CU2,219) – (CU288 + CU277)].

The next step is to make a risk adjustment against non-financial risks. Risk adjustment based on assumptions is calculated as 6% of cash flows. Accordingly, the risk adjustment was calculated as CU294 (CU4,908 x 0.06). After risk adjustment, cash flows related to the fulfilment of the contract were determined (CU4,908 – CU294 = CU4,614).

Under IFRS 17, an insurer is required to measure at initial recognition the fulfilment cash flows of a group of contracts at an amount that will not result in any income or expense. Therefore, the contractual service margin at initial recognition should equal zero when added to the fulfilment cash flows.

	January 1st, 2022
Present value of future cash inflows	(CU10,000)
Present value of future cash outflows	CU4,527
Present value of contract acquisition cost	CU565
Present value of future cash flows	**(CU4,908)**
Risk adjustment for non-financial risk	CU294
Cash Flows Regarding the Fulfilment of the Contract	(CU4,614)
Contractual Service Margin	CU4,614
Insurance contract asset/liability at initial recognition	0

According to the standard, it is necessary to update the estimates of cash flows at the end of the year and recalculate the contractual service margin as:

Present value of future cash outflows: CU2,400 / (1 + 0.04) = CU2,308

Present value of contract acquisition cost: CU300 / (1 + 0.04) = CU288

Also, the risk adjustment based on assumptions is calculated as CU156 (CU 2,596 x 0.06).

	January 1st, 2022	**December 31st, 2022**
Present Value of Future Cash Inflows	(CU10,000)	-
Present Value of Future Cash Outflows	CU4,527	CU2,308
Present Value of Contract Acquisition Cost	CU565	CU288
Present Value of Future Cash Flows	**(CU4,908)**	**CU2,596**
Risk Adjustment for Non-Financial Risk	CU294	CU156
Cash Flows Regarding the Fulfilment of the Contract	(CU4,614)	CU2,752
Contractual Service Margin	CU4,614	-
Insurance Contract Asset / Liability at Initial Recognition	0	

From the date of the insurance contract until the end of the period, interest will be accrued on the amounts arising from the changes related to the future service at the discount rate. The said interest constitutes the insurance's financial expenses.

Calculating interest on the present value of future cash flows: CU4,908 x 0,04 = CU196

Calculating interest on the contractual service margin: CU4,614 x 0,04 = CU185

The contractual service margin recognized in the financial statements at the initial recognition, together with the accrued interest amount until the end of the period, must be amortised over the life of the insurance contract, spread over the years and converted into revenue in this way. In this example, the contractual service margin can be amortised evenly.

Amortisation of Contractual Service Margin: (CU4,614 + CU185) / 2 = CU2,400

The company will calculate the insurance contract revenue as:

Total Earnings and Costs Included in Revenue (Contractual Service Margin + Contract Acquisition Cost + Risk Adjustment) = CU2,400 + CU300 + CU294 = CU2,994

Actual Damages: CU2,400

Total contract revenue: CU2,400 + CU2,994 = CU5,394

Insurance Service Expenses (Actual Damages + Contract Acquisition Cost): CU2,400 + CU300 = CU2,700

Profit or Loss and Other Comprehensive Income Statement for the Period 01.01.2022 - 31.12.2022

URAS Life Insurance Company "Statement of Profit or Loss and Other Comprehensive Income" December 31st, 2022	
Insurance Revenue	CU5,394
Insurance Service Expenses	(CU2,700)
Insurance Financial Expenses	(CU381)
Investment Revenues	-
Profit or Loss for the Period	CU2,313
Comprehensive Income	**CU2,313**

EDITED BY
PROF. AYLİN POROY ARSOY
PROF. YAKUP SELVİ

PASSFR
CASE STUDIES

Global adoption of IFRS among businesses makes IFRS issue an integral part of business education in HEIs which their classrooms are now filled by Generation Z students. GenZ, (born 1995 through 2010), born with technology, and are known as digital natives. Although the timing of GenZ students' admission to HEIs and the Covid 19 pandemic process and therefore the necessity of transition to digital education in almost all over the world seems to be a coincidence, this is actually an opportunity that will contribute greatly to the learning process of digital native GenZ students.This is our inspiration to develop PASSFR. The logic of PASSFR is to combine IFRS principle-based approach with the unique digital native and open-minded characteristics of GenZ students.This logic will lead us to reach high quality IFRS distance learning which will contribute to build digital education readiness and to mitigate the impact of the Covid 19 crisis on business education.

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