In **IFRS:** there is **management report (equivalent to annual report in the US GAAP), that includes corporate governance statement, 4 financial statements and auditor's opinion.**

Financial Reporting Conventions

1. The length of reporting periods – the accounting period is long one year, called the fiscal year (a 12-month period).
2. The number of reporting period – US GAAP requires statements for the current year and two prior years; IFRS requires statements for the current and the prior year.
3. Monetary amounts – the financial statements report numerical amounts for each item on the financial statements. The numerical amount reported is a monetary amount. (measuring units – in billions, in thousands; and the currency in EUR, SEK, GBP, usually the currency of the country where the company is headquartered).
4. Terminology and level of details – broad guidance what the statements should contain, neither system completely specifies the level of details or the names of accounts.

There will be variations in the ways financial statements display the information and variations in the level of details provided, e.g. variations in account titles or forms of the statements.

Income Statement

The income statement helps users of financial statements evaluate the past performance of the enterprise and informs on profitability. It reports an enterprise's success of achieving the goal – which is to generate profit **within a given reporting period**.

Net profit, net earnings and net income are synonyms.

Net income (net loss) is the difference between revenues and expenses.

Net income = revenues – expenses > O; it means revenues exceeds expenses.

Net loss = revenues – expenses < O; it means expenses exceeds revenues.

The major elements of net income are: **revenues, expenses** (gains and losses as well, see p. 70, now for the simplicity they are ignored). The preparation of statements is in the order as follows:

1. Preparation of the Income Statement (or Profit and Loss account).
2. Preparation of Statement of Retained Earnings (see table 1.1, p. 20), or the Statement of Owner´s Capital.
3. Reporting of Other comprehensive income (it includes unrealized revenues/gains or expenses/losses).
4. Preparation of Comprehensive Income Statement.
   (Its simpliest form: net income + other contributed income = comprehensive income.)

Revenues, also sales, sales revenue or turnover (IFRS) can be measured as inflows of assets (A+), or reduction of liabilities (L–) from business activities, e.g. as for instance selling the goods or providing services to customers. The company for providing goods and services will receive cash or customers' promises to pay cash

Table 2.1 ***Double Entry Accounting***

The phase of an accounting cycle	Accounting document
1. Identifications of accounting transactions	Tabular analysis: Accounting aquation
2. Journalizing	General journal Specialized journals
3. Posting	General ledger
4. Preparation of trial balance	Worksheet – trial balance unadjusted
5. Preparation of adjusting entries	Worksheet – separate columns in trial balance
6. Preparation of adjusted trial balance	Worksheet – trial balance adjusted
7. Financial statements preparation	Income statement, balance sheet, cash flows
	Statement of changes in equity, notes to the FSs
8. Closing entries	Worksheet – post-closing trial balance

Accounting Cycle:

1. a 2. Enter the transactions of the period in appropriate journals.
3. Post from the journals to the ledger (or ledgers).
4. Prepare an unadjusted trial balance.
5. Prepare adjusting journal entries and post them to the ledger(s).
6. Prepare a trial balance after adjusting (adjusted balance).
7. Prepare the financial statements from the adjusted trial balance.
8. Prepare closing journal entries and post them to the ledger(s).
   Prepare a trial balance after closing (post-closing trial balance).
9. Prepare reversing entries (optional) and post them to the ledger(s).

1. **Identification of accounting transactions.** The objective of the first phase of accounting cycle is to search for transactions that have to be recorded into an accounting system. It starts with identifying the events that have occurred in the enterprise, which are financial transactions. It requires to gather legal documents related to these transactions. By analysis of the documents (checks, sales invoice, freight bills etc.) the relevant financial information is determined and will be recorded. From all events and transactions those which are (a) past transactions, (b) measurable reliably in money matters, (c) verifiable (accompanied by valid, legal documents) and (d) have impact on a company's economic resources (assets), obligations (liabilities), or residual interest (stockholders') those are financial accounting transactions and eligible for recording.

   Events can be classified as external or internal. External events are those between the enterprise and its environment, whereas internal events relate to transactions totally within the enterprise.

2. **Journalizing.** Transactions are initially recorded daily in a **journal,** sometimes called as **the book of original entry.** A **general journal** chronologically lists transactions expressed in terms of debits and credits to particular accounts. No distinction is made in a general journal concerning the type of transaction involved. Apart from a general journal, **specialized journals** are used to accumulate transactions that possess common characteristics Cash Journal, Journal of Receivables, Payables.

