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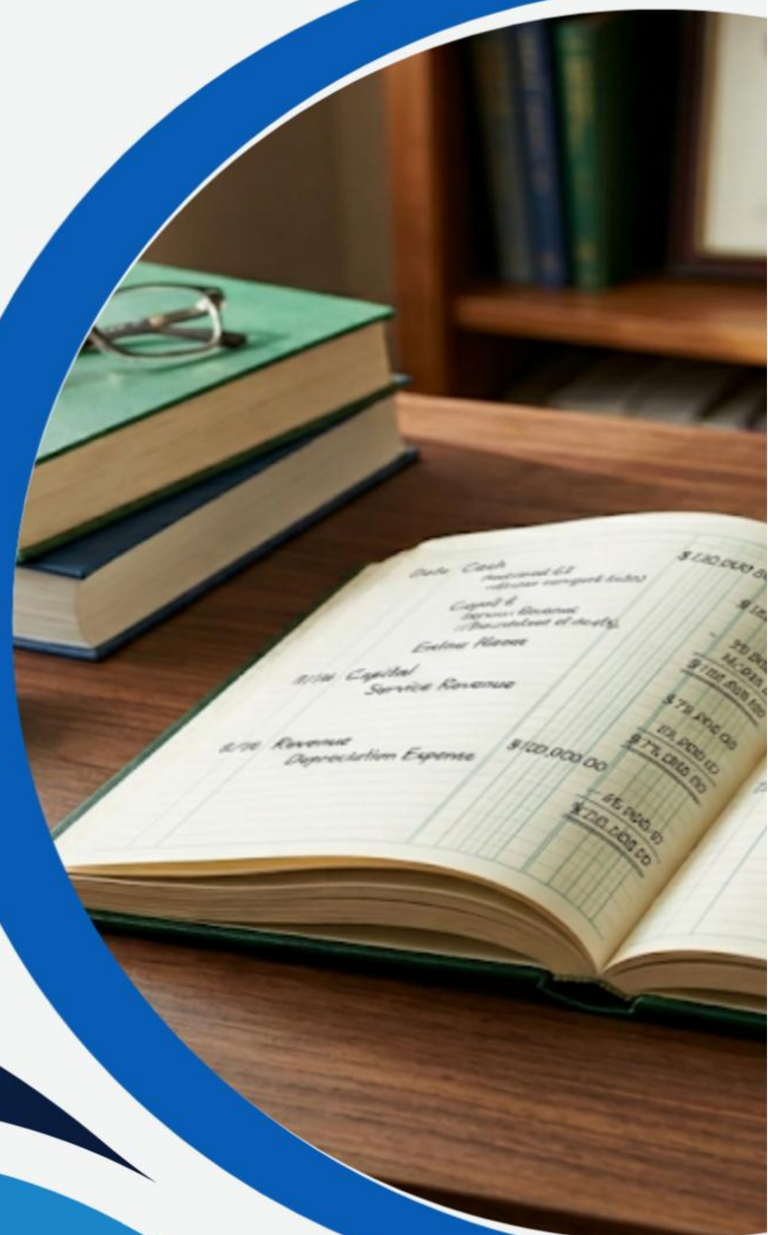
ACC201

FINANCIAL ACCOUNTING I



CODE:ACC 201
COURSE TITLE: Financial Accounting I
COURSE CODE UNIT(3 Units C: LH 30; PH 45)

Series Titles for ACC 201: Financial Accounting I

1. Series 1: IASB Framework for Financial Statement Preparation and Presentation
2. Series 2: Introduction to IFRS 15 – Revenue and IAS 1 Presentation of Financial Statements
3. Series 3: Accounting for Inventories under IAS 2
4. Series 4: Accounting Policies and Property, Plant and Equipment (IAS 8 and IAS 16)
5. Series 5: Government Grants and Borrowing Costs (IAS 20 and IAS 23)

Series 1: IASB Framework for Financial Statement Preparation and Presentation

Main Parts and Sub-Parts Outline

Part 1: Understanding the IASB framework
- Introduction to the IASB and its role
- Objectives of financial reporting
- Qualitative characteristics of useful financial information

Part 2: Elements of financial statements
- Definition and recognition of assets, liabilities, equity, income, and expenses
- Measurement bases in financial reporting
- Concept of capital and capital maintenance

Part 3: Application of the framework in practice
- Preparing financial statements using the IASB framework
- Presentation requirements and disclosure considerations
- Limitations and challenges of applying the framework

Introduction

Financial statements are the primary means by which organisations communicate their financial performance and position to stakeholders. To ensure that these statements are consistent, reliable, and comparable across different entities, the International Accounting Standards Board (IASB) has developed a framework that guides their preparation and presentation. Understanding this framework is essential for learners, as it provides the foundation upon which all other accounting standards and practices are built.

The aim of this Series is to introduce you to the IASB framework and to equip you with the knowledge needed to apply its principles in preparing and presenting financial statements.

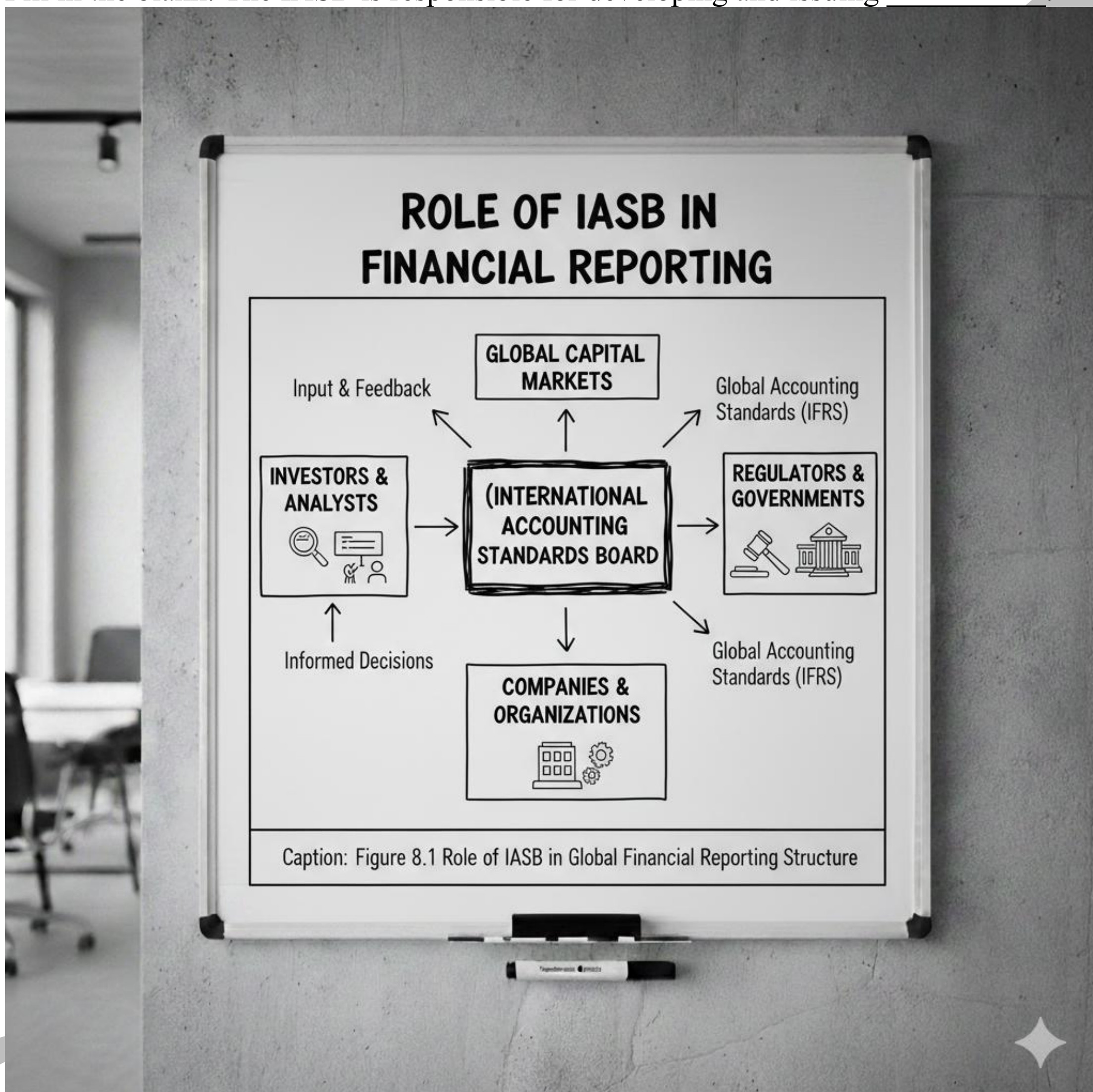
We shall commence this Series by exploring the IASB framework itself, including its objectives and the qualitative characteristics of useful financial information. Next, we will move on to the elements of financial statements, examining how assets, liabilities, equity, income, and expenses are defined, recognised, and measured. Finally, we will conclude by applying the framework in practice, considering how it guides the preparation, presentation, and disclosure of financial statements, while also reflecting on its limitations and challenges.

1.1 Understanding The IASB Framework

1.1.1 Introduction to the IASB and its role

The **International Accounting Standards Board (IASB)** is the independent body responsible for developing and issuing International Financial Reporting Standards (IFRS). Its role is to create a single set of high-quality, globally accepted accounting standards that improve transparency and comparability in financial reporting. By doing so, the IASB helps investors, regulators, and other stakeholders make informed decisions.

Fill in the blank: The IASB is responsible for developing and issuing __________.

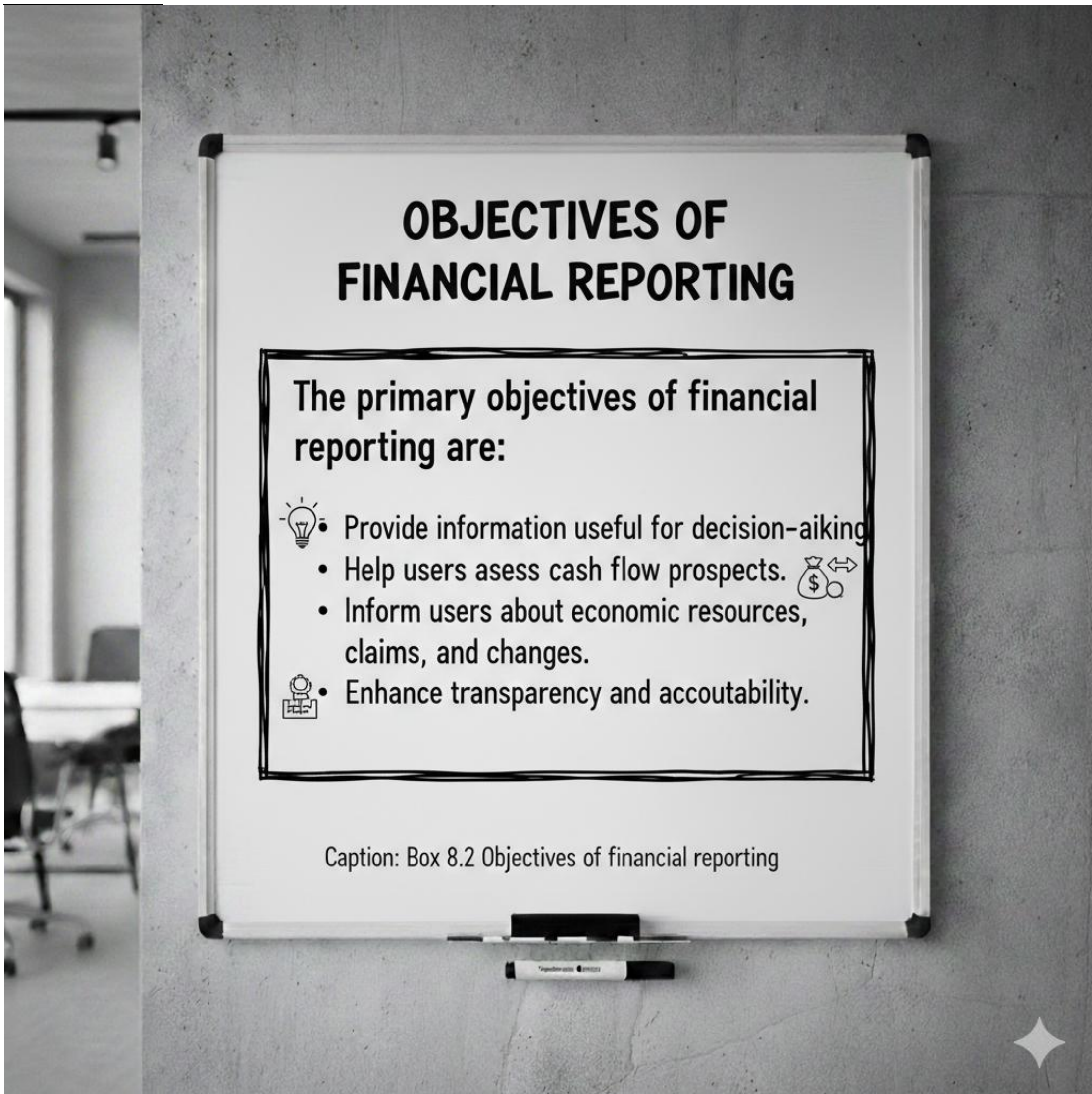


Short description: Diagram showing the IASB at the centre, with arrows pointing to investors, regulators, and companies. Caption: Figure 1.1 Role of the IASB in financial reporting

1.1.2 Objectives of financial reporting

The **objectives of financial reporting** are to provide information that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to an entity. Financial reporting should help users assess the entity's prospects for future cash flows and its stewardship of resources.

Fill in the blank: Financial reporting helps users assess an entity's prospects for future __________ flows.

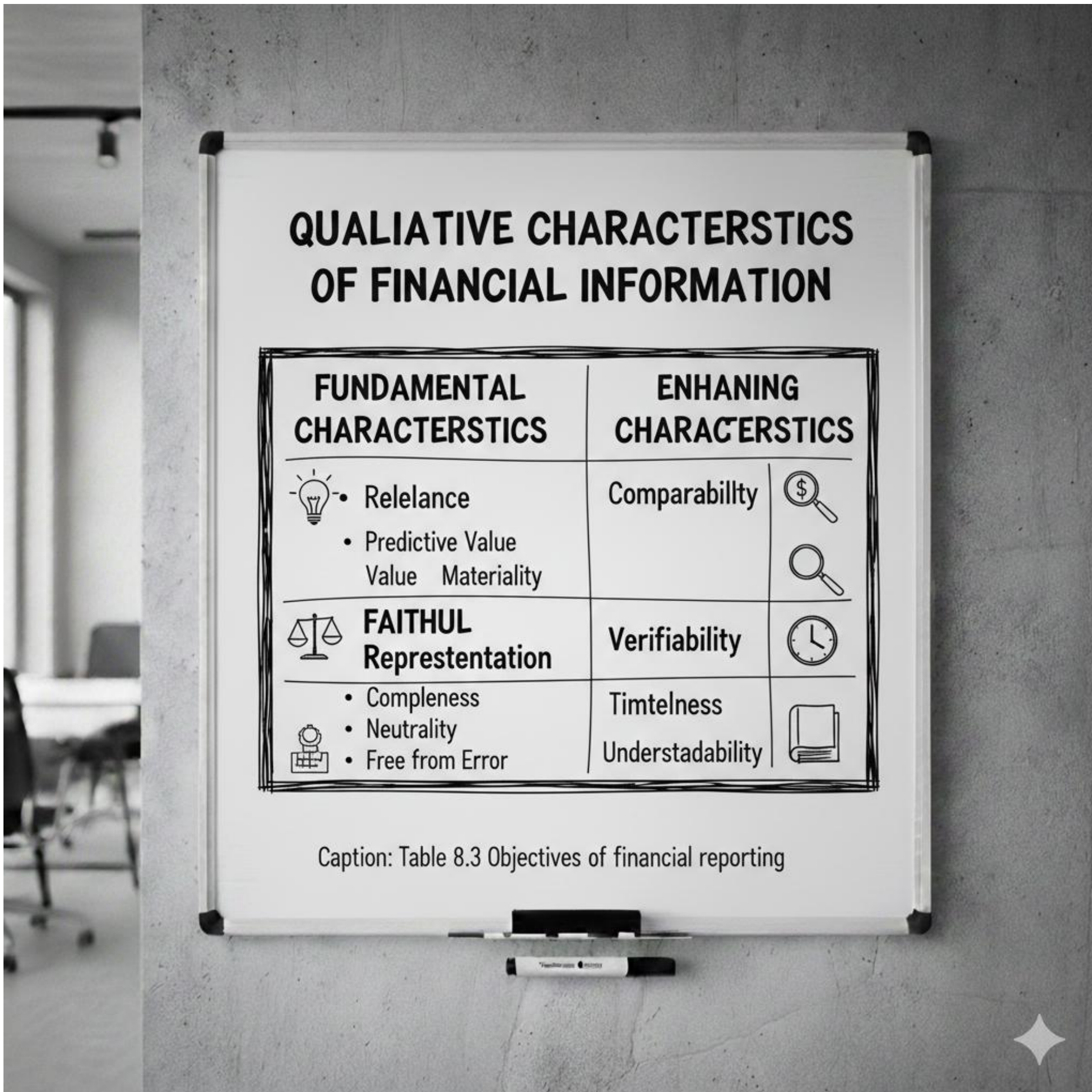


Caption: Box 1.1 Objectives of financial reporting Short description: A boxed text summarising objectives such as decision-usefulness, cash flow assessment, and stewardship.

1.1.3 Qualitative characteristics of useful financial information

Qualitative characteristics are the attributes that make financial information useful. The fundamental characteristics are relevance and faithful representation. Enhancing characteristics include comparability, verifiability, timeliness, and understandability. Together, these ensure that financial statements provide reliable and meaningful information to users.

Fill in the blank: The two fundamental qualitative characteristics of useful financial information are relevance and __________ representation.



