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About ExPress Notes

We are very pleased that you have downloaded a copy of our ExPress notes for this paper. We expect that you are keen to get on with the job in hand, so we will keep the introduction brief.

First, we would like to draw your attention to the terms and conditions of usage. It’s a condition of printing these notes that you agree to the terms and conditions of usage. These are available to view at www.theexpgroup.com. Essentially, we want to help people get through their exams. If you are a student for the ACCA exams and you are using these notes for yourself only, you will have no problems complying with our fair use policy.

You will however need to get our written permission in advance if you want to use these notes as part of a training programme that you are delivering.

WARNING! These notes are not designed to cover everything in the syllabus!

They are designed to help you assimilate and understand the most important areas for the exam as quickly as possible. If you study from these notes only, you will not have covered everything that is in the ACCA syllabus and study guide for this paper.

Components of an effective study system

On ExP classroom courses, we provide people with the following learning materials:

- The ExPress notes for that paper
- The ExP recommended course notes / essential text or the ExPedite classroom course notes where we have published our own course notes for that paper
- The ExP recommended exam kit for that paper.
- In addition, we will recommend a study text / complete text from one of the ACCA official publishers, but we do not necessarily give this as part of a classroom course, as we think that it can sometimes slow people down and reduce the time that they are able to spend practising past questions.

ExP classroom course students will also have access to various online support materials, including:

- The unique ExP & Me e-portal, which amongst other things allows “view again” of the classroom course that was actually attended.
- ExPand, our online learning tool and questions and answers database
Everybody in the World has free access to ACCA’s own database of past exam questions, answers, syllabus, study guide and examiner’s commentaries on past sittings. This can be an invaluable resource. You can find links to the most useful pages of the ACCA database that are relevant to your study on ExPand at www.theexpgroup.com.

How to get the most from these ExPress notes

For people on a classroom course, this is how we recommend that you use the suite of learning materials that we provide. This depends where you are in terms of your exam preparation for each paper.

<table>
<thead>
<tr>
<th>Your stage in study for each paper</th>
<th>These ExPress notes</th>
<th>ExP recommended course notes, or ExPedite notes</th>
<th>ExP recommended exam kit</th>
<th>ACCA online past exams</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prior to study, e.g. deciding which optional papers to take</td>
<td>Skim through the ExPress notes to get a feel for what’s in the syllabus, the “size” of the paper and how much it appeals to you.</td>
<td>Don’t use yet</td>
<td>Don’t use yet</td>
<td>Have a quick look at the two most recent real ACCA exam papers to get a feel for examiner’s style.</td>
</tr>
<tr>
<td>At the start of the learning phase</td>
<td>Work through each chapter of the ExPress notes in detail before you then work through your course notes. Don’t try to feel that you have to understand everything — just get an idea for what you are about to study. Don’t make any annotations on the ExPress notes at this stage.</td>
<td>Work through in detail. Review each chapter after class at least once. Make sure that you understand each area reasonably well, but also make sure that you can recall key definitions, concepts, approaches to exam questions, mnemonics, etc.</td>
<td>Nobody passes an exam by what they have studied—we pass exams by being efficient in being able to prove what we know. In other words, you need to have effectively input the knowledge and be effective in the output of what you know. Exam practice is key to this. Try to do at least one past exam question on the learning phase for each major chapter.</td>
<td>Don’t use at this stage.</td>
</tr>
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<td><strong>Practice phase</strong></td>
<td>Work through the ExPress notes again, this time <strong>annotating</strong> to explain bits that you think are easy and be brave enough to cross out the bits that you are confident you'll remember without reviewing them.</td>
<td><strong>Avoid reading through</strong> your notes again. Try to focus on doing past exam questions first and then go back to your course notes/ExPress notes if there’s something in an answer that you don’t understand.</td>
<td><strong>This is your most important tool</strong> at this stage. You should aim to have worked through and understood at least two or three questions on each major area of the syllabus. You pass real exams by passing mock exams. Don’t be tempted to fall into “passive” revision at this stage (e.g. reading notes or listening to CDs). Passive revision tends to be a waste of time.</td>
<td>Download the two most recent real exam questions and answers. Read through the technical articles written by the examiner. Read through the two most recent examiner’s reports in detail. Read through some other older ones. Try to see if there are any recurring criticisms he or she makes. You must avoid these!</td>
</tr>
<tr>
<td><strong>The night before the real exam</strong></td>
<td><strong>Read through the ExPress notes in full.</strong> Highlight the bits that you think are important but you think you are most likely to forget.</td>
<td>Unless there are specific bits that you feel you must revise, avoid looking at your course notes. Give up on any areas that you still don’t understand. It’s too late now.</td>
<td><strong>Don’t touch it!</strong></td>
<td>Do a final review of the two most recent examiner’s reports for the paper you will be taking tomorrow.</td>
</tr>
<tr>
<td><strong>At the door of the exam room before you go in.</strong></td>
<td><strong>Read quickly through the full set of ExPress notes</strong>, focusing on areas you’ve highlighted, key workings, approaches to exam questions, etc.</td>
<td><strong>Avoid looking at them in detail, especially if the notes are very big. It will scare you.</strong></td>
<td><strong>Leave at home.</strong></td>
<td><strong>Leave at home.</strong></td>
</tr>
</tbody>
</table>
Our ExPress notes fit into our portfolio of materials as follows:

