

HKAS 1 “Presentation of Financial Statements”
(Relevant to AAT Examination Paper 7: Financial Accounting)
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Introduction

HKAS 1 “Presentation of Financial Statements” sets out overall requirements for presentation of financial statements, guidelines for their structures and minimum requirements for their contents.

HKAS 1 is one of the most frequently examined issues in Paper 7: Financial Accounting. The purpose of this article is to equip students with the particular knowledge and skills required to attempt questions on the preparation and presentation of financial statements for a single entity.

This article includes the amendments issued by the Hong Kong Institute of Certified Public Accountants on 14 July 2011 in respect of the presentation of items of other comprehensive income.

Components of financial statements

This article discusses the following three components of a complete set of financial statements:

- (a) A statement of financial position;
- (b) A statement of profit or loss and other comprehensive income; and
- (c) A statement of changes in equity.

Statement of financial position

A statement of financial position (formerly known as the balance sheet) is the statement showing an entity’s assets, liabilities and equity as at the end of the reporting period.

HKAS 1 requires an entity to present assets and liabilities as non-current and current items in its statement of financial position, except in circumstances when a liquidity-based presentation provides more reliable and relevant information.

Example 1 shows the format of a statement of financial position of a single entity:

Example 1

An entity presents its statement of financial position at 31 December 20X9 as follows:

<i>Statement of Financial Position at 31 December 20X9</i>		
	<i>20X9</i>	<i>20X8</i>
	<i>\$’000</i>	<i>\$’000</i>
<i>ASSETS</i>		
<i>Non-current assets</i>		
<i>Property, plant and equipment</i>	<i>350,700</i>	<i>360,020</i>

<i>Investment property</i>	120,000	100,000
<i>Intangible assets</i>	408,420	429,440
<i>Financial assets — Investments in shares</i>	22,500	56,000
Total non-current assets	<u>901,620</u>	<u>945,460</u>
Current assets		
<i>Inventories</i>	135,230	132,500
<i>Trade receivables</i>	91,600	110,800
<i>Other current assets</i>	25,650	12,540
<i>Cash and cash equivalents</i>	312,400	322,900
Total current assets	<u>564,880</u>	<u>578,740</u>
Total assets	<u>1,466,500</u>	<u>1,524,200</u>
EQUITY AND LIABILITIES		
Equity		
<i>Share capital</i>	650,000	600,000
<i>Share premium</i>	5,000	—
<i>Retained earnings</i>	293,550	210,300
<i>Revaluation reserve</i>	25,200	21,200
Total equity	<u>973,750</u>	<u>831,500</u>
Non-current liabilities		
<i>Bank loans</i>	160,000	180,000
<i>Finance lease liability</i>	18,000	33,000
<i>Long-term provisions</i>	44,550	25,280
Total non-current liabilities	<u>222,550</u>	<u>238,280</u>
Current liabilities		
<i>Trade and other payables</i>	70,200	187,620
<i>Short-term borrowings</i>	140,000	200,000
<i>Current portion of bank loans</i>	20,000	20,000
<i>Current portion of finance lease liability</i>	15,000	12,000
<i>Current tax payable</i>	20,000	30,000
<i>Short-term provisions</i>	4,000	4,000
<i>Bank overdrafts</i>	1,000	800
Total current liabilities	<u>270,200</u>	<u>454,420</u>
Total liabilities	<u>492,750</u>	<u>692,700</u>
Total equity and liabilities	<u>1,466,500</u>	<u>1,524,200</u>

Statement of profit or loss and other comprehensive income

A statement of profit or loss and other comprehensive income shows the total comprehensive income earned during a reporting period. Total comprehensive income is defined in HKAS 1 as the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners.

HKAS 1 provides that an entity may use the title “statement of comprehensive

income” instead of “statement of profit or loss and other comprehensive income”. The title “statement of comprehensive income” is used throughout this article.

A statement of comprehensive income is commonly presented in a single statement, with profit or loss and other comprehensive income shown in two sections. The sections are presented together, with the profit or loss section first followed directly by the other comprehensive income:

(a) Profit or loss

The profit or loss is the total of income less expenses, excluding the components of other comprehensive income.