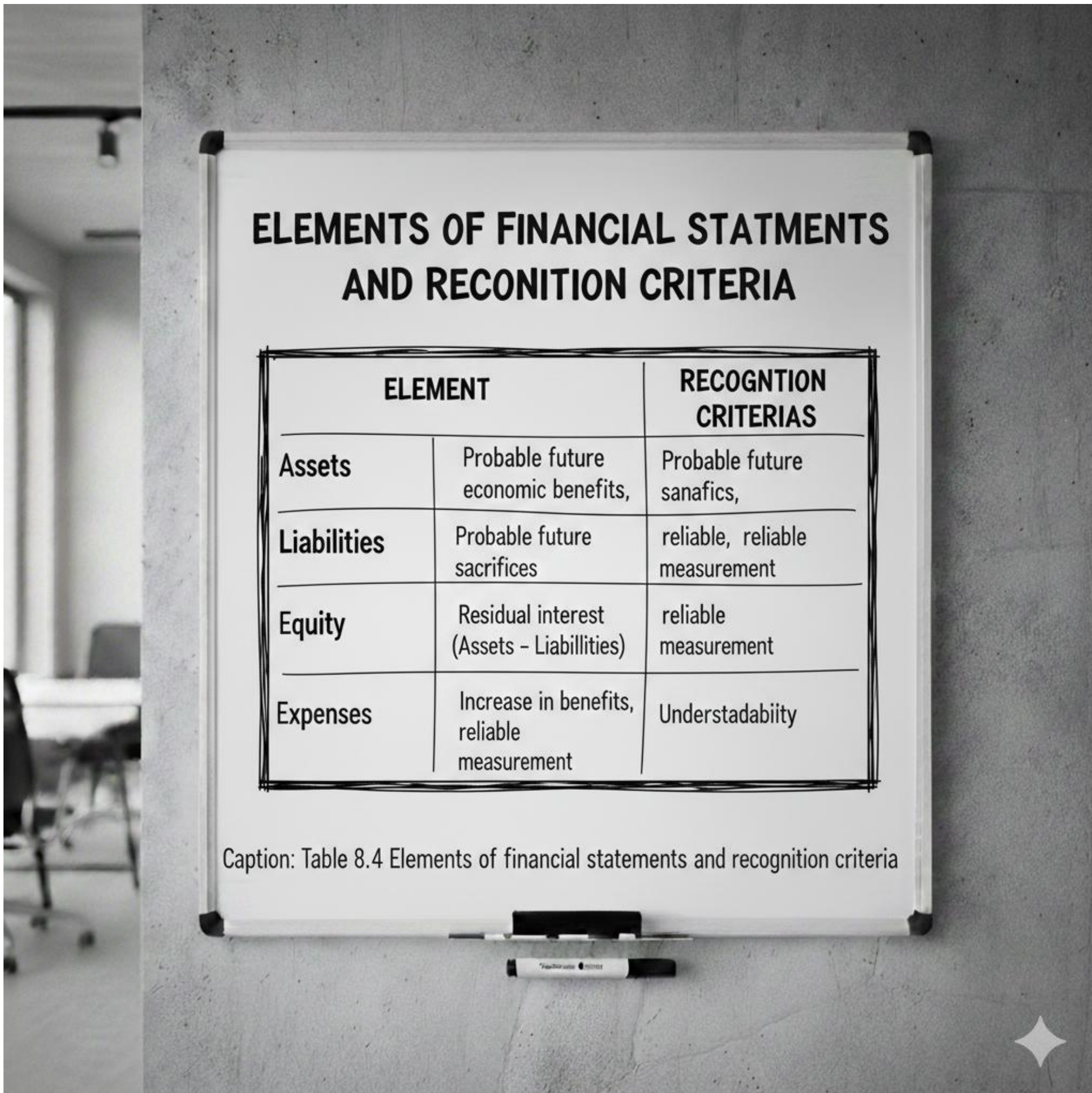
Caption: Table 1.1 Qualitative characteristics of useful financial information Short description: A table listing fundamental characteristics (relevance, faithful representation) and enhancing characteristics (comparability, verifiability, timeliness, understandability).

1.2 Elements Of Financial Statements

1.2.1 Definition and recognition of elements

The **elements of financial statements** are the building blocks used to present an entity's financial position and performance. They include assets, liabilities, equity, income, and expenses. Recognition refers to the process of formally recording these elements in the financial statements when they meet the criteria of probability of future economic benefit and reliable measurement.

Fill in the blank: The elements of financial statements include assets, liabilities, equity, __________, and expenses.

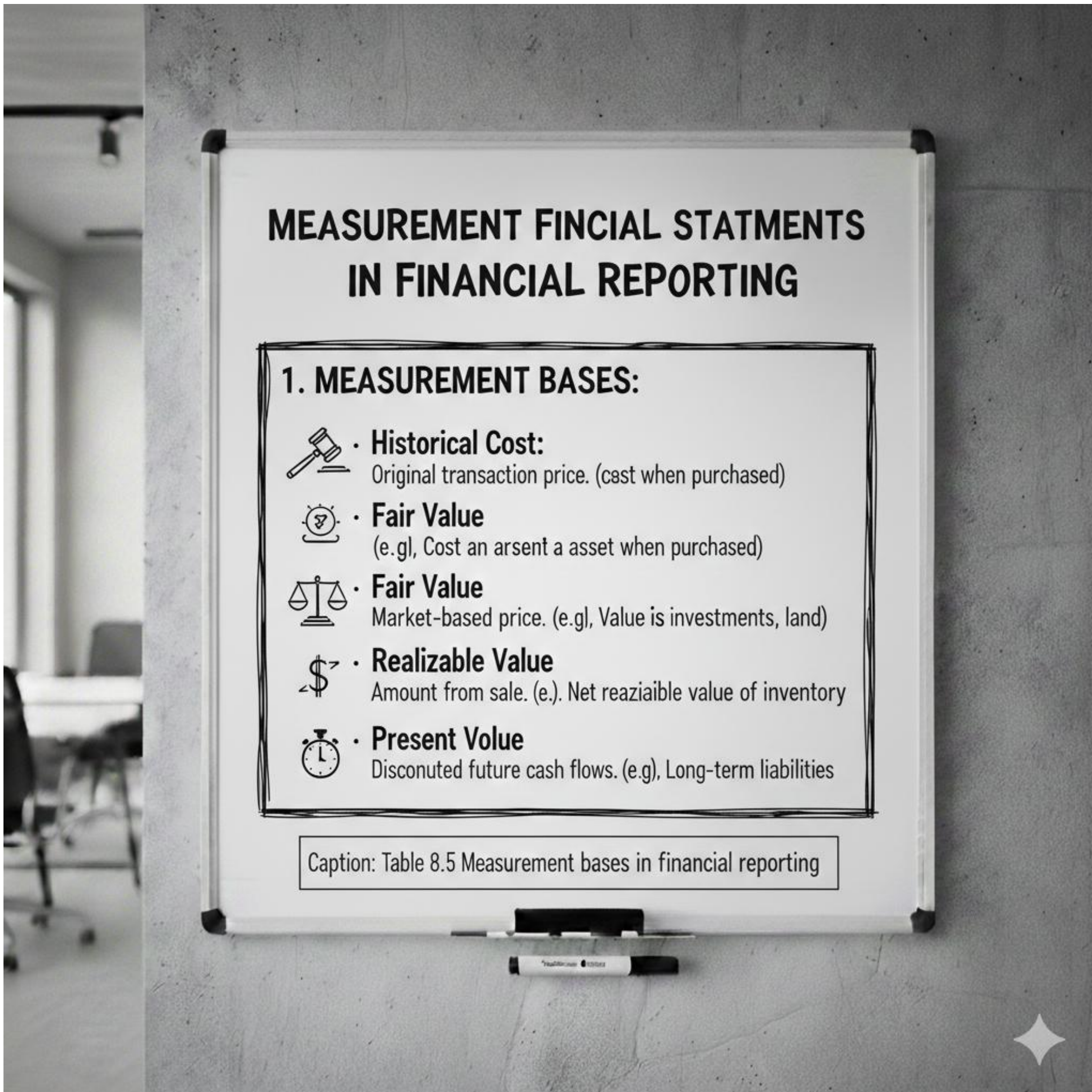


Caption: Table 1.2 Elements of financial statements and recognition criteria Short description: A table listing assets, liabilities, equity, income, and expenses, with recognition criteria for each.

1.2.2 Measurement bases in financial reporting

Measurement bases are the methods used to determine the monetary amounts at which elements are recognised and reported. Common bases include historical cost, current cost, realisable value, and present value. Each basis provides different perspectives, and the choice depends on the relevance and faithful representation of the information.

Fill in the blank: Historical cost, current cost, realisable value, and __________ value are examples of measurement bases.

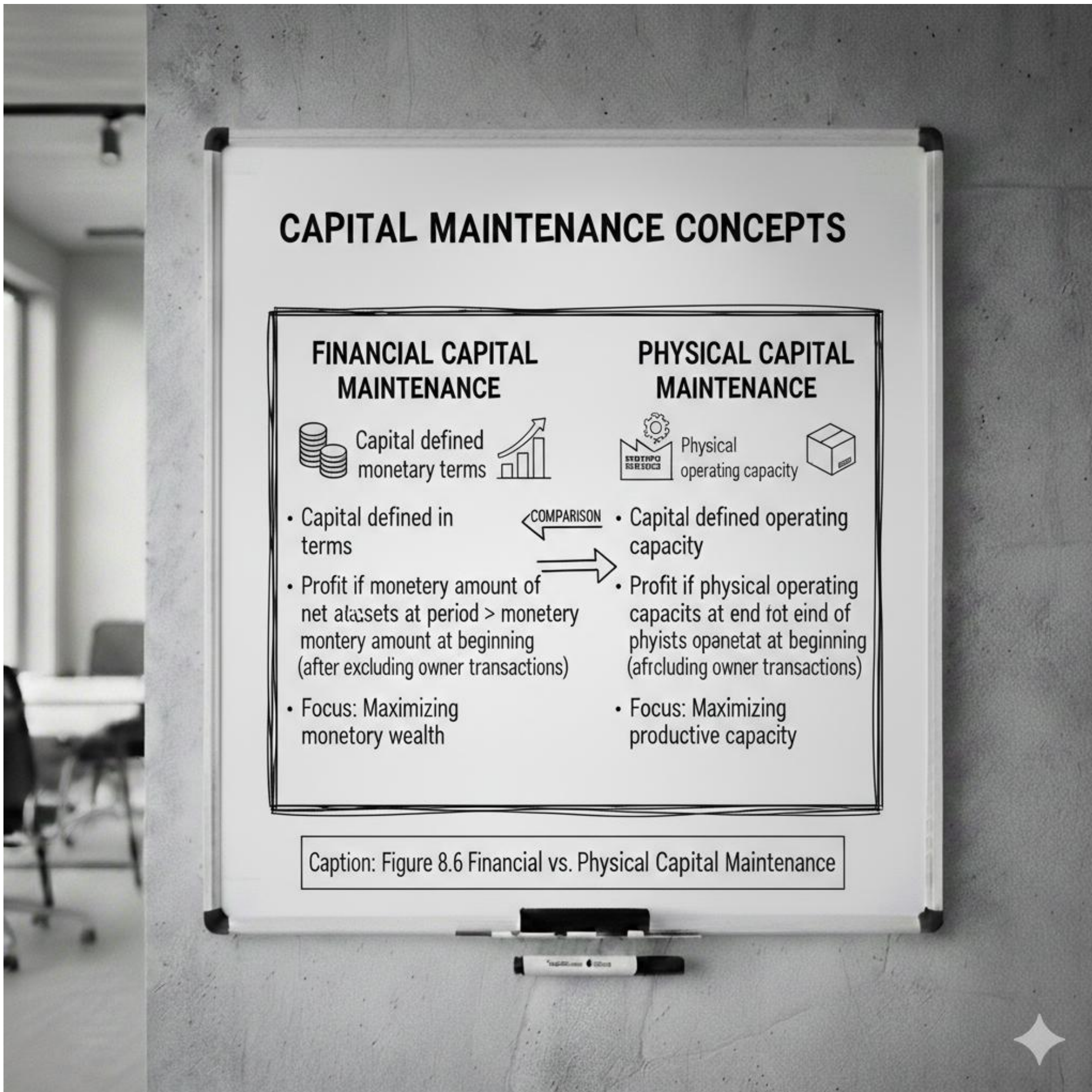


Caption: Box 1.2 Measurement bases in financial reporting Short description: A boxed text explaining historical cost, current cost, realisable value, and present value with brief examples.

1.2.3 Concept of capital and capital maintenance

The **concept of capital** refers to the resources invested in a business, while **capital maintenance** ensures that profit is only recognised after the capital at the beginning of the period has been maintained. There are two approaches: financial capital maintenance, which focuses on maintaining the monetary value of net assets, and physical capital maintenance, which focuses on maintaining the productive capacity of the entity.

Fill in the blank: Profit is recognised only after the __________ at the beginning of the period has been maintained.



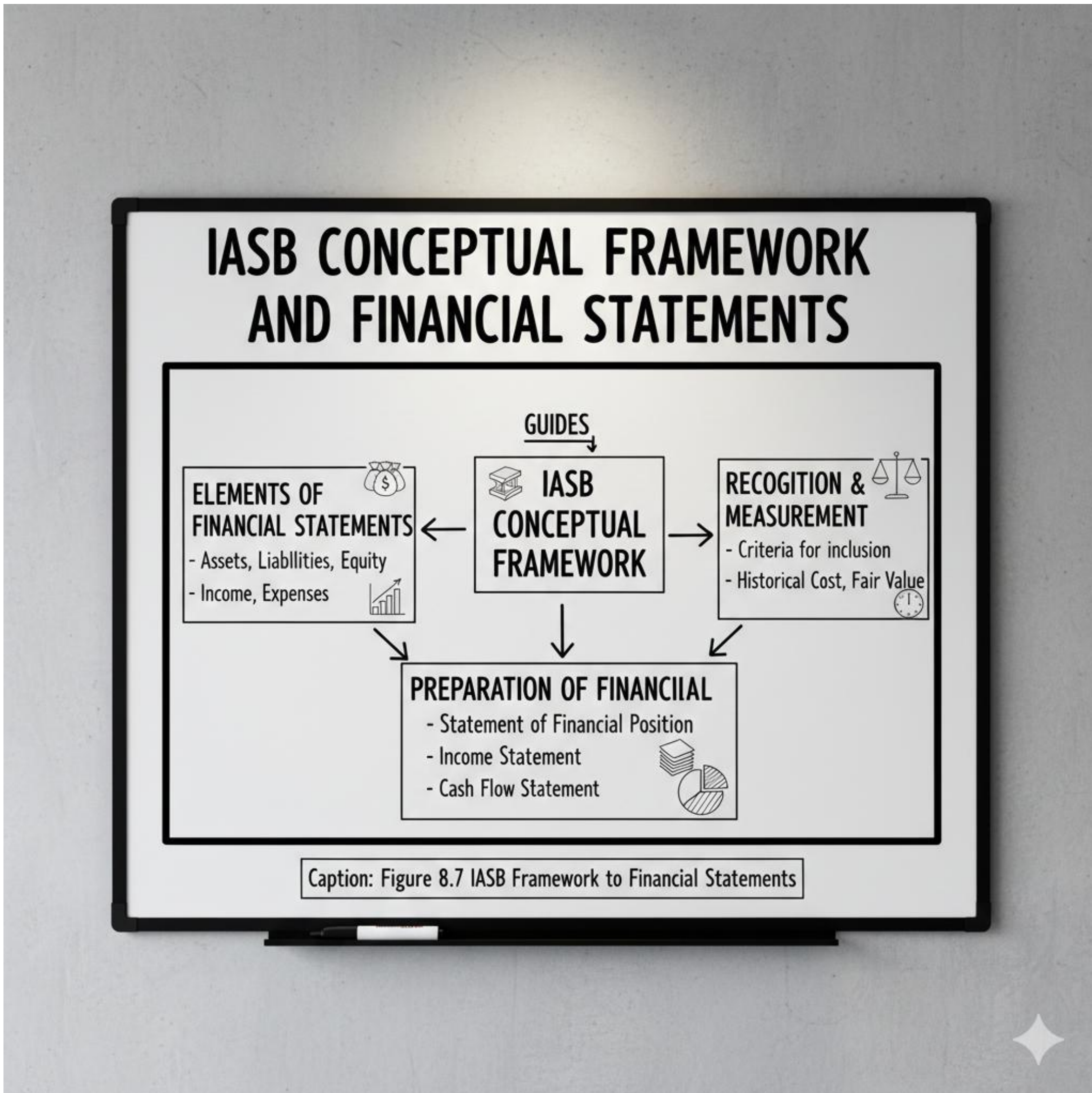
Short description: Diagram comparing financial capital maintenance and physical capital maintenance.
Caption: Figure 1.2 Capital and capital maintenance concepts

1.3 Application Of The Framework In Practice

1.3.1 Preparing financial statements using the IASB framework

The IASB framework provides guidance on how to prepare financial statements that are consistent and comparable. It ensures that entities present information about their financial position, performance, and cash flows in a structured manner. This involves applying recognition and measurement principles to assets, liabilities, income, and expenses, and ensuring that disclosures are clear and relevant.

Fill in the blank: The IASB framework ensures that financial statements are __________ and comparable.

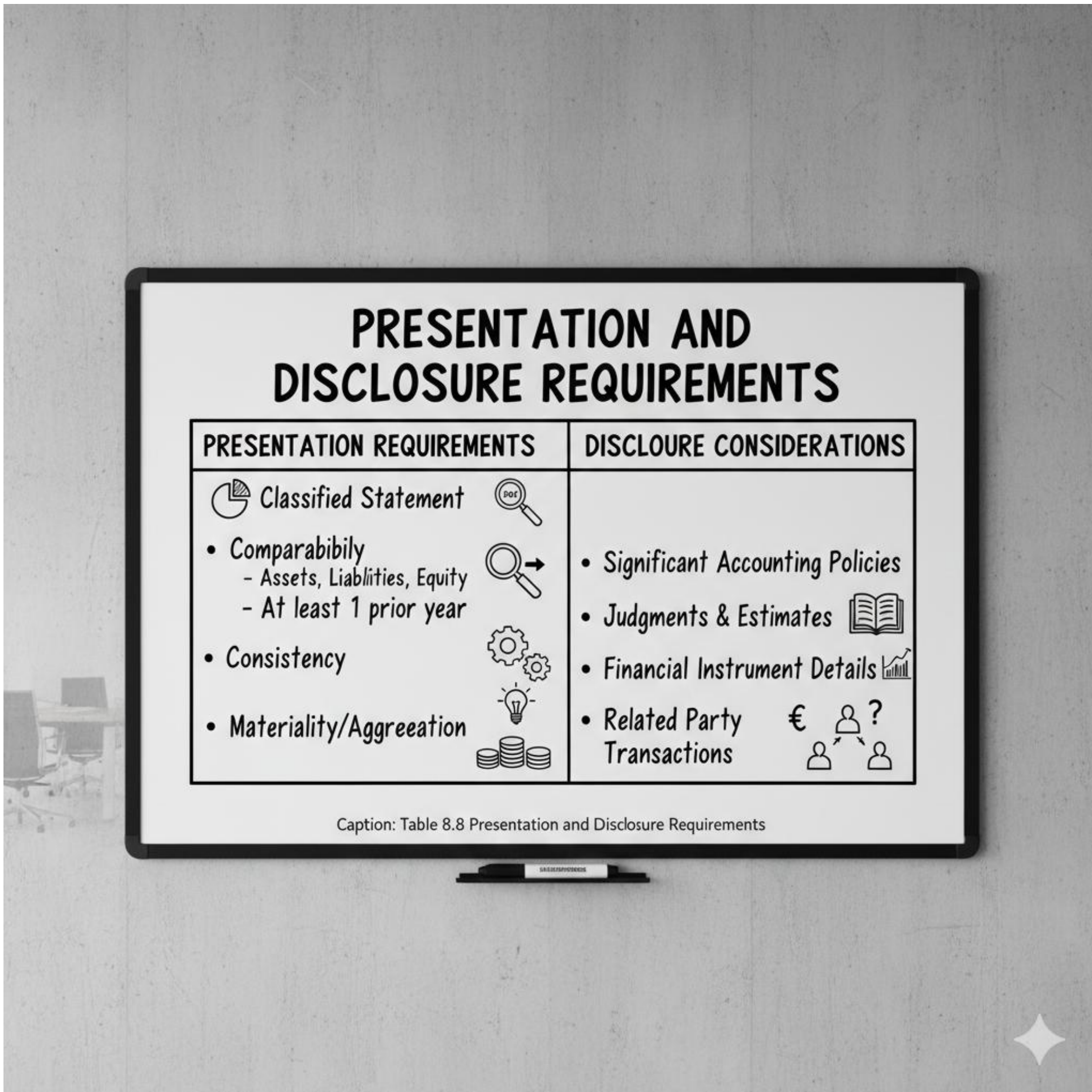


Short description: Diagram showing the preparation process of financial statements guided by the IASB framework. Caption: Figure 1.3 Preparing financial statements using the IASB framework

1.3.2 Presentation requirements and disclosure considerations

Presentation requirements refer to the way financial information is organised and displayed in financial statements. This includes the structure of the statement of financial position, statement of profit or loss, and statement of cash flows. **Disclosure considerations** involve providing additional information in notes to the accounts, ensuring transparency and helping users understand the figures presented.

Fill in the blank: Disclosure considerations involve providing additional information in __________ to the accounts.