- **ExPress Notes**
  - Provide a base understanding of the most important areas of the syllabus only.

- **Exedite Notes**
  - Provide a comprehensive coverage of the syllabus and accompany our face to face professional exam courses.

- **Expert Notes**
  - Provide detailed coverage of particular technical areas and are used on our Professional Development and Executive Programmes.

To maximise your chances of success in the exam we recommend you visit www.theexpgroup.com where you will be able to access additional free resources to help you in your studies.

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**START**

**About The ExP Group**

Born with a desire to be the leading supplier of business training services, the ExP Group delivers courses through either one of its permanent centres or onsite at a variety of locations around the world. Our clients range from multinational household corporate names, through local companies to individuals furthering themselves through studying for one of the various professional exams or professional development courses.

As well as courses for ACCA and other professional qualifications, our portfolio of expertise covers all areas of financial training ranging from introductory financial awareness courses for non-financial staff to high level corporate finance and banking courses for senior executives.

Our expert team has worked with many different audiences around the world ranging from graduate recruits through to senior board level positions.

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Chapter 1

The Conceptual Framework

START
The Big Picture

IFRS provides a series of accounting rules that should enhance understandability and consistency of financial statements. However, these rules cannot possibly cover every type of accounting transaction that could ever happen.

To give guidance on what to do with situations that are not covered by a standard, the Framework exists.

The Framework document does not have the status of an IFRS and if there is any conflict between the Framework and a specific provision in an IFRS, the IFRS prevails.

The Framework also provides an underlying logic for the development of new IFRS. This means that each IFRS should define an asset or a gain in the same way, for example. This is a marked difference from the historical tendency for accounting standards to be developed in a piecemeal way, sometimes called a “patchwork quilt”.

The Framework document starts by discussing what characteristics financial information needs to have and defining some of these key concepts.
KEY DEFINITIONS

Qualitative characteristics of financial information

Understandability  An essential quality of the information provided in financial statements is that it is readily understandable by users. For this purpose, users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand.

Relevance  To be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

Reliability  To be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.

Comparability  Users must be able to compare the financial statements of an entity through time in order to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different entities in order to evaluate their relative financial position, performance and changes in financial position. Hence, the measurement and display of the financial effect of like transactions and other events must be carried out in a consistent way throughout an entity and over time for that entity and in a consistent way for different entities.
Elements of financial statements

All financial information, whether presented in the balance sheet (now called “statement of financial position”), profit statement or wherever is made up of five elements of financial statements. These definitions are worth knowing well, as their application comes up again and again in understanding IFRS.

Asset
A resource that is both controlled by an entity and is expected to produce future economic benefits that will flow to the entity.

Liability
A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Equity
The residual interest in the assets of the entity after deducting all its liabilities.

Note: Assets – liabilities = equity = capital + reserves

This mathematical identity comes in very handy when preparing group financial statements.

Income
Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

Expenses
Decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Recognition criteria

For an item to be recognised in the financial statements, it must pass the recognition criteria (Framework, paragraph 83):

- It meets the definition of one of the five elements of financial statements, and
- (if an asset) it is probable that any economic benefit it will generate will flow to the entity, and
- It can be given a monetary value with reasonable reliability.
**True and fair view**

This phrase is not defined by the IASB in any IFRS or the Framework document, although it is a core concept. This is probably to allow a little latitude in its interpretation between companies.

Broadly, it means that if an entity complies with all extant IFRS, then its financial statements will give a true and fair view.