The profit or loss section should be presented based on the function of expenses. Under this method, expenses are classified according to their function as part of cost of sales, distribution or administrative activities, or financing.

(b) Other comprehensive income section

Other comprehensive income comprises items of income and expenses that are not recognized in profit or loss as required or permitted by other HKFRSs. This includes changes in revaluation surpluses on non-current assets (see HKAS 16 “Property, Plant and Equipment”), and exchange differences arising from translating the financial statements of a foreign operation (see HKAS 21 “The Effects of Changes in Foreign Exchange Rates”).

Example 2 shows the single-statement format of a statement of comprehensive income of a single entity:

Example 2

An entity presents its statement of comprehensive income for the year ended 31 December 20X9 using a single-statement format as follows:

Statement of comprehensive income for the year ended 31 December 20X9		
	20X9	20X8
	\$'000	\$'000
Revenue	390,000	355,000
Cost of sales	(245,000)	(230,000)
Gross profit	145,000	125,000
Other income	55,767	41,400
Distribution costs	(9,000)	(8,700)
Administrative expenses	(20,000)	(21,000)
Other expenses	(2,100)	(1,200)
Finance costs	(8,000)	(7,500)
Profit before tax	161,667	128,000
Income tax expense	(40,417)	(32,000)
Profit for the year	121,250	96,000
Other comprehensive income:		
Gains on property revaluation	4,000	3,367
Other comprehensive income for the year, net of tax	4,000	3,367

Total comprehensive income for the year	125,250	99,367
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Statement of changes in equity

An entity is required to present a statement of changes in equity that includes the following information:

- (a) total comprehensive income for the period;
- (b) for each component of equity, the effects of retrospective application or retrospective restatement recognized in accordance with HKAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”; and
- (c) for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period.

The component of equity includes, for example, share capital, share premium, retained earnings, and each class of other comprehensive income (e.g. revaluation reserve, exchange reserve).

An entity shall also present in the statement of changes in equity the amount of dividends recognized as distribution to owners during the period.

Example 3 shows the format of a statement of changes in equity of a single entity:

Example 3

An entity presents its statement of changes in equity for the year ended 31 December 20X9 as follows:

Statement of changes in equity for the year ended 31 December 20X9					
	Share capital \$'000	Share premium \$'000	Retained earnings \$'000	Revaluation reserve \$'000	Total \$'000
Balance at 1 January 20X9	600,000	-	210,600	21,200	791,700
Changes in accounting policy			(300)		300
Restated balance	600,000	-	210,300	21,200	831,500
Changes in equity for the year					
Issue of share capital	50,000	5,000			55,000
Dividends			(38,000)		(38,000)
Total comprehensive income for the			121,250	4,000	125,250

year

Balance at 31 December 20X9	650,000	5,000	293,550	25,200	973,750
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Techniques for the preparation of financial statements

The basic principle for preparation of financial statements is to classify the items from the trial balance into the appropriate components of financial statements involving some adjustments like closing inventories, depreciation, doubtful debts, accruals and prepayments. The techniques required for the preparation of financial statements will vary with different circumstances but basically follow these steps:

Step 1: Record the items not included in the trial balance

Most examination questions provide additional information which shows items not included in the trial balance. You are expected to review this information in order to make adjustments to items such as property, plant and equipment, intangible assets, leases, provisions, borrowing costs, and so on.

Step 2: Classify and present the items in the appropriate headings

Next you need to classify the items under the appropriate headings. At this level, you need to be familiar with the following issues:

- Separate the items into their current and non-current portions, e.g. bank borrowings, lease obligations.
- Review cash and cash equivalents and make sure that bank overdrafts are presented under current liabilities.
- Present the dividend paid in the statement of changes in equity rather than in the statement of comprehensive income.
- Identify other comprehensive income from the trial balance and present it in the bottom section of statement of comprehensive income.
- Identify opening and closing inventory. Opening inventory can usually be found in the trial balance while closing inventory can be obtained from the additional information.