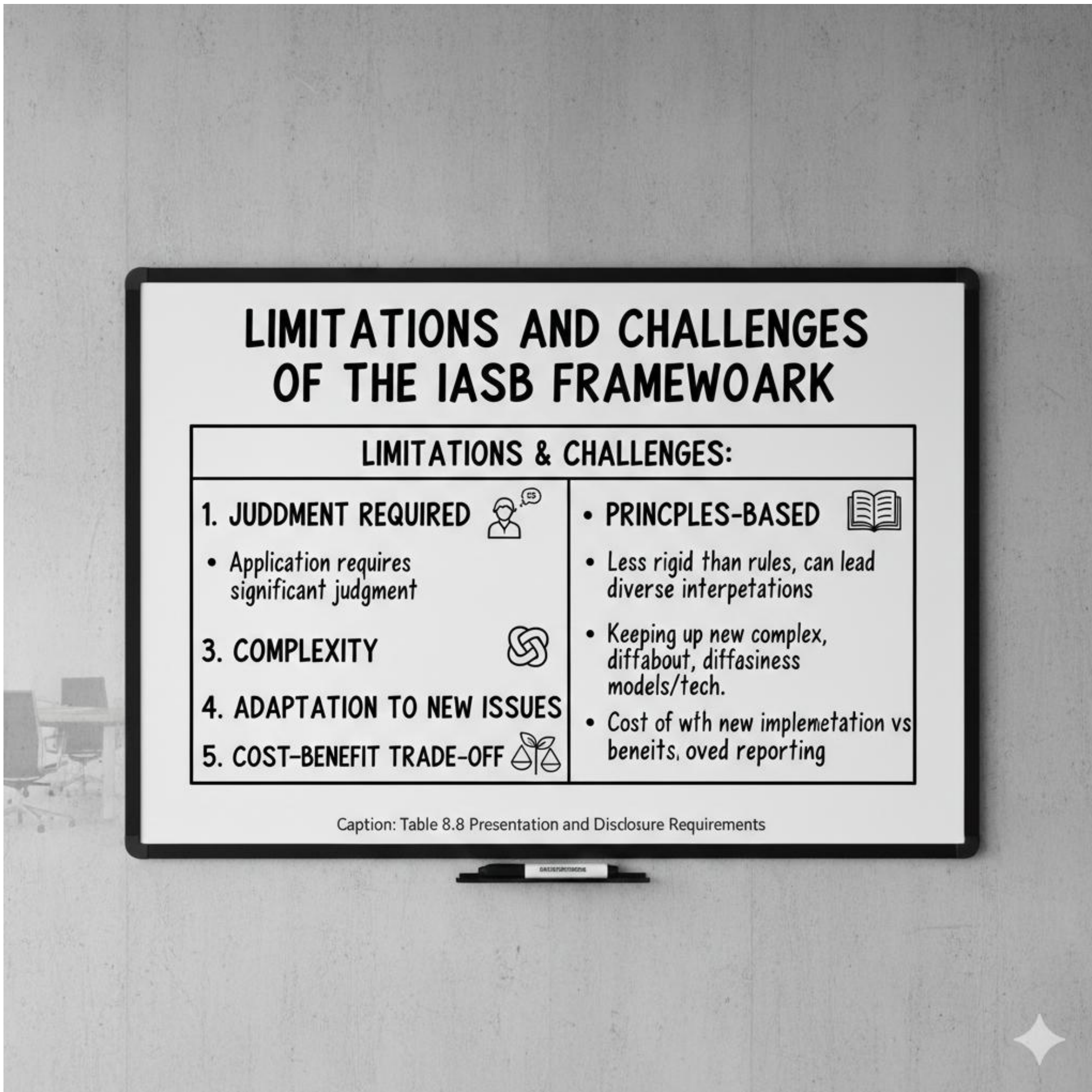


Caption: Table 1.3 Presentation requirements and disclosure considerations Short description: A table outlining presentation requirements (statement formats) and disclosure considerations (notes, policies, contingencies

1.3.3 Limitations and challenges of applying the framework

While the IASB framework provides a strong foundation, there are limitations. For example, it may not fully address emerging issues such as digital assets or sustainability reporting. Challenges also arise in applying concepts consistently across different jurisdictions, especially where local regulations differ. Accountants must balance the framework's principles with practical realities, ensuring relevance and faithful representation.

Fill in the blank: One challenge of applying the IASB framework is addressing emerging issues such as ___________ assets.



Caption: Box 1.3 Limitations and challenges of applying the IASB framework Short description: A boxed text listing limitations such as digital assets, sustainability reporting, and jurisdictional differences.

Series Summary

This Series has introduced you to the IASB framework, which serves as the foundation for preparing and presenting financial statements. Its relevance lies in ensuring that financial information is consistent, transparent, and comparable across organisations, thereby supporting decision-making by investors, regulators, and other stakeholders.

We began by examining the IASB's role, the objectives of financial reporting, and the qualitative characteristics that make information useful. Then we explored the elements of financial statements, their recognition criteria, measurement bases, and the concepts of capital and capital maintenance. Finally, we applied the framework in practice, considering how it guides preparation, presentation, and disclosure, while also reflecting on its limitations and challenges.

By completing this Series, you should now be able to define the IASB's role (SLO 1.1), explain objectives and qualitative characteristics (SLO 1.2 and SLO 1.3), identify and distinguish elements and measurement bases (SLO 1.4 and SLO 1.5), explain capital concepts (SLO 1.6),

demonstrate preparation of statements (SLO 1.7), analyse presentation and disclosure (SLO 1.8), and evaluate limitations of the framework (SLO 1.9).
Glossary of Terms

Assets: Resources controlled by an entity that are expected to provide future economic benefits.

Capital maintenance: The principle that profit should only be recognised after the capital at the beginning of the period has been preserved.

Disclosure: Additional information provided in notes to the accounts to explain or support figures in the financial statements.

Equity: The residual interest in the assets of an entity after deducting liabilities.

Expenses: Decreases in economic benefits during an accounting period in the form of outflows or reductions of assets.

IASB (International Accounting Standards Board): The independent body responsible for developing and issuing International Financial Reporting Standards (IFRS).

Income: Increases in economic benefits during an accounting period in the form of inflows or enhancements of assets.

Liabilities: Present obligations of an entity arising from past events, expected to result in an outflow of resources.

Measurement bases: Methods used to determine the monetary amounts of elements in financial statements, such as historical cost, current cost, realisable value, and present value.

Qualitative characteristics: Attributes that make financial information useful, including relevance, faithful representation, comparability, verifiability, timeliness, and understandability.

Recognition: The process of formally recording an item in the financial statements when it meets defined criteria.

Stewardship: The responsibility of management to safeguard and efficiently use the resources entrusted to them.

Concept Check Questions – Series 1

Multiple Choice
1. Which body is responsible for issuing International Financial Reporting Standards (IFRS)?
a) IASB
b) FASB
c) SEC
d) IMF

2. Which of the following is NOT a fundamental qualitative characteristic of useful financial information?
a) Relevance

b) Faithful representation
c) Comparability
d) Timeliness

3. Which measurement basis records assets at the amount paid to acquire them?
a) Current cost
b) Historical cost
c) Realisable value
d) Present value

True/False
4. Financial reporting aims to provide information useful for decision-making by investors, lenders, and creditors. (True/False)

5. Equity represents the residual interest in assets after deducting liabilities. (True/False)

6. Profit can be recognised before capital at the beginning of the period has been maintained. (True/False)

Fill in the Blank
7. The IASB framework ensures that financial statements are __________ and comparable.

8. Disclosure considerations involve providing additional information in __________ to the accounts.

9. One challenge of applying the IASB framework is addressing emerging issues such as __________ assets.

Pilot Questions – Series 1

1. Define the role of the IASB in financial reporting.

2. Explain one objective of financial reporting and why it is important for stakeholders.

3. Identify two fundamental qualitative characteristics of useful financial information.

4. State the recognition criteria for assets in financial statements.

5. Distinguish between historical cost and present value as measurement bases.

6. Explain the difference between financial capital maintenance and physical capital maintenance.

7. Demonstrate how the IASB framework guides the preparation of a statement of financial position.

8. Analyse one disclosure consideration that enhances transparency in financial statements.

9. Evaluate one limitation of applying the IASB framework in practice.

References and Attributions – Series 1

Figure 1.1 Role of the IASB in financial reporting
AI prompt: "Create a diagram showing the IASB at the centre, connected to investors, regulators, and companies."
Search string: "IASB role in financial reporting diagram OER"

Box 1.1 Objectives of financial reporting
AI prompt: "Create a text box summarising the objectives of financial reporting."
Search string: "objectives of financial reporting OER"

Table 1.1 Qualitative characteristics of useful financial information
AI prompt: "Create a table listing fundamental and enhancing qualitative characteristics of financial information."
Search string: "qualitative characteristics financial information table OER"

Table 1.2 Elements of financial statements and recognition criteria
AI prompt: "Create a table showing the elements of financial statements and their recognition criteria."
Search string: "elements of financial statements recognition criteria OER"

Box 1.2 Measurement bases in financial reporting
AI prompt: "Create a text box summarising measurement bases in financial reporting with examples."
Search string: "measurement bases financial reporting OER"

Figure 1.2 Capital and capital maintenance concepts
AI prompt: "Create a diagram comparing financial capital maintenance and physical capital maintenance."
Search string: "capital maintenance financial vs physical diagram OER"

Figure 1.3 Preparing financial statements using the IASB framework
AI prompt: "Create a diagram showing how the IASB framework guides the preparation of financial statements."
Search string: "IASB framework financial statements preparation diagram OER"

Table 1.3 Presentation requirements and disclosure considerations
AI prompt: "Create a table showing presentation requirements and disclosure considerations in financial statements."
Search string: "presentation and disclosure requirements IASB OER"

Box 1.3 Limitations and challenges of applying the IASB framework
AI prompt: "Create a text box summarising limitations and challenges of applying the IASB framework."
Search string: "limitations IASB framework accounting OER"

Open educational resources and references
- International Accounting Standards Board. (n.d.). *Conceptual Framework for Financial Reporting*. Retrieved from https://www.ifrs.org
- OpenStax. (2022). *Principles of Accounting, Volume 1: Financial Accounting*. Rice University. Retrieved from https://openstax.org/books/principles-accounting-volume-1-financial-accounting

- Financial Reporting Council. (n.d.). *UK Financial Reporting Standards*. Retrieved from https://www.frc.org.uk

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COURSE TITLE: Financial Accounting I
COURSE CODE UNIT(3 Units C: LH 30; PH 45)

Series Titles for ACC 201: Financial Accounting I

1. Series 1: IASB Framework for Financial Statement Preparation and Presentation
2. Series 2: Introduction to IFRS 15 – Revenue and IAS 1 Presentation of Financial Statements
3. Series 3: Accounting for Inventories under IAS 2
4. Series 4: Accounting Policies and Property, Plant and Equipment (IAS 8 and IAS 16)
5. Series 5: Government Grants and Borrowing Costs (IAS 20 and IAS 23)

Series 2: Introduction to IFRS 15 – Revenue and IAS 1 Presentation of Financial Statements
Main Parts and Sub-Parts Outline

Part 2.1: Fundamentals of IFRS 15 – Revenue
- Definition of revenue under IFRS 15
- Five-step model for revenue recognition
- Key terms and concepts

Part 2.2: Presentation of Financial Statements under IAS 1
- Objectives and scope of IAS 1
- Required components of financial statements
- General presentation requirements

Part 2.3: Application and Disclosure
- Applying IFRS 15 in practice with illustrative examples
- Disclosure requirements under IAS 1
- Challenges and limitations in presentation and revenue recognition

Introduction

Revenue is one of the most critical figures in financial reporting, as it reflects the inflows that sustain an organisation's operations and growth. At the same time, the way financial statements are presented determines how clearly and effectively this information is communicated to stakeholders. Together, IFRS 15 on Revenue and IAS 1 on Presentation of Financial Statements provide the framework for recognising income and presenting it in a transparent and consistent manner.

The aim of this Series is to equip you with the knowledge and skills to apply the principles of IFRS 15 in recognising revenue and to understand the requirements of IAS 1 in presenting financial statements.

We shall commence this Series by examining the fundamentals of IFRS 15, including the definition of revenue and the five-step model for recognition. Next, we will move on to IAS 1, exploring its objectives, scope, and the required components of financial statements, along with general presentation requirements. Finally, we will wrap up by applying these standards in practice, considering illustrative examples, disclosure requirements, and the challenges that may arise in presentation and revenue recognition.

Series Learning Outcomes

Upon completing this Series, you should be able to:

SLO 2.1 define revenue as outlined in IFRS 15,
SLO 2.2 explain the five-step model for revenue recognition under IFRS 15,
SLO 2.3 describe the objectives and scope of IAS 1,
SLO 2.4 identify the required components of financial statements under IAS 1,
SLO 2.5 analyse general presentation requirements for financial statements,
SLO 2.6 apply IFRS 15 principles to practical revenue recognition scenarios,
SLO 2.7 demonstrate how disclosure requirements under IAS 1 enhance transparency, and
SLO 2.8 evaluate challenges and limitations in applying IFRS 15 and IAS 1 in practice.

2.1 Fundamentals Of IFRS 15 – Revenue

2.1.1 Definition of revenue under IFRS 15
Revenue is defined in IFRS 15 as income arising in the course of an entity's ordinary activities, usually from the sale of goods, the rendering of services, or the use of entity resources by others that yield interest, royalties, or dividends. The standard provides a single, principles-based framework for recognising revenue, ensuring consistency across industries and transactions.

Fill in the blank: Revenue is recognised when an entity transfers __________ to a customer.

Short description: Diagram showing revenue sources (goods, services, interest, royalties, dividends).
Caption: Figure 2.1 Sources of revenue under IFRS 15

2.1.2 The five-step model for revenue recognition
IFRS 15 introduces a five-step model for recognising revenue:
1. Identify the contract with a customer.
2. Identify the performance obligations in the contract.
3. Determine the transaction price.
4. Allocate the transaction price to performance obligations.
5. Recognise revenue when (or as) performance obligations are satisfied.

This model ensures that revenue is recognised in line with the transfer of goods or services, rather than simply when cash is received.

Fill in the blank: The transaction price must be allocated to the identified __________ obligations in the contract.

Caption: Table 2.1 The five-step model for revenue recognition
Short description: A table listing the five steps with brief explanations.

2.1.3 Key terms and concepts

Several important terms are central to IFRS 15:
- Contract: An agreement between two or more parties that creates enforceable rights and obligations.
- Performance obligation: A promise to transfer a distinct good or service to a customer.
- Transaction price: The amount of consideration an entity expects to receive in exchange for fulfilling performance obligations.
- Satisfaction of performance obligations: Occurs when control of the good or service is transferred to the customer.

Fill in the blank: A performance obligation is a promise to transfer a distinct __________ or service to a customer.

Caption: Box 2.1 Key terms in IFRS 15
Short description: A boxed summary of definitions for contract, performance obligation, transaction price, and satisfaction of obligations.

This completes Part 2.1 Fundamentals of IFRS 15 – Revenue, providing a clear foundation for understanding how revenue is defined, recognised, and structured under IFRS 15.

2.2 Presentation Of Financial Statements Under IAS 1

2.2.1 Objectives and scope of IAS 1
IAS 1 sets out the overall requirements for the presentation of financial statements, guidelines for their structure, and minimum content. Its objective is to ensure comparability both with the entity's financial statements of previous periods and with those of other entities. The scope of IAS 1 applies to all general-purpose financial statements prepared and presented in accordance with International Financial Reporting Standards.

Fill in the blank: IAS 1 ensures comparability with both previous periods and __________ entities.

Short description: Diagram showing IAS 1 at the centre, connected to comparability across time and across entities.
Caption: Figure 2.2 Objectives and scope of IAS 1

2.2.2 Required components of financial statements
IAS 1 specifies the components that must be included in a complete set of financial statements:
- Statement of financial position
- Statement of profit or loss and other comprehensive income
- Statement of changes in equity
- Statement of cash flows
- Notes, including significant accounting policies and other explanatory information

These components provide a comprehensive view of an entity's financial performance and position.

Fill in the blank: A complete set of financial statements must include notes with significant __________ policies.

Caption: Table 2.2 Required components of financial statements under IAS 1
Short description: A table listing the five required components with brief explanations.

2.2.3 General presentation requirements
IAS 1 also outlines general presentation requirements, such as:
- Fair presentation and compliance with IFRS
- Consistency of presentation from period to period
- Materiality and aggregation of items
- Offsetting only when permitted by IFRS
- Identification of financial statements and reporting period

These requirements ensure clarity, transparency, and comparability across reporting periods.

Fill in the blank: IAS 1 requires consistency of __________ from one period to the next.

Caption: Box 2.2 General presentation requirements under IAS 1
Short description: A boxed summary of fair presentation, consistency, materiality, aggregation, offsetting, and identification requirements.

This completes Part 2.2 Presentation Of Financial Statements Under IAS 1, giving learners a structured understanding of objectives, scope, required components, and presentation requirements.

2.3 Application And Disclosure

2.3.1 Applying IFRS 15 in practice
Applying IFRS 15 requires entities to carefully analyse contracts with customers and follow the five-step model. In practice, this means identifying performance obligations, determining transaction prices, and recognising revenue as obligations are satisfied. For example, a software company may need to separate licence fees from ongoing support services, recognising revenue at different points in time.

Fill in the blank: Revenue is recognised when control of the __________ is transferred to the customer.
Short description: Diagram showing a contract with multiple performance obligations and how revenue is recognised over time.
Caption: Figure 2.3 Applying IFRS 15 in practice

2.3.2 Disclosure requirements under IAS 1
IAS 1 requires entities to provide disclosures that explain the figures presented in the financial statements. These include accounting policies, judgements made in applying standards, and information about risks and uncertainties. Disclosures enhance transparency and help users understand the context behind reported numbers.

Fill in the blank: IAS 1 requires disclosure of significant accounting __________ and explanatory information.

Caption: Table 2.3 Disclosure requirements under IAS 1
Short description: A table listing key disclosure requirements such as accounting policies, judgements, risks, and explanatory notes.

2.3.3 Challenges and limitations

Despite its strengths, applying IFRS 15 and IAS 1 can present challenges. Complex contracts may make it difficult to identify performance obligations, while estimates of transaction prices may involve significant judgement. Similarly, disclosure requirements can be extensive, leading to concerns about information overload. Entities must balance compliance with clarity, ensuring that disclosures remain useful without overwhelming users.

Fill in the blank: One limitation of applying IFRS 15 is the complexity of identifying __________ obligations in contracts.

Caption: Box 2.3 Challenges and limitations of applying IFRS 15 and IAS 1
Short description: A boxed summary of challenges such as complex contracts, judgement in transaction prices, and extensive disclosure requirements.

This completes Part 2.3 Application And Disclosure, bringing together IFRS 15 and IAS 1 in practice with examples, disclosure requirements, and challenges.

Series Summary

This Series has focused on IFRS 15 and IAS 1, two standards that are central to how revenue is recognised and how financial statements are presented. Their relevance lies in ensuring that organisations report income accurately and present financial information in a way that is transparent, consistent, and useful to stakeholders.

We began by exploring the fundamentals of IFRS 15, including the definition of revenue and the five-step model for recognition. Then we moved on to IAS 1, examining its objectives, scope, required components, and general presentation requirements. Finally, we applied both standards in practice, considering illustrative examples, disclosure requirements, and the challenges that may arise. By completing this Series, you should now be able to define revenue (SLO 2.1), explain the five-step model (SLO 2.2), describe the objectives and scope of IAS 1 (SLO 2.3), identify required components (SLO 2.4), analyse presentation requirements (SLO 2.5), apply IFRS 15 in practice (SLO 2.6), demonstrate disclosure requirements (SLO 2.7), and evaluate challenges in applying both standards (SLO 2.8).