Exercise 2.14 Closing Journal Entries

Presented below is information from the accounting books of Thomas Corporation for the months of June 2019:

Cost of goods sold	€320,000	Salary expenses	€110,000
Freight-out	1,200	Sales discounts	3,000
Insurance expense	12,500	Sales returns and allowances	14,000
		Sales	457,000

Instructions:

Prepare the necessary closing entries using T-accounts.

Solution:

Sales Returns & Allowances and Sales Discounts may be closed into a) Sales account or into b) Income summary directly. We apply a) closing S D, R&A, into Sales account.

Sales

Dr.	Cr.
Cl 1) 17,000	457,000
Cl 2) 440,000	440,000 EB.
	0

Sales R&A

Dr.	
14,000	Cl 1) 14,000
0	

COGS

Dr.	Cr.
320,000	320,000 (Cl 3)
0	

Freight-out

Dr.	Cr.
1,200	1,200 (Cl 3)
0	

Sales Discounts

Dr.	Cr.
3,000	Cl 1) 3,000
0	

Insurance Exp.

Dr.	Cr.
12,500	12,500 (Cl 3)
0	

Income summary

Dr.	Cr.
Cl 3) 443,700	440,000 (Cl 2)
E.B) NL=3,700	3,700 (Cl 4)
0	

Retained Earnings

Dr.	Cr.
Cl 4) 3,700	
Net Loss	

Salary Exp.

Dr.	Cr.
110,000	110,000 (Cl 3)
0	

Exercise 2.15 Closing Journal Entries

Saxon's Inc. uses periodic inventory system, COGS is calculated at the end of the period. Presented below is information from the accounting books of Saxon Inc. for June 2019:

Cost of goods sold	€400,000	Purchase discounts	€11,000
Freight-in	1,200	Purchase returns & allowances	12,500
Merchandise purchases	323,500	Sales returns & allowances	14,000
Inventory, Beg. Bal.	147,000	Sales	564,000
Inventory, End. Bal.	48,200		

Earnings Per Share – EPS

By many financial statement users earnings per share (EPS) is considered the most significant statistic for measuring business performance which is presented in the financial statements. It expresses the ratio of net income minus preferred dividends (income available to common shareholders) divided by the weighted average number of common shares outstanding. EPS **must be disclosed on the face of the income statement, the basic and diluted ones if it is for a publicly traded corporation.**

Per share amounts for gain or loss on discontinued operations and gain or loss on extraordinary items must be disclosed on the face of the income statement or in the notes to the financial statements.

$$EPS_{basic} = \frac{\text{net income – preferred dividends}}{\text{weighted average common shares outstanding}}$$

$$EPS_{diluted} = \underbrace{\underbrace{\frac{\text{net income – preferred dividends}}{\text{weighted average common shares outstanding}}}_{EPS_{basic}} - \text{impact of convertibles} - \text{impact of options, warrants, and other dilutive securities}}_{EPS_{diluted}}$$

EPS earnings per share figures must be disclosed in the income statement for the following amounts:

1. Income from continuing operations.
2. Discontinued operations.
3. Income before extraordinary items.
4. Extraordinary items.
5. Net income.

Diluted EPS must be also calculated if there are convertible securities, stock options, and stock warrants in the company which may reduce EPS when these securities become common stock.

EPS basic- the best possible results per share

EPS diluted – the worst possible results per share

It shows the interval in which values EPS may be achieved, assuming none anti-diluting items exist.

Formula for EPS diluted contains:

a) in the numerator – the income available to common stockholders adjusted for interest (net of tax) and preferred dividends on dilutive securities,
b) in the denominator – weighted average number of common shares assuming maximum dilution from all dilutive securities.

4 STATEMENT OF RETAINED EARNINGS, OTHER COMPREHENSIVE INCOME, COMPREHENSIVE INCOME

4.1 Retained Earnings

The **statement of retained earnings is a summary disclosure of the changes in the balance of the Retained Earnings account from the beginning to the end of the year.** The statement of retained earnings includes the important information for users, such as information about:

a) income or loss which arose due to corrections of errors in the financial statements of a prior period, they are reported net of tax and they are considered PPA,
b) changes in accounting principle,
c) the relationship of dividend distributions to net income for the period, and
d) any transfers to and from retained earnings.

Statement of Retained Earnings

The following items are disclosed in the retained earnings statement:

1. **Prior period adjustments (PPA)** require adjustments to the beginning balance of retained earnings.
   a) Transactions that are accounted for as prior period adjustments are:
      - correction of errors in financial statements of prior periods,
      - changes in accounting principle.

   b) The entry to record a PPA usually involves the following types of accounts:
      - The retained earnings account,
      - A balance sheet account (e.g., Accumulated depreciation, Inventory etc.).
2. Dividends and net income.
3. Restrictions of retained earnings.