Step 3: Prepare necessary workings

To work out the figures in the financial statements, you need to prepare necessary workings such as cost of sales, administrative expenses, distribution costs, property, plant and equipment and so on.

Step 4: Prepare the financial statements

This final step requires you to write up the financial statements showing the main headings, then work through the figures in the question line by line and put them in the correct positions.

Comprehensive example

The following example is modified from the AAT June 2010 examination. It demonstrates the techniques required to prepare the financial statements of an entity in accordance with the requirements of HKAS 1.

The following trial balance relates to Elite Ltd. as at 31 December 2009:

	Debit	Credit
	<u>\$'000</u>	<u>\$'000</u>
Sales revenue		339,441
Rental income		9,000
Inventory as at 1 January 2009	32,500	
Purchases	207,500	
Distribution expenses	27,000	
Other expenses	5,200	
Administrative expenses	36,000	
Finance costs	2,050	
Interim dividend paid – ordinary shares	500	
25-year leasehold building, at cost – purchased on 1 January 2009	62,000	
36-year leasehold building, at cost – purchased on 1 January 2006	72,000	
Plant and equipment, at cost	12,800	
Accumulated depreciation as at 1 January 2009		
– 36-year leasehold building		6,000
– plant and equipment		1,200
Rental charge	300	
Accounts receivable	40,850	
Accounts payable		29,000
Bank borrowings		19,600
Cash and cash equivalents	5,441	
Ordinary shares of \$1 each		55,000
Retained earnings		41,400
Exchange gain on translating foreign operations		2,500
Gain on disposal of plant		1,000
Total	<u>504,141</u>	<u>504,141</u>

The following information is relevant:

- (1) From 1 January 2009, Elite Ltd. used the newly acquired building for its own operation and leased out its 36-year leasehold building, which has been occupied by the company's own operation since acquisition, to an outside party. The directors of Elite Ltd. have decided to account for all of its properties at valuation. Results of valuation as at 31 December 2009 are as follows:

25-year leasehold building	\$80,000,000
36-year leasehold building	\$62,000,000

Both depreciation and fair value change of leasehold building are to be included under administrative expenses.

- (2) The depreciation of plant and equipment is on straight-line basis at 10% per annum, and the depreciation amount is to be included under distribution expenses. No depreciation is charged for plant and equipment disposed of during the year.

- (3) The rental charge of \$300,000 represents the first two payments of \$150,000 each out of the ten payments for a five-year lease of equipment. Payments were made on 1 January 2009 and 1 July 2009 respectively. The fair value of this equipment at inception of the lease on 1 January 2009 was \$1,200,000 which was equal to the present value of the total minimum lease payments.

Information obtained from the treasury department confirmed that this should be a finance lease at a rate of interest of 10% per annum. The company needs to reclassify the lease and has decided to depreciate the leased asset over the term of the lease. The depreciation amount is included under administrative expenses.

- (4) A customer has made a claim against the company for injury suffered due to its product. Legal advisers have confirmed that the company will probably have to pay damages of \$700,000 because of a deficiency in the product design.

- (5) The breakdown of cash and cash equivalents at 31 December 2009 is as follows:

Cash at bank	\$5,680,000
Cash in hand	\$561,000
Bank overdrafts	\$800,000

- (6) The breakdown of bank borrowings at 31 December 2009 is as follows:
(a) Mortgage loan: \$10,000,000. The loan amounted to \$11,000,000 and was obtained on 1 January 2009. The annual repayment of the principal is \$1,000,000.
(b) Short-term borrowings: \$9,600,000.

- (7) The inventory at 31 December 2009 was valued at \$55,670,000.

- (8) A tax provision of \$25,000,000 is required for the year to 31 December 2009.

Required:

- (a) Referring to note (3) above, prepare the lease amortization schedule for 2009 and 2010.
- (b) Prepare the following statements for Elite Ltd:
- (i) Statement of comprehensive income for the year ended 31 December 2009, using a single-statement format.
 - (ii) Statement of financial position as at 31 December 2009.
 - (iii) Statement of changes in equity for the year ended 31 December 2009.

Round your answers up to thousands of dollars. Presentation of the statements should comply with the format required under HKAS 1 "Presentation of Financial Statements".