Glossary of Terms

Contract: An agreement between two or more parties that creates enforceable rights and obligations.

Disclosure: Additional information provided in notes to the accounts to explain or support figures in the financial statements.

IAS 1 (Presentation of Financial Statements): The standard that sets out requirements for the presentation of financial statements, including objectives, scope, components, and general presentation rules.

IFRS 15 (Revenue from Contracts with Customers): The standard that provides a single framework for recognising revenue, based on the transfer of goods or services to customers.

Performance obligation: A promise to transfer a distinct good or service to a customer within a contract.

Revenue: Income arising in the course of an entity's ordinary activities, such as sales of goods, provision of services, or use of entity resources by others.

Satisfaction of performance obligations: The point at which control of a good or service is transferred to the customer, triggering revenue recognition.

Transaction price: The amount of consideration an entity expects to receive in exchange for fulfilling performance obligations.
This glossary captures the essential terms introduced in **Series 2: Introduction to IFRS 15 – Revenue and IAS 1 Presentation of Financial Statements**, explained clearly for independent learners.
Concept Check Questions – Series 2

Objective Questions
1. Which standard provides a single framework for recognising revenue? (Linked to SLO 2.1)
2. In the five-step model of IFRS 15, which step comes immediately after identifying performance obligations? (Linked to SLO 2.2)
3. Which of the following is NOT a required component of financial statements under IAS 1? (Linked to SLO 2.4)

Short-Answer Questions
4. Define a performance obligation as used in IFRS 15. (Linked to SLO 2.1)
5. Explain the objective of IAS 1 in one or two sentences. (Linked to SLO 2.3)
6. Identify two general presentation requirements outlined in IAS 1. (Linked to SLO 2.5)

Long-Answer Questions
7. Describe the five-step model for revenue recognition under IFRS 15, giving an example of how it applies in practice. (Linked to SLO 2.2 and SLO 2.6)
8. Analyse the disclosure requirements under IAS 1 and explain how they enhance transparency in financial reporting. (Linked to SLO 2.7)
9. Evaluate one challenge in applying IFRS 15 and one limitation in applying IAS 1, suggesting how an entity might address them. (Linked to SLO 2.8)

Answers to Concept Check Questions – Series 2

Objective Questions
1. IFRS 15.
2. Determine the transaction price.
3. Statement of retained earnings only.

Short-Answer Questions
4. A performance obligation is a promise to transfer a distinct good or service to a customer within a contract.
5. The objective of IAS 1 is to ensure comparability of financial statements across time and across entities by setting presentation requirements.
6. Examples include fair presentation and compliance with IFRS, and consistency of presentation from one period to the next.

Long-Answer Questions
7. Basic response: The five-step model involves identifying the contract, identifying performance obligations, determining the transaction price, allocating the price to obligations, and recognising revenue when obligations are satisfied. For example, a construction company recognises revenue as work is completed rather than when cash is received.
Value-added response: Beyond the basics, learners may note that the model ensures revenue reflects the transfer of control, not just cash flow, and that it requires careful judgement in complex contracts, such as separating goods from services in bundled arrangements.

8. Basic response: IAS 1 requires disclosures such as accounting policies, judgements, and risks, which help users understand the figures presented.
Value-added response: Outstanding learners may add that disclosures enhance transparency by providing context, reducing information asymmetry, and supporting investor confidence, while also noting the challenge of balancing detail with clarity.

9. Basic response: A challenge in IFRS 15 is identifying performance obligations in complex contracts, while a limitation in IAS 1 is the risk of information overload from extensive disclosures.
Value-added response: Learners may suggest that entities can address these issues by improving contract analysis processes, using clear materiality thresholds, and adopting best practices in disclosure to ensure information remains relevant and accessible.

Answers to Pilot Questions – Series 2

1. The IASB develops and issues International Financial Reporting Standards (IFRS), providing a global framework for financial reporting.

2. One objective of financial reporting is to provide information useful for decision-making by investors, lenders, and other stakeholders.

3. Two fundamental qualitative characteristics are relevance and faithful representation.

4. Assets are recognised when it is probable that future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably.

5. Historical cost records assets at the amount paid to acquire them, while present value reflects the discounted future cash flows expected from the asset.

6. Financial capital maintenance focuses on preserving the monetary value of capital, while physical capital maintenance focuses on maintaining the productive capacity of capital.

7. The IASB framework guides preparation of the statement of financial position by defining elements such as assets, liabilities, and equity, and setting recognition and measurement criteria.

8. Disclosure considerations include providing notes that explain accounting policies, judgements, and risks, which enhance transparency and comparability.

9. A limitation of the IASB framework is that it may not fully address emerging issues such as intangible assets, requiring entities to apply judgement and supplementary guidance.

References and Attributions – Series 2

Figure 2.1 Sources of revenue under IFRS 15
AI prompt: "Create a diagram showing sources of revenue such as goods, services, interest, royalties, and dividends."
Search string: "IFRS 15 revenue definition diagram OER"

Table 2.1 The five-step model for revenue recognition
AI prompt: "Create a table outlining the five-step model for revenue recognition under IFRS 15."
Search string: "IFRS 15 five step model table OER"

Box 2.1 Key terms in IFRS 15
AI prompt: "Create a text box summarising key terms in IFRS 15 such as contract, performance obligation, transaction price, and satisfaction of obligations."
Search string: "IFRS 15 key terms glossary OER"

Figure 2.2 Objectives and scope of IAS 1
AI prompt: "Create a diagram showing IAS 1 ensuring comparability across time and across entities."
Search string: "IAS 1 objectives scope diagram OER"

Table 2.2 Required components of financial statements under IAS 1
AI prompt: "Create a table listing the required components of financial statements under IAS 1 with explanations."
Search string: "IAS 1 required components financial statements table OER"

Box 2.2 General presentation requirements under IAS 1
AI prompt: "Create a text box summarising general presentation requirements under IAS 1."
Search string: "IAS 1 general presentation requirements OER"

Figure 2.3 Applying IFRS 15 in practice
AI prompt: "Create a diagram showing how a contract with multiple performance obligations leads to revenue recognition at different times."
Search string: "IFRS 15 application example diagram OER"

Table 2.3 Disclosure requirements under IAS 1
AI prompt: "Create a table summarising disclosure requirements under IAS 1."
Search string: "IAS 1 disclosure requirements table OER"

Box 2.3 Challenges and limitations of applying IFRS 15 and IAS 1
AI prompt: "Create a text box summarising challenges and limitations of applying IFRS 15 and IAS 1."
Search string: "IFRS 15 IAS 1 challenges limitations OER"

Open educational resources and references

- International Accounting Standards Board. (n.d.). *IFRS 15 Revenue from Contracts with Customers* and *IAS 1 Presentation of Financial Statements*. Retrieved from https://www.ifrs.org
- OpenStax. (2022). *Principles of Accounting, Volume 1: Financial Accounting*. Rice University. Retrieved from https://openstax.org/books/principles-accounting-volume-1-financial-accounting
- Financial Reporting Council. (n.d.). *UK Financial Reporting Standards*. Retrieved from https://www.frc.org.uk

COURSE CODE:ACC 201
COURSE TITLE: Financial Accounting I
COURSE CODE UNIT(3 Units C: LH 30; PH 45)

Series Titles for ACC 201: Financial Accounting I

1. Series 1: IASB Framework for Financial Statement Preparation and Presentation
2. Series 2: Introduction to IFRS 15 – Revenue and IAS 1 Presentation of Financial Statements

3. Series 3: Accounting for Inventories under IAS 2
4. Series 4: Accounting Policies and Property, Plant and Equipment (IAS 8 and IAS 16)
5. Series 5: Government Grants and Borrowing Costs (IAS 20 and IAS 23)

Series 3: Introduction to IAS 2 – Inventories and IAS 16 – Property, Plant and Equipment

Main Parts and Sub-Parts Outline

Part 3.1: Fundamentals of IAS 2 – Inventories
- Definition and scope of inventories
- Measurement at cost and net realisable value
- Cost formulas (FIFO, weighted average)

Part 3.2: Fundamentals of IAS 16 – Property, Plant and Equipment (PPE)
- Definition and recognition criteria for PPE
- Measurement at cost and subsequent measurement models (cost model vs revaluation model)
- Depreciation methods and useful life considerations

Part 3.3: Presentation and Disclosure Requirements
- Presentation of inventories and PPE in financial statements
- Disclosure requirements under IAS 2 and IAS 16
- Common challenges and practical considerations

Part 3.4: Application and Case Examples
- Practical examples of inventory valuation
- Case illustrations of PPE recognition, measurement, and depreciation
- Limitations and judgement areas in applying IAS 2 and IAS 16

Introduction

In the last Series, we explored how revenue is recognised under IFRS 15 and how financial statements are presented using IAS 1. Building on that foundation, this Series turns to two equally important standards: IAS 2 on Inventories and IAS 16 on Property, Plant and Equipment. These standards are vital because they deal with assets that form the backbone of most organisations, influencing both profitability and long-term sustainability.

The aim of this Series is to introduce you to the principles of IAS 2 and IAS 16, equipping you with the knowledge to measure, present, and disclose inventories and property, plant and equipment in line with international standards.

We shall commence this Series by examining the fundamentals of IAS 2, including the definition, scope, and measurement of inventories. Next, we will move on to IAS 16, focusing on recognition criteria, measurement models, and depreciation methods. Following that, we will consider how inventories and PPE are presented and disclosed in financial statements, highlighting common challenges. Finally, we will wrap up with practical applications and case examples that illustrate how these standards are applied in real-world scenarios.

Series Learning Outcomes

Upon completing this Series, you should be able to:

SLO 3.1 define inventories and explain their scope under IAS 2,
SLO 3.2 demonstrate how to measure inventories at cost and net realisable value,
SLO 3.3 apply cost formulas such as FIFO and weighted average to inventory valuation,
SLO 3.4 describe the recognition criteria for property, plant and equipment under IAS 16,
SLO 3.5 analyse subsequent measurement models for PPE, including the cost model and revaluation model,
SLO 3.6 calculate depreciation using different methods and evaluate useful life considerations,
SLO 3.7 identify presentation and disclosure requirements for inventories and PPE in financial statements,
SLO 3.8 apply IAS 2 and IAS 16 principles to practical case examples, and
SLO 3.9 evaluate challenges and judgement areas in applying IAS 2 and IAS 16.

3.1 Fundamentals Of IAS 2 – Inventories

3.1.1 Definition and scope of inventories
Inventories are assets held for sale in the ordinary course of business, in the process of production for such sale, or in the form of materials or supplies to be consumed in production. IAS 2 applies to most inventories but excludes items such as work in progress under construction contracts and financial instruments.

Fill in the blank: Inventories include assets held for sale, in production, or as __________ to be consumed in production.

Short description: Diagram showing categories of inventories (finished goods, work in progress, raw materials).
Caption: Figure 3.1 Categories of inventories under IAS 2

3.1.2 Measurement at cost and net realisable value
IAS 2 requires inventories to be measured at the lower of **cost** and **net realisable value (NRV)**. Cost includes all expenditures incurred in bringing the inventories to their present location and condition, such as purchase price, conversion costs, and other costs. NRV is the estimated selling price in the ordinary course of business, less estimated costs of completion and selling.

Fill in the blank: Inventories are measured at the lower of cost and __________ value.

Caption: Table 3.1 Measurement of inventories under IAS 2
Short description: A table comparing cost components (purchase, conversion, other costs) with net realisable value definition.

3.1.3 Cost formulas (FIFO, weighted average)
IAS 2 permits the use of **FIFO (First-In, First-Out)** and **weighted average cost** formulas to assign costs to inventories. FIFO assumes that the earliest goods purchased are the first to be sold, while weighted average calculates an average cost of all items available during the period. The use of these formulas ensures consistency and fairness in valuing inventories.

Fill in the blank: The __________ method assumes that the earliest goods purchased are the first to be sold.

Caption: Box 3.1 Cost formulas permitted under IAS 2
Short description: A boxed summary of FIFO and weighted average methods with brief explanations.

3.2 Fundamentals Of IAS 16 – Property, Plant And Equipment

3.2.1 Definition and recognition criteria for PPE

Property, plant and equipment (PPE) are tangible assets that are held for use in the production or supply of goods and services, for rental to others, or for administrative purposes, and are expected to be used during more than one reporting period. Recognition of PPE requires that it is probable future economic benefits will flow to the entity and that the cost of the asset can be measured reliably.

Fill in the blank: PPE are tangible assets expected to be used during more than one __________ period.

Short description: Diagram showing categories of PPE (land, buildings, machinery, vehicles, equipment).
Caption: Figure 3.2 Categories of property, plant and equipment

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3.2.2 Measurement at cost and subsequent measurement models
At initial recognition, PPE are measured at **cost**, which includes purchase price, directly attributable costs, and estimated costs of dismantling and removing the asset. After recognition, entities may choose between the **cost model** (carrying the asset at cost less accumulated depreciation and impairment losses) or the **revaluation model** (carrying the asset at fair value at the date of revaluation, less subsequent depreciation and impairment).

Fill in the blank: After recognition, PPE can be measured using either the cost model or the __________ model.

Caption: Table 3.2 Measurement models for PPE under IAS 16
Short description: A table comparing the cost model and revaluation model with definitions and key features.

3.2.3 Depreciation methods and useful life considerations
Depreciation is the systematic allocation of the depreciable amount of an asset over its **useful life**. Common methods include the straight-line method, reducing balance method, and units of production method. The choice of method should reflect the pattern in which the asset's future economic benefits are expected to be consumed. Entities must also review useful life and residual value at least annually to ensure accuracy.

Fill in the blank: Depreciation is the systematic allocation of the depreciable amount of an asset over its __________ life.

Caption: Box 3.2 Depreciation methods under IAS 16
Short description: A boxed summary of straight-line, reducing balance, and units of production methods.

3.3 Presentation And Disclosure Requirements

3.3.1 Presentation of inventories and PPE in financial statements
Inventories are presented as current assets in the statement of financial position, reflecting their role in the operating cycle of the business. PPE, on the other hand, are shown as non-current assets, representing long-term resources used in production or administration. Clear presentation helps users distinguish between short-term and long-term assets and assess liquidity and capital investment.

Fill in the blank: Inventories are presented as __________ assets in the statement of financial position.
Short description: Diagram showing inventories under current assets and PPE under non-current assets in a financial statement layout.

Caption: Figure 3.3 Presentation of inventories and PPE in financial statements

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3.3.2 Disclosure requirements under IAS 2 and IAS 16
IAS 2 requires disclosure of accounting policies adopted in measuring inventories, the carrying amount of inventories, and any write-downs recognised. IAS 16 requires disclosure of measurement bases, depreciation methods, useful lives, gross carrying amounts, accumulated depreciation, and reconciliation of carrying amounts at the beginning and end of the period. These disclosures provide transparency and allow stakeholders to understand how values were derived.

Fill in the blank: IAS 16 requires disclosure of depreciation __________ and useful lives of assets.

Caption: Table 3.3 Disclosure requirements under IAS 2 and IAS 16
Short description: A table listing disclosure requirements for inventories (IAS 2) and PPE (IAS 16).

3.3.3 Common challenges and practical considerations
Applying disclosure requirements can be challenging, particularly when dealing with complex inventories or large portfolios of PPE. Judgement is often required in estimating useful lives, residual values, and net realisable values. Entities must balance the need for transparency with the risk of overwhelming users with excessive detail. Effective disclosure should be clear, concise, and relevant to decision-making.

Fill in the blank: One challenge in applying disclosure requirements is estimating __________ values of assets.
Caption: Box 3.3 Challenges in presentation and disclosure
Short description: A boxed summary of challenges such as estimating useful lives, residual values, NRV, and balancing detail with clarity.
Applying IAS 2 in practice often involves determining whether inventories should be valued at cost or net realisable value. For instance, a retailer may purchase goods at a certain cost but later face declining market prices. In such cases, the inventories must be written down to NRV to reflect their true economic value. This ensures that financial statements present a realistic picture of assets available for sale.

Fill in the blank: When market prices fall below cost, inventories must be written down to __________.

Short description: Diagram showing inventory valuation at cost versus net realisable value.
Caption: Figure 3.4 Inventory valuation in practice

3.4.2 Case illustrations of PPE recognition, measurement, and depreciation
Consider a manufacturing company purchasing machinery. Under IAS 16, the machinery is recognised as PPE if it is expected to generate future economic benefits and its cost can be measured reliably. The company may choose the cost model, depreciating the asset systematically over its useful life, or the revaluation model, adjusting its carrying amount to fair value. Depreciation methods such as straight-line or reducing balance must reflect how the asset's benefits are consumed.

Fill in the blank: PPE can be measured using either the cost model or the __________ model.

Caption: Table 3.4 Case illustration of PPE recognition and measurement
Short description: A table showing recognition criteria, measurement models, and depreciation methods for PPE.

3.4.3 Limitations and judgement areas in applying IAS 2 and IAS 16
Applying these standards requires significant judgement. For inventories, estimating net realisable value can be complex when market conditions are volatile. For PPE, determining useful life and residual value involves assumptions that may change over time. These limitations highlight the importance of professional judgement and regular review to ensure financial statements remain accurate and relevant.

Fill in the blank: Estimating __________ life and residual value of PPE requires significant judgement.

Caption: Box 3.4 Limitations and judgement areas in IAS 2 and IAS 16
Short description: A boxed summary of limitations such as estimating NRV, useful life, and residual value.

Series Summary

This Series has introduced IAS 2 and IAS 16, two standards that are central to the accounting treatment of inventories and property, plant and equipment. Their relevance lies in ensuring that organisations measure, present, and disclose these assets accurately, reflecting both short-term liquidity and long-term investment.
We began by examining the fundamentals of IAS 2, including the definition, scope, measurement, and cost formulas for inventories. Then we explored IAS 16, focusing on recognition criteria, measurement models, and depreciation methods. Following that, we considered how inventories and PPE are presented and disclosed in financial statements, highlighting common challenges. Finally, we applied both standards in practice through case examples and discussed limitations and judgement areas. By completing this Series, you should now be able to define and measure inventories (SLOs 3.1–3.3), describe and analyse PPE recognition and measurement (SLOs 3.4–3.6), identify presentation and disclosure requirements (SLO 3.7), apply these standards in practical scenarios (SLO 3.8), and evaluate challenges in their application (SLO 3.9).

Glossary of Terms

Cost model: A method of measuring property, plant and equipment after recognition, where assets are carried at cost less accumulated depreciation and impairment losses.
FIFO (First-In, First-Out): An inventory valuation method that assumes the earliest goods purchased are the first to be sold.
Inventories: Assets held for sale in the ordinary course of business, in production for sale, or as materials and supplies to be consumed in production.
Net realisable value (NRV): The estimated selling price of inventories in the ordinary course of business, less the estimated costs of completion and selling.
Property, plant and equipment (PPE): Tangible assets held for use in production, supply of goods or services, rental to others, or administrative purposes, expected to be used for more than one reporting period.
Revaluation model: A method of measuring PPE after recognition, where assets are carried at fair value at the date of revaluation, less subsequent depreciation and impairment.
Residual value: The estimated amount an entity would currently obtain from disposing of an asset, after deducting disposal costs, if the asset were already of the age and condition expected at the end of its useful life.

Straight-line method: A depreciation method that allocates the depreciable amount of an asset evenly over its useful life.
Useful life: The period over which an asset is expected to be available for use by an entity, or the number of production units expected to be obtained from the asset.
Weighted average cost: An inventory valuation method that calculates an average cost of all items available during the period, applied to items sold and those remaining in inventory.