Exercises: solved or to be solved; for your practise

Exercise 4.1 Income Statement

Messi Inc. reported the following information for 2018:

Sales revenue	€25,000,000
Cost of goods sold	10,050,000
Operating expenses	2,055,000
Unrealized holding gain on available-for-sale securities	740,000
Cash dividends received on the securities	122,000
Retained earnings, beg. balance	5,000,000

Instructions:

1. Determine the balance of retained earnings at December 31, 2018 using T-account.

Dr	Retained earnings	Cr

2. What amount would Messi Inc. report as other comprehensive income at the end of 2018?
3. What amount would Messi Inc. report as comprehensive income at the end of 2018?

Exercise 4.2 Percentage-of-Completion and Completed-Contract Method

On February 1, 2018, City Constructions agreed to construct a university complex for Faculty of management, Comenius University at a contract price of €25,000,000. City Constructions estimated total construction costs would be €19,000,000 and the project would be finished in 2020. Information relating to the costs and billings for this contract is as follows:

	2018	2019	2020
Total costs incurred to date	$8,000,000	$14,000,000	$19,000,000
Estimated costs to complete	11,000,000	6,000,000	-0-
Customer billings to date	7,000,000	16,000,000	25,000,000
Collections to date	6,000,000	12,000,000	22,000,000

Instructions:

1. Journalize transactions for the year 2018, 2019, 2020.
2. Prepare the calculation applying percentage of completion methos for the year 2018, 2019, 2020.
3. Prepare partial balance sheet statement for the years 2018, 2019, 2020.

Exercise 5.2 Account Classification

Instructions:

Decide how would you classify the following items shown below choose a proper subcategory for the item? Look at the example what is done for you.

a) Current assets	g) Current liabilities
b) Investments	h) Long-term liabilities
c) Plant and equipment	i) Preferred stock
d) Intangibles	j) Common stock
e) Other assets	k) Additional paid-in capital
f) Retained earnings	l) Items excluded from balance sheet

(a) 0. Cash (current assets subcategory)
_ 1. Bond sinking fund.
_ 2. Common stock distributable.
_ 3. Appropriation for plant expansion.
_ 4. Bank overdraft.
_ 5. Bonds payable (due 2020).
_ 6. Premium on common stock.
_ 7. Securities owned by another company which are collateral for that company's note.
_ 8. Held-to maturity securities (2022).
_ 9. Inventory.
_ 10. Treasury stock.
_ 11. Patents.
_ 12. Advanced payments from customers.

Exercise 5.3 Preparation of a Classified Balance Sheet, Periodic Inventory

Presented below is a list of accounts in an alphabetical order.

Instructions:

1. Discuss individual elements and prepare the proper statement of classified balance sheet.
2. What would the difference be if the company was using perpetual inventory accounting system?

Equity. Residual interest in the assets of an entity that remains after deducting its liabilities. In a business enterprise, the equity is the ownership interest.

Investments by owners. Increases in net assets of a particular enterprise resulting from transfers to it from other entities of something of value to obtain or increase ownership interests (or equity) in it. Assets are most commonly received as investments by owners, but that which is received may include services or satisfaction or conversion of liabilities of the enterprise.

Distributions to owners. Decreases in net assets of a particular enterprise that result from transferring assets, rendering services, or incurring liabilities by the enterprise to owners. Distributions to owners decrease ownership interests (or equity) in an enterprise.

Comprehensive income. Change in equity (net assets) of an entity during a period from transactions and other events and circumstances from nonowner sources. It includes all changes in equity during a period, except those resulting from investments by owners and distributions to owners.

Revenues. Inflows or other enhancements of assets of an entity or settlement of its liabilities (or a combination of both) during a period from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.

Expenses. Outflows or other using up of assets or incurrences of liabilities (or a combination of both) during a period from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations.

Gains. Increases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity during a period except those that result from revenues or investments by owners.

Losses. Decrease in equity (net assets) from peripheral or incidental transactions of an entity from all other transactions and other events and circumstances affecting the entity during a period except those that result from expenses or distributions to owners.

The conceptual framework structure includes *SFAC No. 5, "Recognition and Measurement in Financial Statements." SFAC No. 5 indicates that an information item should meet four fundamental recognition criteria to be recognized in the financial statements:*

1. **Definitions.** The item meets the definition of an element of financial statements.
2. **Measurability.** It has a relevant attribute (e.g., historical cost, current cost etc.) which is measurable with sufficient reliability.
3. **Relevance.** The information is capable of making a difference in user decisions.
4. **Reliability.** The information is representationally faithful, verifiable, and neutral.