Solution:

(a) Lease amortization schedule

Period	Opening obligation	Lease payment	Sub-total	Finance charge	Closing obligation
	\$'000	\$'000	\$'000	\$'000	\$'000
1.1.2009	1,200	150	1,050	52	1,102
1.7.2009	1,102	150	952	48	1,000
1.1.2010	1,000	150	850	43	893
1.7.2010	893	150	743	37	780

(b) Financial statements

Step 1: Record the items not included in the trial balance

Here, you need to know the accounting treatments of various items such as property, plant and equipment (PPE), investment property (IP) provisions and so on. In this example, the following adjustments are required:

(a) 25-year leasehold building

Reflecting the revaluation of the 25-year leasehold building:

	Dr.	Cr.
	\$'000	\$'000
Administrative expenses – depreciation	2,480	
Accumulated depreciation \$62,000/25 years		2,480
Record the depreciation for 2009		
Accumulated depreciation	2,480	
PPE – leasehold building	18,000	
Revaluation reserve		20,480
Record gain on revaluation of leasehold building		

(b) 36-year leasehold building

Reflecting the change of usage from PPE to investment property:

	Dr.	Cr.
	\$'000	\$'000
Investment property	62,000	
Accumulated depreciation	6,000	
Administrative expenses – loss on fair value of IP	4,000	
PPE – leasehold building		72,000
Record the loss on fair value of IP from a transfer		

(c) Plant and equipment

Adjustment for the depreciation of plant and equipment:

	Dr.	Cr.
	\$'000	\$'000
Distribution costs – depreciation	1,280	
Accumulated depreciation \$12,800 x 10%		1,280
Record the depreciation for 2009		

(d) Leased equipment

Dr.	Cr.
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	\$'000	\$'000
Finance lease equipment	1,200	
Finance lease liability		1,200
Record leased equipment and obligation at the inception of the finance lease contract		
Administrative expenses – depreciation	240	
Accumulated depreciation \$1,200 / 5		240
Record the depreciation for 2009		
Finance costs \$52 + \$48	100	
Finance lease liability	248	
Rental charge		300
Accrued interest		48
Record adjustment of lease payment for 2009		

(e) Provision for claims

Since the legal advisors have confirmed that the company will probably have to pay the damages, a provision for claims is required.

	Dr.	Cr.
	\$'000	\$'000
Cost of sales	700	
Provision for claims		700
Record the provision for claims		

(f) Provision for tax

The journal entry for provision of tax is as follows:

	Dr.	Cr.
	\$'000	\$'000
Income tax expense	25,000	
Current tax payable		25,000
Record the provision for tax		

Step 2: Classify and present the items in the appropriate headings

(a) Bank borrowings and finance lease liability are reclassified into current and non-current liabilities as follows:

	\$'000
<i>Non-current liabilities</i>	
Finance lease liability	742
Bank borrowings (\$10,000 – \$1,000)	9,000
<i>Current liabilities</i>	
Current portion of finance lease liability (\$952 – \$742)	210
Current portion of bank borrowings (\$9,600 + \$1,000)	10,600

(b) The bank overdrafts in the cash and cash equivalents are presented as current liabilities.

(c) The interim dividend paid and shown in the trial balance is presented in the statement of changes in equity.

- (d) Gain on property revaluation and exchange gain on translating foreign operations are other comprehensive income to be presented in the bottom section of the statement of comprehensive income.

Step 3: Prepare necessary workings

(1) Cost of sales

	\$'000
Opening inventory	32,500
Add : Purchases	207,500
Provision for claims	700
Less : Closing inventory	(55,670)
	<u>185,030</u>

(2) Distribution costs

	\$'000
Per trial balance	27,000
Depreciation for plant and equipment \$12,800 x 10%	1,280
	<u>28,280</u>

(3) Administrative expenses

	\$'000
Per trial balance	36,000
Depreciation of 25-year leasehold building \$62,000/25 years	2,480
Depreciation of leased equipment \$1,200/ 5 years	240
Loss in fair value of 36-year leasehold building	4,000
	<u>42,720</u>