Concept Check Questions – Series 3

Objective Questions
1. Which standard governs the accounting treatment of inventories? (Linked to SLO 3.1)
2. Inventories are measured at the lower of cost and __________. (Linked to SLO 3.2)
3. Which cost formulas are permitted under IAS 2? (Linked to SLO 3.3)
4. PPE are classified as __________ assets in the statement of financial position. (Linked to SLO 3.4)
5. Which two subsequent measurement models are allowed under IAS 16? (Linked to SLO 3.5)

Short-Answer Questions
6. Define net realisable value. (Linked to SLO 3.2)
7. Explain the difference between FIFO and weighted average cost formulas. (Linked to SLO 3.3)
8. State the recognition criteria for PPE under IAS 16. (Linked to SLO 3.4)
9. Identify two common depreciation methods used under IAS 16. (Linked to SLO 3.6)
10. List two disclosure requirements for inventories under IAS 2. (Linked to SLO 3.7)

Long-Answer Questions
11. Describe the measurement of inventories under IAS 2, including cost components and NRV, with an example. (Linked to SLOs 3.1–3.3)
12. Analyse the cost model and revaluation model for PPE, explaining their advantages and limitations. (Linked to SLOs 3.5–3.6)
13. Evaluate the challenges of applying IAS 2 and IAS 16, suggesting how entities can address judgement areas. (Linked to SLOs 3.8–3.9)

Answers to Concept Check Questions – Series 3

Objective Questions
1. IAS 2.
2. Net realisable value.
3. FIFO and weighted average.
4. Non-current.
5. Cost model and revaluation model.

Short-Answer Questions
6. Net realisable value is the estimated selling price of inventories in the ordinary course of business, less the estimated costs of completion and selling.
7. FIFO assumes the earliest goods purchased are the first to be sold, while weighted average calculates an average cost of all items available during the period.
8. PPE are recognised when future economic benefits are probable and the cost can be measured reliably.
9. Straight-line and reducing balance methods.
10. Disclosure of accounting policies adopted and the carrying amount of inventories.

Long-Answer Questions

11. **Basic response:** Inventories are measured at the lower of cost and NRV. Cost includes purchase price, conversion costs, and other costs. NRV is the estimated selling price less costs of completion and selling. For example, if goods cost £100 but can only be sold for £90 after deducting selling costs, they are valued at £90.
   Value-added response: Learners may add that this approach prevents overstating assets, ensures prudence, and reflects market realities. They may also discuss how volatile markets make NRV estimation challenging.

12. **Basic response:** The cost model carries PPE at cost less depreciation and impairment, while the revaluation model carries PPE at fair value less depreciation and impairment.
   Value-added response: Outstanding learners may note that the cost model is simpler and less costly to apply, while the revaluation model provides more relevant information but introduces volatility and requires regular valuations.

13. **Basic response:** Challenges include estimating NRV for inventories and useful life for PPE. Judgement is required, and errors can misstate financial statements.
   Value-added response: Learners may suggest that entities address these challenges by adopting robust estimation techniques, reviewing assumptions annually, and applying materiality thresholds to disclosures.

Answers to Pilot Questions – Series 3

1. IAS 2 governs the accounting treatment of inventories.
2. Inventories are measured at the lower of cost and net realisable value.
3. FIFO and weighted average are the cost formulas permitted under IAS 2.
4. PPE are recognised when future economic benefits are probable and the cost can be measured reliably.
5. PPE are classified as non-current assets in the statement of financial position.
6. The two subsequent measurement models allowed under IAS 16 are the cost model and the revaluation model.
7. Straight-line and reducing balance are two common depreciation methods used under IAS 16.
8. Disclosure requirements for inventories include accounting policies adopted and carrying amounts.
9. Disclosure requirements for PPE include measurement bases, depreciation methods, useful lives, and reconciliation of carrying amounts.
10. A practical example of inventory valuation is writing down goods to net realisable value when market prices fall below cost.
11. A case illustration of PPE recognition is a company purchasing machinery, measuring it at cost, and depreciating it systematically over its useful life.
12. Limitations in applying IAS 2 include estimating net realisable value, while limitations in IAS 16 include determining useful life and residual value.

References and Attributions – Series 3

Figure 3.1 Categories of inventories under IAS 2
AI prompt: "Create a diagram showing categories of inventories: finished goods, work in progress, and raw materials."
Search string: "IAS 2 inventories categories diagram OER"

Table 3.1 Measurement of inventories under IAS 2
AI prompt: "Create a table comparing cost components of inventories with net realisable value under IAS 2."
Search string: "IAS 2 inventory measurement cost NRV table OER"

Box 3.1 Cost formulas permitted under IAS 2
AI prompt: "Create a text box summarising FIFO and weighted average cost formulas under IAS 2."
Search string: "IAS 2 FIFO weighted average inventory valuation OER"

Figure 3.2 Categories of property, plant and equipment
AI prompt: “Create a diagram showing categories of PPE such as land, buildings, machinery, vehicles, and equipment.”
Search string: “IAS 16 property plant equipment categories diagram OER”

Table 3.2 Measurement models for PPE under IAS 16
AI prompt: “Create a table comparing cost model and revaluation model for PPE under IAS 16.”
Search string: “IAS 16 PPE cost model revaluation model table OER”

Box 3.2 Depreciation methods under IAS 16
AI prompt: “Create a text box summarising depreciation methods under IAS 16: straight-line, reducing balance, and units of production.”
Search string: “IAS 16 depreciation methods summary OER”

Figure 3.3 Presentation of inventories and PPE in financial statements
AI prompt: “Create a diagram showing inventories as current assets and PPE as non-current assets in a financial statement layout.”
Search string: “IAS 2 IAS 16 presentation inventories PPE diagram OER”

Table 3.3 Disclosure requirements under IAS 2 and IAS 16
AI prompt: “Create a table summarising disclosure requirements under IAS 2 and IAS 16.”
Search string: “IAS 2 IAS 16 disclosure requirements table OER”

Box 3.3 Challenges in presentation and disclosure
AI prompt: “Create a text box summarising challenges in presentation and disclosure of inventories and PPE.”
Search string: “IAS 2 IAS 16 disclosure challenges OER”

Figure 3.4 Inventory valuation in practice
AI prompt: “Create a diagram comparing inventory valuation at cost and net realisable value under IAS 2.”
Search string: “IAS 2 inventory valuation cost NRV example diagram OER”

Table 3.4 Case illustration of PPE recognition and measurement
AI prompt: “Create a table illustrating PPE recognition, measurement models, and depreciation methods under IAS 16.”
Search string: “IAS 16 PPE recognition measurement depreciation case table OER”

Box 3.4 Limitations and judgement areas in IAS 2 and IAS 16
AI prompt: “Create a text box summarising limitations and judgement areas in applying IAS 2 and IAS 16.”
Search string: “IAS 2 IAS 16 limitations judgement OER”

Open educational resources and references

- International Accounting Standards Board. (n.d.). *IAS 2 Inventories* and *IAS 16 Property, Plant and Equipment*. Retrieved from https://www.ifrs.org
- OpenStax. (2022). *Principles of Accounting, Volume 1: Financial Accounting*. Rice University. Retrieved from https://openstax.org/books/principles-accounting-volume-1-financial-accounting
- Financial Reporting Council. (n.d.). *UK Financial Reporting Standards*. Retrieved from https://www.frc.org.uk

COURSE CODE:ACC 201
COURSE TITLE: Financial Accounting I
COURSE CODE UNIT(3 Units C: LH 30; PH 45)

Series Titles for ACC 201: Financial Accounting I

1. Series 1: IASB Framework for Financial Statement Preparation and Presentation
2. Series 2: Introduction to IFRS 15 – Revenue and IAS 1 Presentation of Financial Statements
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5. Series 5: Government Grants and Borrowing Costs (IAS 20 and IAS 23)

Series 4: Introduction To IAS 7 – Statement Of Cash Flows

Main Parts And Sub-Parts Outline

Part 4.1: Fundamentals of IAS 7 – Purpose and scope
- Definition and objectives of the statement of cash flows
- Importance of cash flow information for decision-making
- Scope and applicability of IAS 7

Part 4.2: Classification of cash flows
- Operating activities
- Investing activities
- Financing activities
- Distinguishing between categories with examples

Part 4.3: Methods of reporting cash flows
- Direct method of reporting operating cash flows
- Indirect method of reporting operating cash flows
- Advantages and limitations of each method

Part 4.4: Presentation, disclosure, and practical considerations
- Presentation requirements under IAS 7
- Disclosure of non-cash transactions
- Common challenges in preparing cash flow statements
- Practical examples and case illustrations

Compliance Check
- Number of Parts: 4, which is within the required range of 3 to 5 Parts for a 3-credit course.
- Structure: Balanced coverage of IAS 7, moving from fundamentals to classification, reporting methods, and disclosure with practical application.

Introduction

Cash is often described as the lifeblood of any organisation, and understanding how it flows in and out of a business is essential for assessing financial health. While profit figures can sometimes be misleading, the statement of cash flows provides a clearer picture of liquidity,

solvency, and the ability to generate cash. This makes IAS 7 a critical standard for both preparers and users of financial statements.
The aim of this Series is to introduce you to the principles and requirements of IAS 7, equipping you with the skills to classify, report, and disclose cash flows in a way that enhances transparency and supports informed decision-making.
We shall commence this Series by exploring the fundamentals of IAS 7, including its purpose, objectives, and scope. Next, we will examine the classification of cash flows into operating, investing, and financing activities, supported by practical examples. Following that, we will consider the methods of reporting cash flows, comparing the direct and indirect approaches. Finally, we will wrap up by discussing presentation and disclosure requirements, highlighting common challenges and practical considerations to bring the Series to a close.

Series Learning Outcomes

Upon completing this Series, you should be able to:
SLO 4.1 define the purpose and scope of IAS 7 and explain why cash flow information is important, SLO 4.2 classify cash flows into operating, investing, and financing activities with appropriate examples, SLO 4.3 demonstrate how to report operating cash flows using both the direct and indirect methods, SLO 4.4 analyse the advantages and limitations of the direct and indirect methods of reporting cash flows, and SLO 4.5 evaluate presentation and disclosure requirements under IAS 7, including non-cash transactions and practical challenges.
4.1 Fundamentals Of IAS 7 – Purpose And Scope

4.1.1 Definition and objectives of the statement of cash flows
The **statement of cash flows** is a financial statement that shows how cash and cash equivalents move in and out of an organisation during a reporting period. Its objective is to provide information about an entity's ability to generate cash and cash equivalents, and the needs of the entity to use those cash flows. This helps users assess liquidity, solvency, and financial flexibility.

Fill in the blank: The statement of cash flows provides information about an entity's ability to generate __________ and the needs to use them.

Short description: Diagram showing inflows and outflows of cash in a business cycle.
Caption: Figure 4.1 Objectives of the statement of cash flows

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4.1.2 Importance of cash flow information for decision-making
Cash flow information is crucial because profit figures alone may not reveal the true financial health of an organisation. For example, a company may report profits but struggle to pay its debts if cash inflows are insufficient. Investors, creditors, and managers rely on cash flow statements to make informed decisions about investing, lending, and managing operations.

Fill in the blank: Profit figures may not reveal the true financial health of an organisation if __________ inflows are insufficient.
Caption: Box 4.1 Importance of cash flow information
Short description: A boxed summary of why cash flow information is important for investors, creditors, and managers.

4.1.3 Scope and applicability of IAS 7

IAS 7 applies to all entities that prepare financial statements in accordance with IFRS. It requires the presentation of a statement of cash flows as part of the complete set of financial statements. The standard applies regardless of the nature of the entity’s activities, ensuring consistency and comparability across industries and jurisdictions.

Fill in the blank: IAS 7 requires the presentation of a __________ of cash flows as part of the complete set of financial statements.

Caption: Table 4.1 Scope and applicability of IAS 7
Short description: A table summarising the scope of IAS 7, including entities covered and requirements.

This completes Part 4.1 Fundamentals of IAS 7 – Purpose and Scope, providing learners with a clear understanding of the definition, objectives, importance, and applicability of the statement of cash flows.

4.2 Classification Of Cash Flows

4.2.1 Operating activities
Operating activities are the principal revenue-producing activities of an entity and other activities that are not investing or financing. They include cash receipts from sales of goods and services, cash payments to suppliers and employees, and cash flows related to taxes. These activities reflect the day-to-day operations of the business.

Fill in the blank: Operating activities are the principal __________-producing activities of an entity.
Short description: Diagram showing examples of operating cash flows such as receipts from customers and payments to suppliers.
Caption: Figure 4.2 Examples of operating cash flows

4.2.2 Investing activities
Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents. Examples include cash payments to acquire property, plant and equipment, and cash receipts from the sale of such assets. These activities show how an entity uses cash to grow and sustain its operations.

Fill in the blank: Investing activities involve the acquisition and disposal of __________ assets and other investments.

Caption: Table 4.2 Examples of investing cash flows
Short description: A table listing examples of investing cash flows such as purchase of PPE, sale of PPE, and acquisition of investments.
”

4.2.3 Financing activities
Financing activities are activities that result in changes in the size and composition of the equity capital and borrowings of the entity. Examples include cash proceeds from issuing shares, cash payments to owners for dividends, and cash flows from borrowing and repaying loans. These activities highlight how an entity funds its operations and growth.

Fill in the blank: Financing activities result in changes in the size and composition of the entity's __________ capital and borrowings.

Caption: Box 4.2 Examples of financing cash flows
Short description: A boxed summary of financing cash flows such as issuing shares, paying dividends, and borrowing or repaying loans.

This completes Part 4.2 Classification of Cash Flows, giving learners a clear understanding of how cash flows are categorised into operating, investing, and financing activities.
4.3 Methods Of Reporting Cash Flows

4.3.1 Direct method of reporting operating cash flows
The **direct method** presents major classes of gross cash receipts and payments, such as cash received from customers and cash paid to suppliers and employees. This method provides a clear picture of actual cash movements, making it easier for users to understand the sources and uses of cash. However, it can be more demanding to prepare because it requires detailed cash transaction records.

Fill in the blank: The direct method presents major classes of gross cash __________ and payments.
Short description: Diagram showing direct method cash flows (cash received from customers, cash paid to suppliers, cash paid to employees).
Caption: Figure 4.3 Direct method of reporting operating cash flows

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4.3.2 Indirect method of reporting operating cash flows
The **indirect method** adjusts profit or loss for non-cash transactions, changes in working capital, and items of income or expense associated with investing or financing activities. It starts with net profit and reconciles it to net cash from operating activities. This method is widely used because it is easier to prepare from existing accounting records.

Fill in the blank: The indirect method starts with net __________ and reconciles it to net cash from operating activities.

[
Caption: Table 4.3 Indirect method adjustments
Short description: A table showing adjustments in the indirect method (non-cash items, working capital changes, investing/financing items).

4.3.3 Advantages and limitations of each method
The direct method offers greater transparency by showing actual cash inflows and outflows, which can be more useful for decision-making. The indirect method, while less detailed, is easier to prepare and links net profit to cash flows, helping users understand differences between accrual accounting and cash movements. Entities may choose either method, but IAS 7 encourages the use of the direct method.

Fill in the blank: IAS 7 encourages the use of the __________ method for reporting operating cash flows.

Caption: Box 4.3 Advantages and limitations of direct and indirect methods

Short description: A boxed summary comparing advantages and limitations of direct and indirect methods.

This completes Part 4.3 Methods of Reporting Cash Flows, giving learners a clear understanding of both the direct and indirect methods, along with their advantages and limitations.

4.4 Presentation, Disclosure, And Practical Considerations

4.4.1 Presentation requirements under IAS 7

IAS 7 requires that the statement of cash flows be presented as part of the complete set of financial statements. Cash flows must be classified into operating, investing, and financing activities, and reported in a way that provides clarity and comparability. This presentation helps users assess how an entity generates and uses cash across different aspects of its operations.

Fill in the blank: IAS 7 requires that the statement of __________ flows be presented as part of the complete set of financial statements.
Short description: Diagram showing the placement of the statement of cash flows alongside the income statement, balance sheet, and statement of changes in equity.
Caption: Figure 4.4 Presentation of the statement of cash flows in financial reporting

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4.4.2 Disclosure of non-cash transactions

IAS 7 requires disclosure of non-cash investing and financing transactions, such as acquiring assets through leases or converting debt to equity. Although these do not involve cash, they are important for understanding an entity's financing and investing activities. Disclosure ensures transparency and helps users evaluate the entity's financial position more accurately.

Fill in the blank: Non-cash transactions such as acquiring assets through __________ must be disclosed under IAS 7.

Caption: Table 4.4 Examples of non-cash transactions
Short description: A table listing examples of non-cash transactions including leases, conversion of debt to equity, and asset exchanges.

4.4.3 Common challenges in preparing cash flow statements

Preparing cash flow statements can be challenging due to the need to classify transactions correctly and adjust for non-cash items. Entities often face difficulties in distinguishing between operating and investing activities, or in reconciling accrual accounting with cash movements. Regular review and careful application of IAS 7 guidance are essential to avoid misclassification and ensure accuracy.

Fill in the blank: One challenge in preparing cash flow statements is reconciling accrual accounting with __________ movements.

Caption: Box 4.4 Challenges in preparing cash flow statements
Short description: A boxed summary of challenges such as classification issues, reconciliation of accruals with cash, and treatment of non-cash items.

4.4.4 Practical examples and case illustrations

Practical application of IAS 7 can be seen in scenarios such as a company issuing shares to raise capital, purchasing machinery, or paying dividends. Each of these transactions must be classified and reported appropriately in the statement of cash flows. Case illustrations help learners connect the principles of IAS 7 to real-world financial reporting situations.

Fill in the blank: Paying ___________ to shareholders is classified as a financing activity under IAS 7.

Short description: Diagram showing practical examples of cash flows classified into operating, investing, and financing activities.
Caption: Figure 4.5 Practical examples of cash flow classification

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This completes Part 4.4 Presentation, Disclosure, And Practical Considerations, giving learners a structured understanding of how cash flows are presented, disclosed, and the challenges faced in practice.

Series Summary

This Series has focused on IAS 7, the standard that governs the statement of cash flows, which is essential for understanding how cash moves through an organisation. Its relevance lies in helping stakeholders assess liquidity, solvency, and financial flexibility, offering insights that profit figures alone cannot provide.

We began by examining the fundamentals of IAS 7, including its purpose, objectives, and scope. Then we explored the classification of cash flows into operating, investing, and financing activities. Following that, we considered the methods of reporting cash flows, comparing the direct and indirect approaches along with their advantages and limitations. Finally, we discussed presentation and disclosure requirements, including non-cash transactions, and highlighted common challenges with practical examples. By completing this Series, you should now be able to define the purpose and scope of IAS 7 (SLO 4.1), classify cash flows accurately (SLO 4.2), demonstrate and analyse reporting methods (SLOs 4.3–4.4), and evaluate presentation and disclosure requirements in practice (SLO 4.5).

Glossary of Terms

Direct method: A method of reporting operating cash flows that shows major classes of gross cash receipts and payments, such as cash received from customers and cash paid to suppliers.
Financing activities: Cash flows that result in changes in the size and composition of equity capital and borrowings, such as issuing shares, paying dividends, or borrowing and repaying loans.
Indirect method: A method of reporting operating cash flows that starts with net profit and adjusts for non-cash items, changes in working capital, and items related to investing or financing activities.
Investing activities: Cash flows related to the acquisition and disposal of long-term assets and investments, such as purchasing or selling property, plant and equipment.
Non-cash transactions: Investing or financing activities that do not involve cash but must be disclosed, such as acquiring assets through leases or converting debt to equity.
Operating activities: The principal revenue-producing activities of an entity, including cash receipts from sales and cash payments to suppliers, employees, and for taxes.

Statement of cash flows: A financial statement that shows how cash and cash equivalents move in and out of an organisation during a reporting period, helping users assess liquidity and solvency.

Working capital: The difference between current assets and current liabilities, often adjusted in the indirect method to reconcile profit with cash flows.

Concept Check Questions – Series 4

Objective Questions

1. Which standard governs the statement of cash flows? (Linked to SLO 4.1)
2. Cash flows must be classified into operating, __________, and financing activities. (Linked to SLO 4.2)
3. The direct method presents major classes of gross cash __________ and payments. (Linked to SLO 4.3)
4. The indirect method begins with net __________ and reconciles it to net cash from operating activities. (Linked to SLO 4.3)
5. IAS 7 requires disclosure of __________ transactions such as leases or conversion of debt to equity. (Linked to SLO 4.5)

Short-Answer Questions

6. Define operating activities under IAS 7. (Linked to SLO 4.2)
7. State two examples of investing activities. (Linked to SLO 4.2)
8. Explain one advantage of the direct method of reporting cash flows. (Linked to SLO 4.4)
9. Identify one limitation of the indirect method of reporting cash flows. (Linked to SLO 4.4)
10. List two examples of non-cash transactions that must be disclosed under IAS 7. (Linked to SLO 4.5)

Long-Answer Questions

11. Describe the purpose and scope of IAS 7, explaining why cash flow information is important for decision-making. (Linked to SLO 4.1)
12. Demonstrate how cash flows are classified into operating, investing, and financing activities, using practical examples. (Linked to SLO 4.2)
13. Analyse the advantages and limitations of the direct and indirect methods of reporting cash flows. (Linked to SLO 4.4)
14. Evaluate the presentation and disclosure requirements of IAS 7, including non-cash transactions and common challenges. (Linked to SLO 4.5)

Answers to Concept Check Questions – Series 4

Objective Questions

1. IAS 7.
2. Investing.
3. Receipts.
4. Profit.
5. Non-cash.

Short-Answer Questions

6. Operating activities are the principal revenue-producing activities of an entity, including cash receipts from customers and cash payments to suppliers, employees, and taxes.
7. Purchase of property, plant and equipment; sale of property, plant and equipment.
8. It provides a clear picture of actual cash movements, making it easier for users to understand sources and uses of cash.
9. It provides less detail about actual cash movements and can obscure transparency.

10. Acquisition of assets through leases; conversion of debt to equity.

Long-Answer Questions
11. **Basic response:** IAS 7 requires the statement of cash flows to show how cash and cash equivalents move in and out of an organisation. This helps users assess liquidity and solvency.
Value-added response: Learners may add that cash flow information complements profit figures, highlights financial flexibility, and supports investment and lending decisions.

12. **Basic response:** Operating activities include receipts from customers and payments to suppliers; investing activities include purchase and sale of PPE; financing activities include issuing shares and paying dividends.
Value-added response: Outstanding learners may provide detailed examples, such as a company purchasing machinery (investing), paying wages (operating), and repaying a loan (financing), showing how each is classified.

13. **Basic response:** The direct method shows actual cash inflows and outflows, while the indirect method reconciles profit to cash flows.
Value-added response: Learners may note that the direct method enhances transparency but is harder to prepare, while the indirect method is simpler but less informative. They may also discuss why IAS 7 encourages the direct method.

14. **Basic response:** IAS 7 requires presentation of cash flows by activity, disclosure of non-cash transactions, and classification accuracy.
Value-added response: Learners may add that challenges include reconciling accrual accounting with cash movements and correctly classifying transactions. They may suggest solutions such as robust internal controls and regular review of classifications.

Answers to Pilot Questions – Series 4

1. IAS 7 governs the statement of cash flows.
2. Cash flows are classified into operating, investing, and financing activities.
3. The direct method presents major classes of gross cash receipts and payments.
4. The indirect method begins with net profit and reconciles it to net cash from operating activities.
5. Operating activities include cash receipts from customers and cash payments to suppliers and employees.
6. Investing activities include purchase and sale of property, plant and equipment.
7. Financing activities include issuing shares, paying dividends, and borrowing or repaying loans.
8. The direct method provides greater transparency by showing actual cash inflows and outflows.
9. The indirect method is easier to prepare but provides less detail about actual cash movements.
10. Non-cash transactions such as acquiring assets through leases or converting debt to equity must be disclosed.
11. Presentation requirements under IAS 7 include classifying cash flows into operating, investing, and financing activities.
12. Disclosure requirements include reporting non-cash transactions and ensuring comparability across entities.
13. Common challenges include reconciling accrual accounting with cash movements and correctly classifying transactions.
14. Practical examples include purchasing machinery (investing), paying wages (operating), and issuing shares (financing).

References and Attributions – Series 4

Figure 4.1 Objectives of the statement of cash flows
AI prompt: “Create a diagram showing inflows and outflows of cash in a business cycle, highlighting liquidity and solvency.”
Search string: “IAS 7 statement of cash flows objectives diagram OER”

Box 4.1 Importance of cash flow information
AI prompt: “Create a text box summarising the importance of cash flow information for investors, creditors, and managers.”
Search string: “IAS 7 importance of cash flow information OER”

Table 4.1 Scope and applicability of IAS 7
AI prompt: “Create a table summarising the scope and applicability of IAS 7, including entities covered and requirements.”
Search string: “IAS 7 scope applicability table OER”

Figure 4.2 Examples of operating cash flows
AI prompt: “Create a diagram showing examples of operating cash flows: receipts from customers, payments to suppliers, and tax payments.”
Search string: “IAS 7 operating activities cash flows diagram OER”

Table 4.2 Examples of investing cash flows
AI prompt: “Create a table listing examples of investing cash flows under IAS 7.”
Search string: “IAS 7 investing activities cash flows examples table OER”

Box 4.2 Examples of financing cash flows
AI prompt: “Create a text box summarising financing cash flows under IAS 7.”
Search string: “IAS 7 financing activities cash flows examples OER”

Figure 4.3 Direct method of reporting operating cash flows
AI prompt: “Create a diagram showing direct method cash flows: receipts from customers, payments to suppliers, payments to employees.”
Search string: “IAS 7 direct method cash flows diagram OER”

Table 4.3 Indirect method adjustments
AI prompt: “Create a table showing adjustments used in the indirect method of reporting operating cash flows.”
Search string: “IAS 7 indirect method cash flows adjustments table OER”

Box 4.3 Advantages and limitations of direct and indirect methods
AI prompt: “Create a text box summarising advantages and limitations of direct and indirect methods of reporting cash flows.”
Search string: “IAS 7 direct vs indirect method advantages limitations OER”

Figure 4.4 Presentation of the statement of cash flows in financial reporting
AI prompt: “Create a diagram showing the placement of the statement of cash flows within the complete set of financial statements.”
Search string: “IAS 7 statement of cash flows presentation diagram OER”

Table 4.4 Examples of non-cash transactions
AI prompt: “Create a table listing examples of non-cash transactions that must be disclosed under IAS 7.”
Search string: “IAS 7 non cash transactions disclosure examples table OER”

Box 4.4 Challenges in preparing cash flow statements
AI prompt: “Create a text box summarising challenges in preparing cash flow statements under IAS 7.”
Search string: “IAS 7 challenges preparing cash flow statements OER”

Figure 4.5 Practical examples of cash flow classification
AI prompt: “Create a diagram showing practical examples of cash flows classified into operating, investing, and financing activities.”
Search string: “IAS 7 practical examples cash flow classification diagram OER”

Open educational resources and references

- International Accounting Standards Board. (n.d.). *IAS 7 Statement of Cash Flows*. Retrieved from https://www.ifrs.org
- OpenStax. (2022). *Principles of Accounting, Volume 1: Financial Accounting*. Rice University. Retrieved from https://openstax.org/books/principles-accounting-volume-1-financial-accounting
- Financial Reporting Council. (n.d.). *UK Financial Reporting Standards*. Retrieved from https://www.frc.org.uk

COURSE CODE:ACC 201
COURSE TITLE: Financial Accounting I
COURSE CODE UNIT(3 Units C: LH 30; PH 45)

Series Titles for ACC 201: Financial Accounting I

1. Series 1: IASB Framework for Financial Statement Preparation and Presentation
2. Series 2: Introduction to IFRS 15 – Revenue and IAS 1 Presentation of Financial Statements
3. Series 3: Accounting for Inventories under IAS 2
4. Series 4: Accounting Policies and Property, Plant and Equipment (IAS 8 and IAS 16)
5. Series 5: Government Grants and Borrowing Costs (IAS 20 and IAS 23)

Series 5: Introduction To IAS 8 – Accounting Policies, Changes In Accounting Estimates And Errors

Main Parts And Sub-Parts Outline

Part 5.1: Fundamentals of IAS 8 – Purpose and scope
- Definition and objectives of IAS 8
- Scope and applicability of the standard
- Importance of consistency in accounting policies

Part 5.2: Accounting policies
- Criteria for selecting and applying accounting policies
- Role of IFRS and guidance hierarchy
- Disclosure requirements for accounting policies

Part 5.3: Changes in accounting estimates
- Definition and examples of accounting estimates
- Treatment of changes in estimates
- Impact on financial statements

Part 5.4: Prior period errors and corrections

- Definition of prior period errors
  - Methods of correcting errors (retrospective restatement)
  - Disclosure requirements for error corrections

Part 5.5: Practical considerations and case illustrations
  - Common challenges in applying IAS 8
  - Case examples of policy changes, estimate revisions, and error corrections
  - Best practices for transparency and comparability

Introduction

Financial reporting must be consistent, transparent, and reliable if it is to serve the needs of investors, regulators, and other stakeholders. Yet in practice, organisations often face situations where accounting policies need to be applied, estimates must be revised, or errors require correction. IAS 8 provides the framework for handling these issues, ensuring comparability across reporting periods and enhancing the credibility of financial statements.
The aim of this Series is to introduce you to the principles of IAS 8, equipping you with the knowledge to apply accounting policies correctly, treat changes in estimates appropriately, and address prior period errors in line with international standards.
We shall commence this Series by examining the fundamentals of IAS 8, including its purpose, scope, and the importance of consistency. Next, we will explore accounting policies, focusing on how they are selected, applied, and disclosed. Following that, we will consider changes in accounting estimates, looking at their definition, treatment, and impact on financial statements. Afterwards, we will move on to prior period errors and corrections, discussing retrospective restatement and disclosure requirements. Finally, we will conclude with practical considerations and case illustrations, highlighting common challenges and best practices for applying IAS 8 effectively.

Series Learning Outcomes

Upon completing this Series, you should be able to:

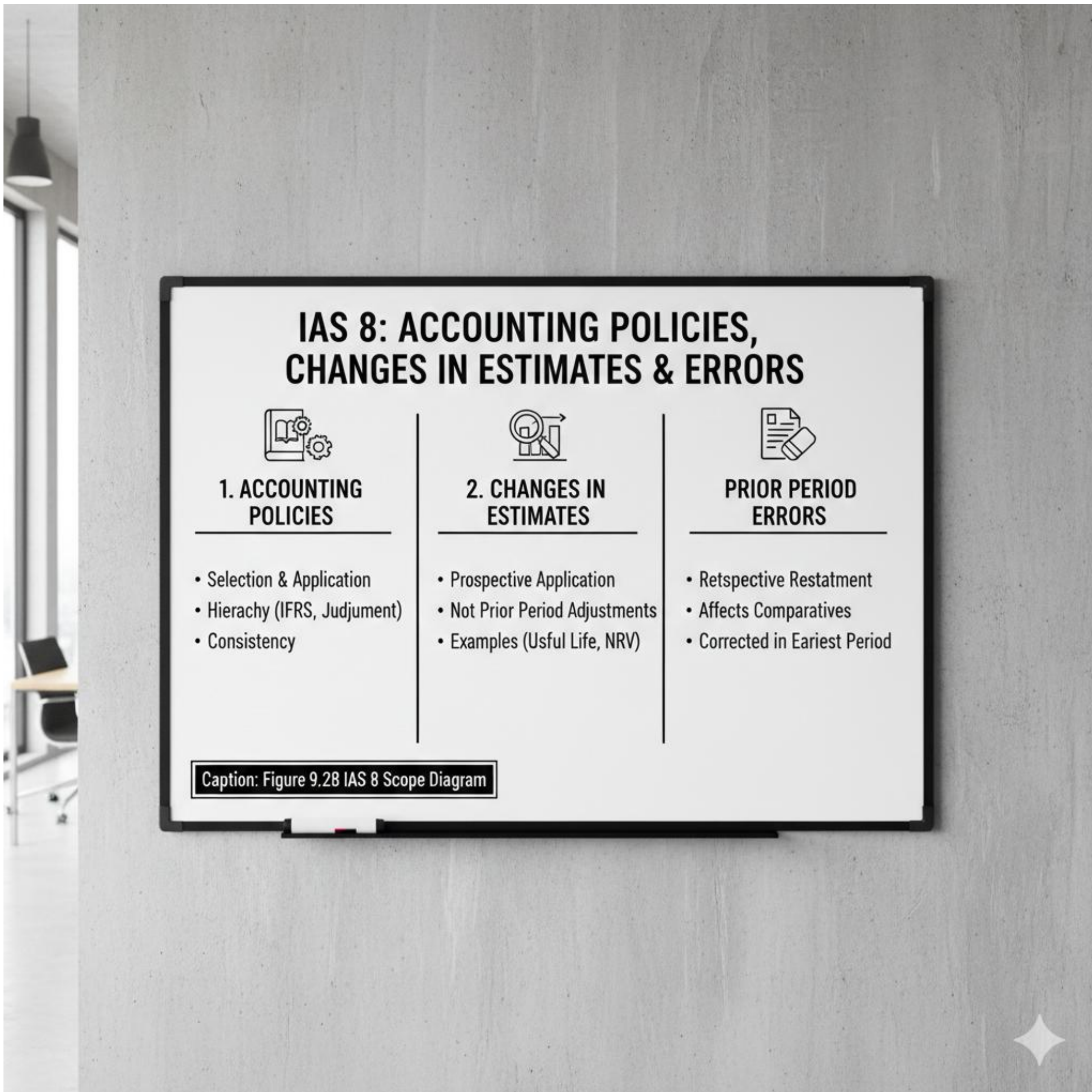
SLO 5.1 define the purpose and scope of IAS 8 and explain the importance of consistency in accounting policies,
SLO 5.2 apply the criteria for selecting and implementing accounting policies in line with IFRS guidance,
SLO 5.3 disclose accounting policies clearly and appropriately in financial statements,
SLO 5.4 define accounting estimates and demonstrate how changes in estimates are treated in financial reporting,
SLO 5.5 analyse the impact of changes in accounting estimates on financial statements,
SLO 5.6 identify prior period errors and explain the methods of correcting them through retrospective restatement,
SLO 5.7 evaluate disclosure requirements for error corrections under IAS 8, and
SLO 5.8 assess practical challenges and illustrate case examples of applying IAS 8 to policy changes, estimate revisions, and error corrections.

5.1 Fundamentals Of IAS 8 – Purpose And Scope

5.1.1 Definition and objectives of IAS 8

IAS 8 is the International Accounting Standard that deals with accounting policies, changes in accounting estimates, and corrections of prior period errors. Its objective is to ensure that financial statements are consistent, comparable, and transparent across reporting periods. By providing clear guidance, IAS 8 helps entities present reliable information that supports decision-making by investors, regulators, and other stakeholders.

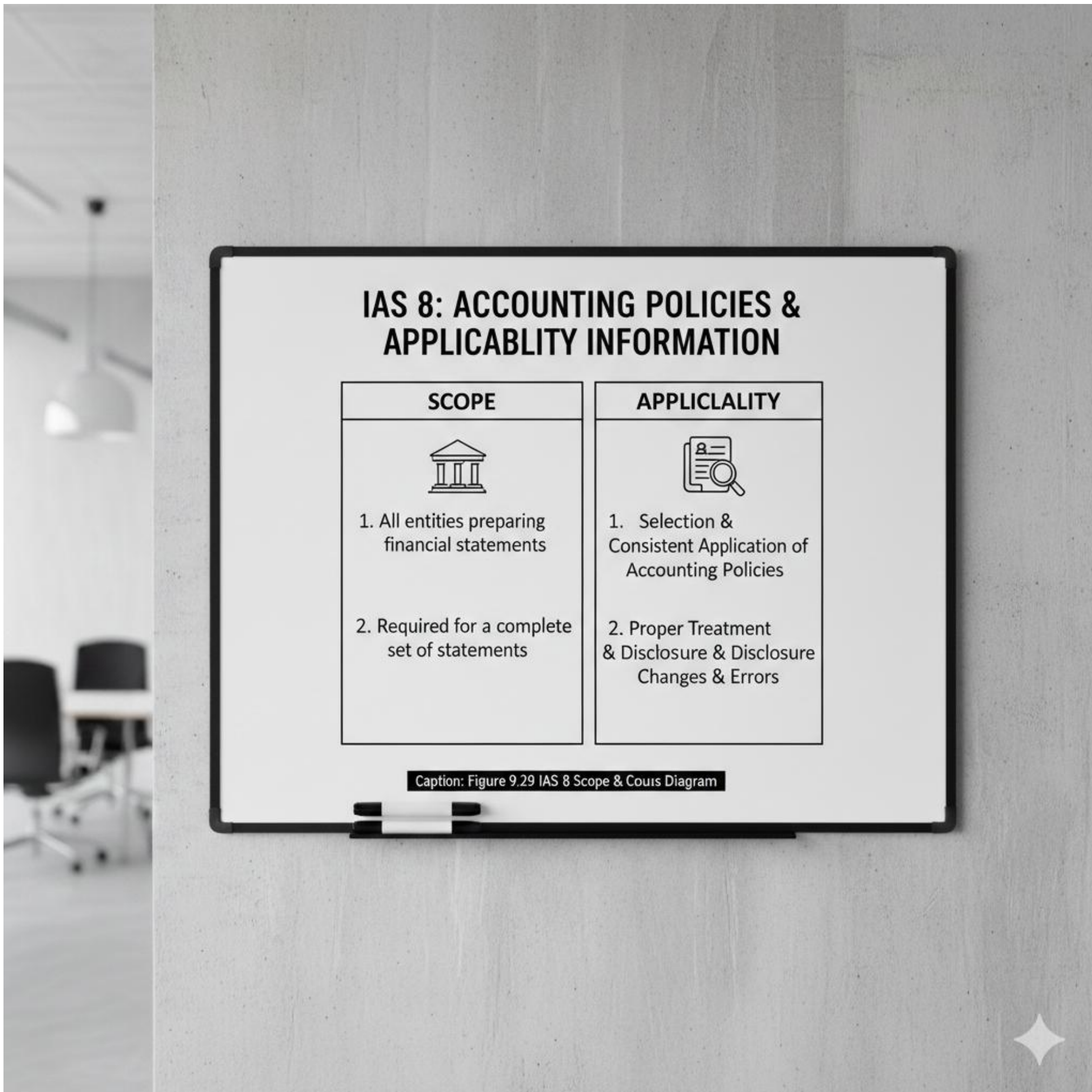
Fill in the blank: IAS 8 deals with accounting policies, changes in accounting __________, and corrections of prior period errors.



Short description: Diagram showing the three main areas covered by IAS 8 (policies, estimates, errors).
Caption: Figure 5.1 Scope of IAS 8

5.1.2 Scope and applicability of the standard
IAS 8 applies to all entities that prepare financial statements under IFRS. It requires consistent application of accounting policies and prescribes how to account for changes in estimates and corrections of errors. The standard ensures comparability across entities and reporting periods, regardless of industry or size.

Fill in the blank: IAS 8 applies to all entities that prepare financial statements under __________.



Caption: Table 5.1 Scope and applicability of IAS 8
Short description: A table summarising the scope of IAS 8, including entities covered and requirements.