(4) Finance costs

	\$'000
Per trial balance	2,050
Finance charge for leased equipment \$52 + \$48	100
	<u>2,150</u>

(5) Property, plant and equipment

	Leasehold building	Plant and equipment	Total
Cost	\$'000	\$'000	\$'000
At 1.1.2009	134,000	12,800	146,800
Addition	-	1,200	1,200
Reclassification	(72,000)		(72,000)
Revaluation	18,000		18,000
At 31.12.2009	<u>80,000</u>	<u>14,000</u>	<u>94,000</u>
Accumulated depreciation			
At 1.1.2009	6,000	1,200	7,200
Charge for the year	2,480	1,520	4,000
Reclassification	(6,000)	-	(6,000)
Revaluation	(2,480)	-	(2,480)
At 31.12.2009	<u>-</u>	<u>2,720</u>	<u>2,720</u>

Carrying amount			
At 31.12.2009	80,000	11,280	91,280
At 31.12.2008	128,000	11,600	139,600

(6) Retained earnings

		\$'000
Retained earnings at 1.1.2009		41,400
Add: Profit for the year		61,061
Less: Interim dividend paid		(500)
		<u>101,961</u>

Step 4: Prepare the financial statements

Elite Limited
Statement of comprehensive income for the year ended 31 December 2009

	\$'000
Sales revenue	339,441
Cost of sales (working 1)	<u>(185,030)</u>
Gross profit	154,411
Other income (\$9,000 + \$1,000)	10,000
Distribution costs (working 2)	(28,280)
Administrative expenses (working 3)	(42,720)
Other expenses	(5,200)
Finance costs (working 4)	<u>(2,150)</u>
Profit before tax	86,061
Income tax expense	<u>(25,000)</u>
Profit for the year	<u>61,061</u>
Other comprehensive income:	
Gain on property revaluation	20,480
Exchange gain on translating foreign operations	<u>2,500</u>
Other comprehensive income for the year, net of tax	<u>22,980</u>
Total comprehensive income for the year	<u><u>84,041</u></u>

Elite Limited
Statement of financial position as at 31 December 2009

	\$'000
ASSETS	
Non-current assets	
Property, plant and equipment (working 5)	91,280
Investment property	<u>62,000</u>
	<u>153,280</u>
Current assets	
Inventory	55,670

Accounts receivable	40,850
Cash and cash equivalents (\$5,680 + \$561)	6,241
	<u>102,761</u>
Total assets	<u><u>256,041</u></u>
EQUITY AND LIABILITIES	
Equity	
Ordinary shares at \$1 each	55,000
Retained earnings (working 6)	101,961
Revaluation reserve	20,480
Exchange gain on translating foreign operations	2,500
Total equity	<u><u>179,941</u></u>
Non-current liabilities	
Finance lease liability	742
Bank borrowings (\$10,000 – \$1,000)	9,000
Total non-current liabilities	<u><u>9,742</u></u>
Current liabilities	
Accounts payable	29,000
Current portion of finance lease liability	210
Current portion of bank borrowings (\$9,600 + \$1,000)	10,600
Accrued interest	48
Current tax payable	25,000
Short-term provisions – provision for claims	700
Bank overdraft	800
Total current liabilities	<u><u>66,358</u></u>
Total equity and liabilities	<u><u>256,041</u></u>

Elite Limited
Statement of changes in equity for the year ended 31 December 2009

	Share capital \$'000	Retained earnings \$'000	Revaluation reserve \$'000	Exchange reserve \$'000	Total \$'000
Balance at 1 January 2009	55,000	41,400	-	-	96,400
Changes in equity for the year					
Total comprehensive income for the year		61,061	20,480	2,500	84,041
Interim dividends paid		(500)			
Balance at 31 December 2009	55,000	101,961	20,480	2,500	179,941

Conclusion

Students sitting the Paper 7 examination must be able to prepare a statement of comprehensive income, a statement of financial position and a statement of changes in equity in accordance with HKAS 1. In particular, they must be aware that other comprehensive income should be presented in the bottom section of a statement of comprehensive income using a single-statement format.