5.1.3 Importance of consistency in accounting policies
Consistency in applying accounting policies is vital for comparability across reporting periods. Without consistency, users of financial statements may struggle to interpret trends or evaluate performance. IAS 8 ensures that changes in policies are justified, disclosed, and applied retrospectively where necessary, thereby maintaining the integrity of financial reporting.

Fill in the blank: Consistency in applying accounting policies is vital for __________ across reporting periods.

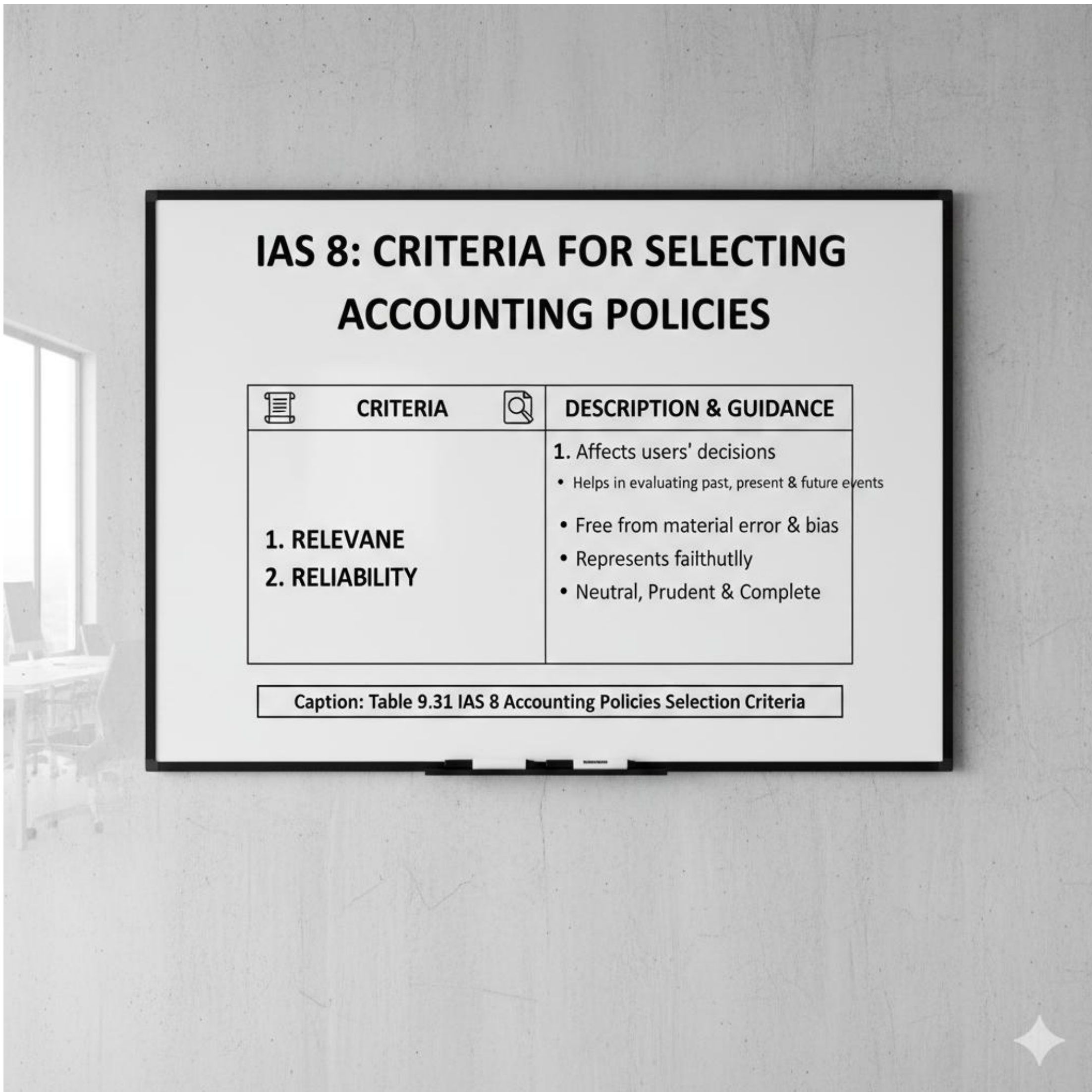
Caption: Box 5.1 Importance of consistency in accounting policies
Short description: A boxed summary explaining why consistency in accounting policies is important for comparability and reliability.

This completes Part 5.1 Fundamentals of IAS 8 – Purpose and Scope, providing learners with a clear understanding of the definition, objectives, scope, and importance of consistency in accounting policies.

5.2 Accounting Policies

5.2.1 Criteria for selecting and applying accounting policies
Accounting policies are the specific principles, bases, conventions, rules, and practices applied by an entity in preparing and presenting financial statements. IAS 8 requires that accounting policies be selected and applied consistently to ensure comparability. When IFRS provides guidance, entities must follow it. Where no specific guidance exists, management should use judgement, considering standards dealing with similar issues and the conceptual framework.

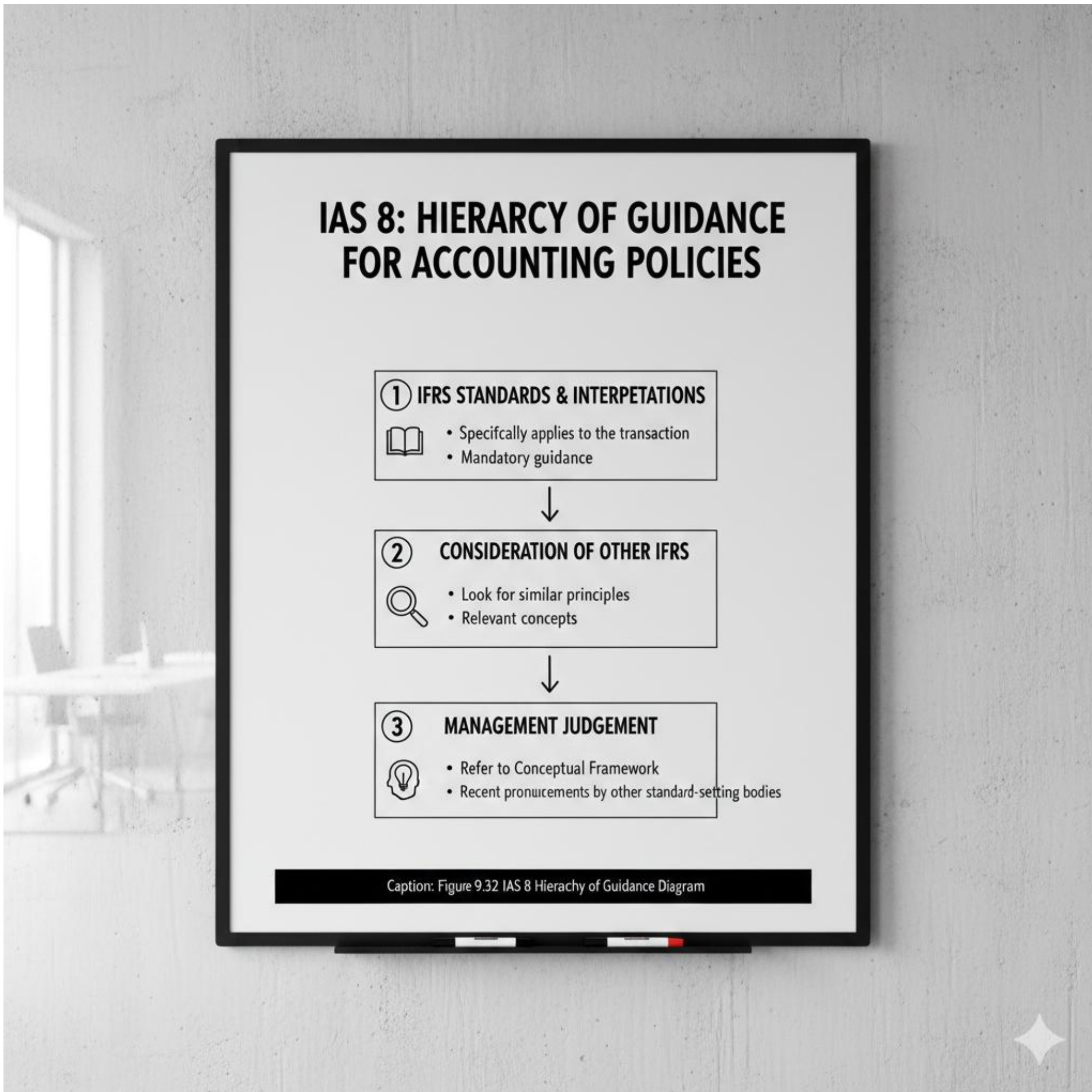
Fill in the blank: Accounting policies are the specific principles, bases, conventions, rules, and __________ applied in preparing financial statements.



Caption: Table 5.2 Criteria for selecting accounting policies
Short description: A table summarising criteria for selecting accounting policies, including IFRS guidance, standards on similar issues, and conceptual framework.
R"

5.2.2 Role of IFRS and guidance hierarchy
IAS 8 establishes a hierarchy for guidance when selecting accounting policies. At the top are IFRS standards and interpretations. If no direct guidance exists, entities should consider standards addressing similar issues and refer to the IFRS conceptual framework. This hierarchy ensures that accounting policies are grounded in authoritative sources and maintain consistency across entities.

Fill in the blank: When no direct IFRS guidance exists, entities should refer to the IFRS __________ framework.



Short description: Diagram showing the hierarchy of guidance for accounting policies (IFRS standards, similar standards, conceptual framework).
Caption: Figure 5.2 Hierarchy of guidance for accounting policies

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5.2.3 Disclosure requirements for accounting policies
Entities must disclose the accounting policies that are significant to the preparation of financial statements. Disclosure should be clear and specific, enabling users to understand how transactions and balances are recognised, measured, and presented. This transparency helps users evaluate comparability and reliability across reporting periods.

Fill in the blank: Entities must disclose accounting policies that are __________ to the preparation of financial statements.

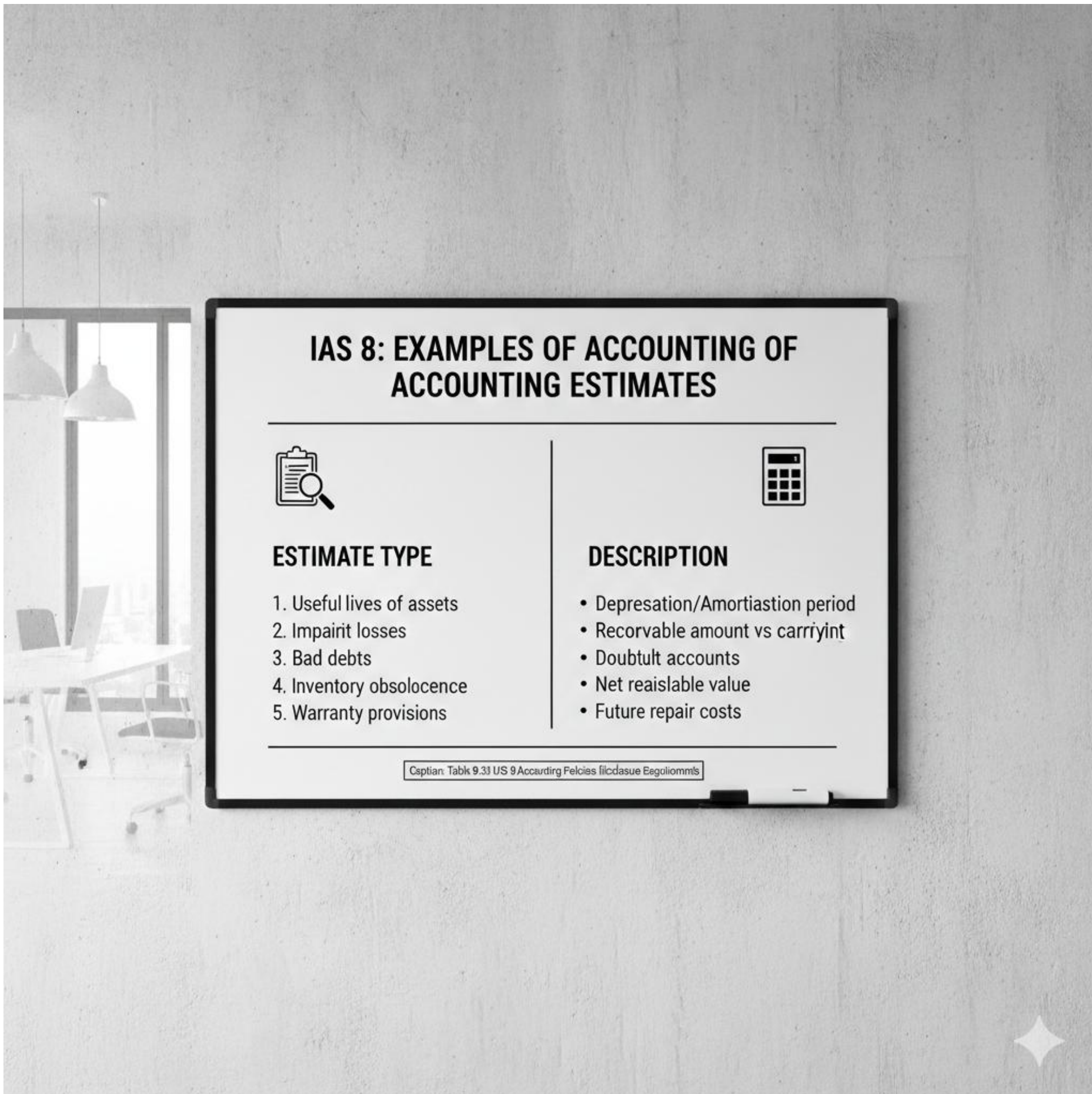
Caption: Box 5.2 Disclosure requirements for accounting policies
Short description: A boxed summary of disclosure requirements, including clarity, specificity, and relevance of accounting policies.

This completes Part 5.2 Accounting Policies, giving learners a clear understanding of how accounting policies are selected, applied, and disclosed under IAS 8.

5.3 Changes In Accounting Estimates

5.3.1 Definition and examples of accounting estimates
Accounting estimates are approximations made by management when precise measurement is not possible. They are used in areas such as depreciation, provisions for doubtful debts, and inventory valuation. Because estimates rely on judgement, they may change as new information becomes available or circumstances evolve.

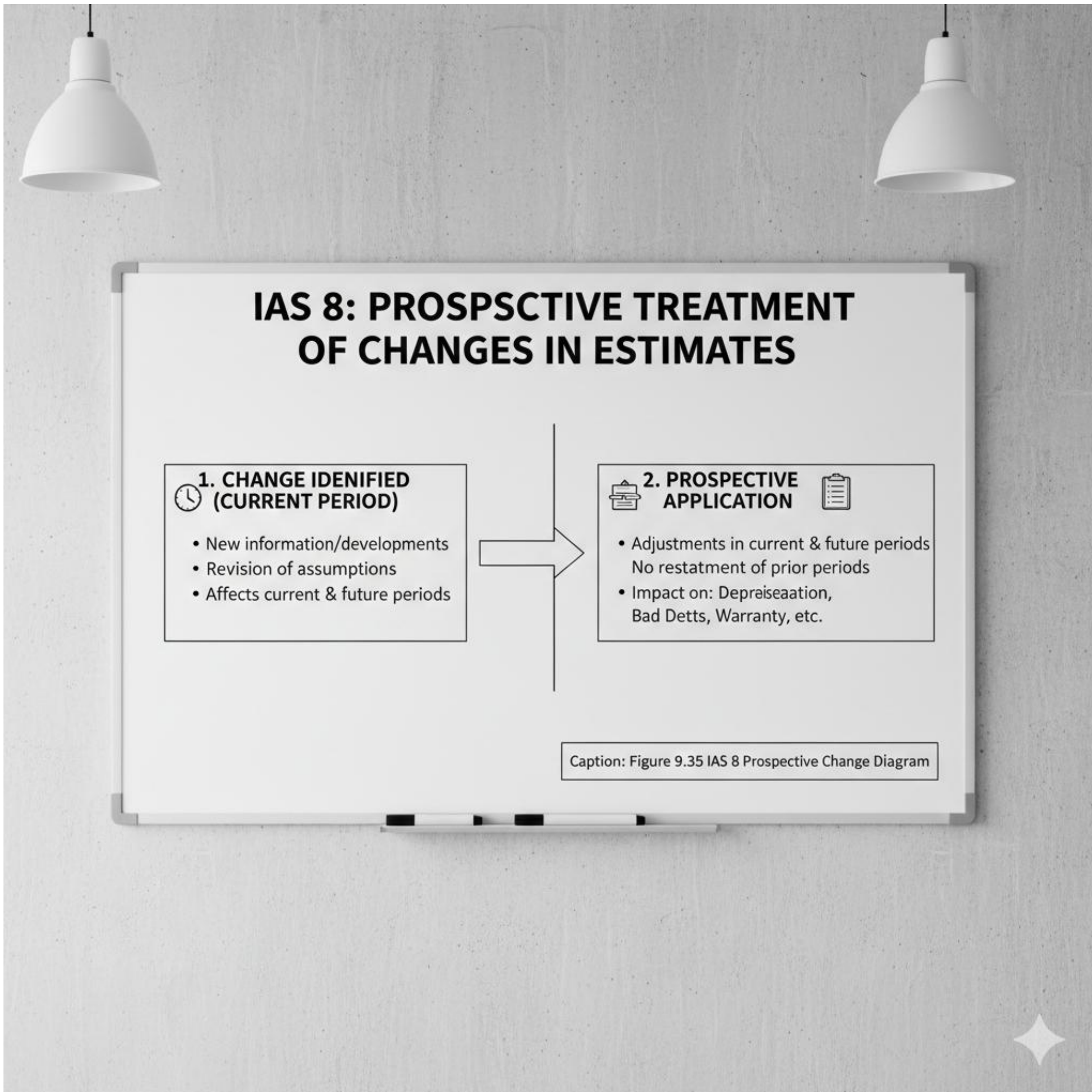
Fill in the blank: Accounting estimates are approximations made by __________ when precise measurement is not possible.



Caption: Box 5.3 Examples of accounting estimates
Short description: A boxed summary listing examples of accounting estimates such as depreciation, doubtful debts, and inventory valuation.

5.3.2 Treatment of changes in estimates
Changes in accounting estimates are recognised prospectively, meaning they affect the current and future periods only. They are not applied retrospectively because they are not corrections of errors but adjustments based on new information. For example, revising the useful life of an asset will change depreciation expense in future periods but not alter past financial statements.

Fill in the blank: Changes in accounting estimates are recognised __________, affecting current and future periods only.



Short description: Diagram showing prospective treatment of changes in estimates (impact on current and future periods, not past).
Caption: Figure 5.3 Prospective treatment of changes in estimates

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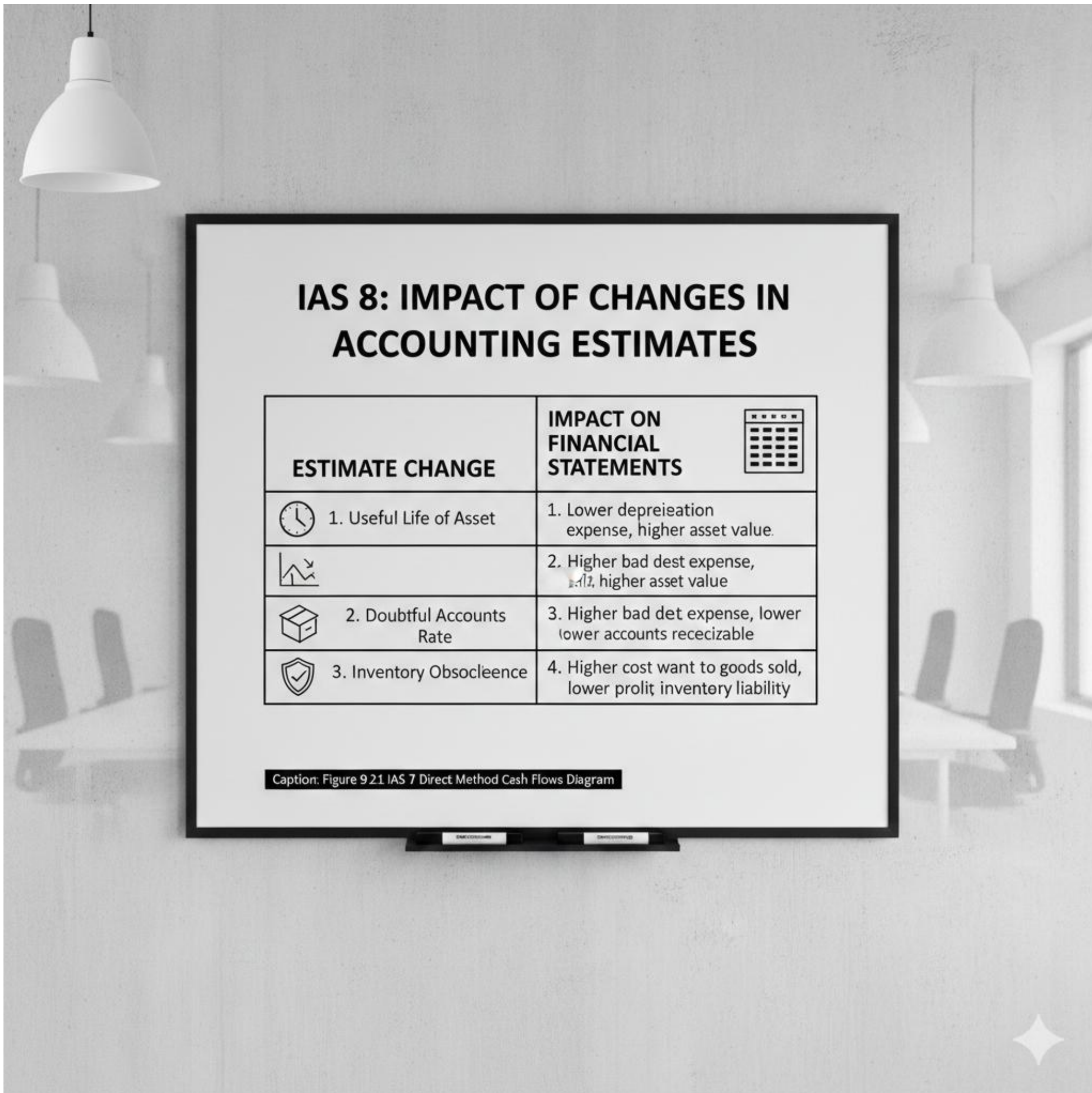
5.3.3 Impact on financial statements
Changes in estimates can significantly affect reported profits, asset values, and liabilities. For example, increasing the provision for doubtful debts reduces profit, while extending the useful life of machinery lowers annual depreciation expense. Transparent disclosure of such changes is essential so that users of financial statements can understand their impact and make informed decisions.

Fill in the blank: Increasing the provision for doubtful debts reduces __________ in the financial statements.



Caption: Table 5.3 Impact of changes in estimates on financial statements
Short description: A table showing examples of how changes in estimates affect profits, assets, and liabilities.

This completes Part 5.3 Changes in Accounting Estimates, giving learners a clear understanding of what estimates are, how changes are treated, and their impact on financial statements.

5.4 Prior Period Errors And Corrections

5.4.1 Definition of prior period errors
Prior period errors are omissions or misstatements in financial statements of one or more prior periods, arising from mistakes in using or applying accounting policies, misinterpretation of facts, or fraud. These errors undermine the reliability of financial reporting and must be corrected to restore accuracy and comparability.

Fill in the blank: Prior period errors are omissions or __________ in financial statements of one or more prior periods.

[Insert box here]
Caption: Box 5.4 Examples of prior period errors
Short description: A boxed summary listing examples of prior period errors such as misapplication of policies, misinterpretation of facts, and fraud.
AI prompt suggestion: “Create a text box summarising examples of prior period errors under IAS 8.”
Search string: “IAS 8 prior period errors examples OER”

5.4.2 Methods of correcting errors (retrospective restatement)
IAS 8 requires that prior period errors be corrected by **retrospective restatement**, meaning the financial statements are adjusted as if the error had never occurred. Comparative figures are restated, and opening balances of assets, liabilities, and equity are adjusted for the earliest period presented. This ensures that users can rely on consistent and accurate information across reporting periods.

Fill in the blank: IAS 8 requires prior period errors to be corrected by __________ restatement.

[Insert figure here]
Short description: Diagram showing retrospective restatement process (adjusting comparative figures and opening balances).
Caption: Figure 5.4 Retrospective restatement of prior period errors
AI prompt suggestion: “Create a diagram showing retrospective restatement of prior period errors under IAS 8.”
Search string: “IAS 8 retrospective restatement prior period errors diagram OER”

5.4.3 Disclosure requirements for error corrections
Entities must disclose the nature of the prior period error, the amount of correction for each financial statement line item, and the impact on earnings per share if applicable. Disclosure should also explain why retrospective restatement was necessary and how it was applied. This transparency ensures that users understand the correction and its effect on financial performance.

Fill in the blank: Entities must disclose the __________ of the prior period error and the amount of correction for each line item.

[Insert table here]
Caption: Table 5.4 Disclosure requirements for prior period errors
Short description: A table summarising disclosure requirements, including nature of error, correction amounts, and impact on earnings per share.
AI prompt suggestion: “Create a table summarising disclosure requirements for prior period errors under IAS 8.”
Search string: “IAS 8 disclosure requirements prior period errors table OER”

This completes Part 5.4 Prior Period Errors And Corrections, giving learners a clear understanding of what prior period errors are, how they are corrected, and the disclosure requirements under IAS 8.

5.5 Practical Considerations And Case Illustrations

5.5.1 Common challenges in applying IAS 8

Applying IAS 8 can be challenging because entities must distinguish between changes in accounting policies, changes in estimates, and corrections of errors. Misclassification can lead to inappropriate treatment and mislead users of financial statements. Another challenge is ensuring transparency in disclosure, particularly when changes significantly affect reported profits or asset values.

Fill in the blank: One challenge in applying IAS 8 is distinguishing between changes in policies, changes in estimates, and corrections of __________.

[Insert box here]
Caption: Box 5.5 Challenges in applying IAS 8
Short description: A boxed summary of common challenges such as misclassification, disclosure transparency, and impact on comparability.
AI prompt suggestion: “Create a text box summarising common challenges in applying IAS 8.”
Search string: “IAS 8 challenges applying accounting policies estimates errors OER”

5.5.2 Case examples of policy changes
An entity may change its inventory valuation method from FIFO to weighted average. Under IAS 8, this change in accounting policy must be applied retrospectively, restating prior period financial statements to reflect the new method. This ensures comparability across reporting periods and prevents misleading trends.

Fill in the blank: A change in inventory valuation method from FIFO to weighted average is treated as a change in accounting __________.

[Insert figure here]
Short description: Diagram showing retrospective application of a change in inventory valuation method.
Caption: Figure 5.5 Retrospective application of policy changes
AI prompt suggestion: “Create a diagram showing retrospective application of a change in inventory valuation method under IAS 8.”
Search string: “IAS 8 retrospective application policy change inventory valuation diagram OER”

5.5.3 Case examples of estimate revisions
Suppose an entity revises the useful life of machinery from 10 years to 15 years. This change is treated prospectively, affecting depreciation expense in current and future periods only. Past financial statements remain unchanged, as the revision reflects updated information rather than an error.

Fill in the blank: Revising the useful life of machinery affects depreciation expense in __________ and future periods only.

[Insert table here]
Caption: Table 5.5 Prospective treatment of estimate revisions
Short description: A table showing examples of estimate revisions and their prospective impact (useful life of assets, provisions, inventory valuation).
AI prompt suggestion: “Create a table showing examples of estimate revisions and their prospective impact under IAS 8.”
Search string: “IAS 8 prospective treatment estimate revisions examples table OER”

5.5.4 Case examples of error corrections
If an entity discovers that it failed to record accrued expenses in a prior period, this is a prior period error. IAS 8 requires retrospective restatement, adjusting comparative figures and opening balances to correct the omission. Disclosure must explain the nature of the error and the correction applied.

Fill in the blank: Failure to record accrued expenses in a prior period is treated as a prior period __________ under IAS 8.

Short description: Diagram showing retrospective restatement of prior period error (adjusting comparative figures and opening balances).
Caption: Figure 5.6 Retrospective restatement of prior period error

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This completes Part 5.5 Practical Considerations And Case Illustrations, providing learners with practical insights into challenges, policy changes, estimate revisions, and error corrections under IAS 8.

Series Summary

This Series has introduced IAS 8, the standard that governs accounting policies, changes in accounting estimates, and corrections of prior period errors. Its relevance lies in ensuring that financial statements remain consistent, comparable, and transparent, thereby supporting reliable decision-making by stakeholders.

We began by exploring the fundamentals of IAS 8, including its purpose, scope, and the importance of consistency. We then examined accounting policies, focusing on how they are selected, applied, and disclosed. Following this, we looked at changes in accounting estimates, considering their definition, prospective treatment, and impact on financial statements. We moved on to prior period errors, discussing retrospective restatement and disclosure requirements. Finally, we considered practical challenges and illustrated case examples of policy changes, estimate revisions, and error corrections. By completing this Series, you should now be able to define the scope of IAS 8 (SLO 5.1), apply and disclose accounting policies (SLOs 5.2–5.3), demonstrate and analyse changes in estimates (SLOs 5.4–5.5), explain and evaluate error corrections (SLOs 5.6–5.7), and assess practical challenges with case illustrations (SLO 5.8).

Glossary of Terms

Accounting policies: The specific principles, bases, conventions, rules, and practices applied by an entity in preparing and presenting financial statements.

Accounting estimates: Approximations made by management when precise measurement is not possible, such as depreciation, provisions for doubtful debts, or inventory valuation.

Disclosure requirements: Obligations under IAS 8 to provide clear and specific information about accounting policies, changes in estimates, and corrections of errors in financial statements.

IFRS conceptual framework: A set of principles that guides the development and application of accounting standards, used when no direct IFRS guidance exists.

Non-cash transactions: Transactions that do not involve cash but must be disclosed, such as acquiring assets through leases or converting debt to equity.

Prior period errors: Omissions or misstatements in financial statements of one or more prior periods, arising from mistakes, misinterpretation of facts, or fraud.

Retrospective restatement: The method required by IAS 8 to correct prior period errors by adjusting comparative figures and opening balances as if the error had never occurred.

Prospective treatment: The method of recognising changes in accounting estimates by applying them to the current and future periods only, without altering past financial statements.

Comparability: The quality of financial information that allows users to identify similarities and differences across reporting periods or between entities.

Concept Check Questions – Series 5

Objective Questions

1. IAS 8 deals with accounting policies, changes in accounting __________, and corrections of prior period errors. (Linked to SLO 5.1)
2. IAS 8 applies to all entities that prepare financial statements under __________. (Linked to SLO 5.1)
3. Accounting policies are the specific principles, bases, conventions, rules, and __________ applied in preparing financial statements. (Linked to SLO 5.2)
4. When no direct IFRS guidance exists, entities should refer to the IFRS __________ framework. (Linked to SLO 5.2)
5. Changes in accounting estimates are recognised __________, affecting current and future periods only. (Linked to SLO 5.4)
6. IAS 8 requires prior period errors to be corrected by __________ restatement. (Linked to SLO 5.6)

Short-Answer Questions
7. Define accounting policies under IAS 8. (Linked to SLO 5.2)
8. State two examples of accounting estimates. (Linked to SLO 5.4)
9. Explain one advantage of disclosing accounting policies clearly in financial statements. (Linked to SLO 5.3)
10. Identify one challenge in applying IAS 8. (Linked to SLO 5.8)
11. List two disclosure requirements for prior period errors. (Linked to SLO 5.7)

Long-Answer Questions
12. Define the purpose and scope of IAS 8, explaining why consistency is important in financial reporting. (Linked to SLO 5.1)
13. Apply the criteria for selecting accounting policies and demonstrate how the IFRS guidance hierarchy is used. (Linked to SLO 5.2)
14. Analyse the prospective treatment of changes in accounting estimates and assess their impact on financial statements. (Linked to SLOs 5.4–5.5)
15. Evaluate retrospective restatement of prior period errors, including disclosure requirements and practical challenges. (Linked to SLOs 5.6–5.7)
16. Assess practical challenges in applying IAS 8, using case examples of policy changes, estimate revisions, and error corrections. (Linked to SLO 5.8)

Answers to Concept Check Questions – Series 5

Objective Questions
1. Estimates.
2. IFRS.
3. Practices.
4. Conceptual.
5. Prospectively.
6. Retrospective.

Short-Answer Questions
7. Accounting policies are the principles, bases, conventions, rules, and practices applied in preparing and presenting financial statements.
8. Depreciation of assets; provision for doubtful debts.
9. Clear disclosure improves transparency and helps users understand how transactions are recognised and measured.
10. Distinguishing between changes in policies, changes in estimates, and corrections of errors.
11. Disclosure of the nature of the error and the amount of correction for each line item.

Long-Answer Questions
12. **Basic response:** IAS 8 ensures consistency, comparability, and transparency in financial statements by guiding policies, estimates, and error corrections.
Value-added response: Learners may add that consistency allows stakeholders to identify trends and make reliable decisions, while scope ensures applicability across all IFRS entities.

13. **Basic response:** Entities select policies based on IFRS standards, similar standards, and the conceptual framework.
Value-added response: Learners may demonstrate the hierarchy with examples, such as applying IFRS directly when guidance exists, or using the conceptual framework when no direct guidance is available.

14. **Basic response:** Changes in estimates are treated prospectively, affecting current and future periods only.

Value-added response: Learners may assess impacts such as reduced profit from increased provisions or lower depreciation expense from extended asset life, and explain why retrospective treatment is inappropriate.

15. **Basic response:** Prior period errors are corrected by retrospective restatement, adjusting comparative figures and opening balances.
Value-added response: Learners may evaluate disclosure requirements, such as explaining the nature of the error and its impact, and discuss challenges like ensuring comparability and transparency.

16. **Basic response:** Common challenges include misclassification of changes, ensuring disclosure transparency, and maintaining comparability.
Value-added response: Learners may illustrate with case examples, such as changing inventory valuation methods (policy change), revising asset useful life (estimate revision), or correcting omitted accrued expenses (error correction).
Answers to Pilot Questions – Series 5

1. IAS 8 deals with accounting policies, changes in accounting estimates, and corrections of prior period errors.
2. IAS 8 applies to all entities that prepare financial statements under IFRS.
3. Accounting policies are the specific principles, bases, conventions, rules, and practices applied in preparing financial statements.
4. When no direct IFRS guidance exists, entities should refer to the IFRS conceptual framework.
5. Entities must disclose accounting policies that are significant to the preparation of financial statements.
6. Accounting estimates are approximations made by management when precise measurement is not possible.
7. Changes in accounting estimates are recognised prospectively, affecting current and future periods only.
8. Increasing the provision for doubtful debts reduces profit in the financial statements.
9. Prior period errors are omissions or misstatements in financial statements of one or more prior periods.
10. IAS 8 requires prior period errors to be corrected by retrospective restatement.
11. Entities must disclose the nature of the prior period error and the amount of correction for each line item.
12. One challenge in applying IAS 8 is distinguishing between changes in policies, changes in estimates, and corrections of errors.
13. A change in inventory valuation method from FIFO to weighted average is treated as a change in accounting policy.
14. Revising the useful life of machinery affects depreciation expense in current and future periods only.
15. Failure to record accrued expenses in a prior period is treated as a prior period error under IAS 8.

References and Attributions – Series 5

Figure 5.1 Scope of IAS 8
AI prompt: “Create a diagram showing the three main areas covered by IAS 8: accounting policies, changes in estimates, and prior period errors.”
Search string: “IAS 8 scope diagram OER”

Table 5.1 Scope and applicability of IAS 8
AI prompt: “Create a table summarising the scope and applicability of IAS 8, including entities covered and requirements.”
Search string: “IAS 8 scope applicability table OER”

Box 5.1 Importance of consistency in accounting policies
AI prompt: “Create a text box summarising the importance of consistency in accounting policies under IAS 8.”
Search string: “IAS 8 consistency accounting policies OER”

Table 5.2 Criteria for selecting accounting policies
AI prompt: “Create a table summarising criteria for selecting accounting policies under IAS 8.”

Search string: “IAS 8 criteria selecting accounting policies table OER”

Figure 5.2 Hierarchy of guidance for accounting policies
AI prompt: “Create a diagram showing the hierarchy of guidance for accounting policies under IAS 8.”
Search string: “IAS 8 hierarchy guidance accounting policies diagram OER”

Box 5.2 Disclosure requirements for accounting policies
AI prompt: “Create a text box summarising disclosure requirements for accounting policies under IAS 8.”
Search string: “IAS 8 disclosure requirements accounting policies OER”

Box 5.3 Examples of accounting estimates
AI prompt: “Create a text box summarising examples of accounting estimates under IAS 8.”
Search string: “IAS 8 accounting estimates examples OER”

Figure 5.3 Prospective treatment of changes in estimates
AI prompt: “Create a diagram showing prospective treatment of changes in accounting estimates under IAS 8.”
Search string: “IAS 8 prospective treatment changes in estimates diagram OER”

Table 5.3 Impact of changes in estimates on financial statements
AI prompt: “Create a table showing examples of the impact of changes in accounting estimates on financial statements.”
Search string: “IAS 8 impact changes in accounting estimates table OER”

Box 5.4 Examples of prior period errors
AI prompt: “Create a text box summarising examples of prior period errors under IAS 8.”
Search string: “IAS 8 prior period errors examples OER”

Figure 5.4 Retrospective restatement of prior period errors
AI prompt: “Create a diagram showing retrospective restatement of prior period errors under IAS 8.”
Search string: “IAS 8 retrospective restatement prior period errors diagram OER”

Table 5.4 Disclosure requirements for prior period errors
AI prompt: “Create a table summarising disclosure requirements for prior period errors under IAS 8.”
Search string: “IAS 8 disclosure requirements prior period errors table OER”

Box 5.5 Challenges in applying IAS 8
AI prompt: “Create a text box summarising common challenges in applying IAS 8.”
Search string: “IAS 8 challenges applying accounting policies estimates errors OER”

Figure 5.5 Retrospective application of policy changes
AI prompt: “Create a diagram showing retrospective application of a change in inventory valuation method under IAS 8.”
Search string: “IAS 8 retrospective application policy change inventory valuation diagram OER”

Table 5.5 Prospective treatment of estimate revisions
AI prompt: “Create a table showing examples of estimate revisions and their prospective impact under IAS 8.”
Search string: “IAS 8 prospective treatment estimate revisions examples table OER”

Figure 5.6 Retrospective restatement of prior period error
AI prompt: “Create a diagram showing retrospective restatement of prior period error under IAS 8.”
Search string: “IAS 8 retrospective restatement prior period error diagram OER”

Open educational resources and references

- International Accounting Standards Board. (n.d.). *IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors*. Retrieved from https://www.ifrs.org
- OpenStax. (2022). *Principles of Accounting, Volume 1: Financial Accounting*. Rice University. Retrieved from https://openstax.org/books/principles-accounting-volume-1-financial-accounting
- Financial Reporting Council. (n.d.). *UK Financial Reporting Standards*. Retrieved from https://www.frc.org.uk