True tends to be more objective (e.g. did the reported transaction actually happen?) and fair tends to mean neutral and unbiased. For example, an allowance for doubtful debts cannot logically be described as true, since it’s an estimate and it involves opinion. It can, however, be described as fairly stated.

Very exceptionally, it may be necessary for a reporting entity to depart from the rules of IFRS in order to present a true and fair view. This is often called the “true and fair override”. This is more likely to happen in very specialist industries. Where this does happen, the reporting entity must report the particular reason and financial effect of the failure to comply with IFRS.

This allows the reader to make up their own mind as to whether the departure from IFRS rules was necessary.

**Valuation of assets and profit**

For the paper F7 exam, you need only a brief overview of the limitations of historical cost accounting.

Historical cost accounting has these principal advantages:

- Relatively easy to understand;
- Easy to audit;
- Simple to apply.

In times of low inflation, this means that historical cost accounting works well. However, in periods of higher inflation, or for transactions with a long life (e.g. plant with a 40 year life) it has some significant limitations, including:

- Matching today’s revenues with yesterday’s costs, thus overstating profit;
- Giving out of date asset valuations;
- Not recording gains where companies are able to hold net trade payables (assuming the payables don’t bear interest);
- Comparatives are misleading, since not expressed in a stable monetary unit;
- Long-term apparent growth can be overstated, due to the compounding effect of inflation.
Possible remedies include:

- Inflation adjusting all figures in the SOCI to year-end values. This is essentially what IAS 29 Hyperinflation requires where inflation exceeds 100% over a three year period.
- Adopting an alternative base of preparation of the financial statements, such as operating capital maintenance.

**Capital maintenance concepts**

Capital maintenance means preserving the initial value of an investor’s investment. This is done using either the **financial capital maintenance concept** or the **operating capital maintenance concept**. Historical cost accounting is the simplest form; being financial capital maintenance with no adjustment for inflation.

Financial capital maintenance means preserving the general purchasing power of an investor’s initial investment. Adjustments will be made using the general rate of inflation.

Operating capital maintenance means preserving the ability of the business to continue trading at its current level. Inflation adjustments are specific to the industry in which it operates. **Current cost accounting** (also known as “replacement cost accounting”) uses this method of capital maintenance.
IAS 1: Presentation of Financial Statements

IAS 1 is a cornerstone accounting standard that includes:

- Components of financial statements;
- Core concepts;
- True and fair override.

It is virtually certain to be tested in the ACCA paper F7 exam.
Components of financial statements

A full set of IFRS financial statements comprises the following primary statements (ie statements that must be shown with equal prominence as each other):

- Statement of financial position (previously called balance sheet);
- Statement of comprehensive income (comprising profit and loss statement and statement of other comprehensive income);
- Statement of changes in equity;
- Statement of cash flows;
- Comparative data for the previous year for each of the above.

In addition, secondary statements are required being notes that explain the accounting policies and other significant explanations or useful “drill down” information.

Question 2 of the F7 exam is likely to require presentation of financial statements from a trial balance with adjustments. A starting point in the exam is to be able to produce a skeleton set of which financial statements are required from memory.

It’s therefore necessary to memorise the formats on the following pages.

Core concepts

IAS 1 includes a number of core concepts, with some overlap with the Framework document.

- Fair presentation – fair, neutral description of transactions.
- Going concern – entity assumed to continue trading into the foreseeable future.
- Accruals (matching) basis of accounting – match costs with associated revenues and items to the time period incurred.
- Consistency of presentation – present similar transactions the same way within the current year and year by year.
- Materiality and aggregation – no need to present information about immaterial transactions, but aggregate transactions with similar characteristics instead.
- Offsetting - offset as little as possible.
• Frequency of reporting – normally annually but can be shorter if necessary and certain disclosures made.

• Comparative information – comparative information must be provided and presented in such a way as to make comparison easy (eg use the same accounting policies in both years. This is further developed in IAS 8).

**True and fair override**

Paragraph 23 of IAS 1 gives details of what to do in the "extremely rare" circumstance when compliance with IFRS will fail to give a true and fair view.

This requires full disclosure of the particulars, reason and effect of the failure to follow all extant IFRS.
**Substance over Form**

The Framework document and IAS 1 both state that for information to be reliable, it must be reported in accordance with its commercial substance, rather than strictly in adherence to its legal form.

We have already encountered one example of substance over form in the context of finance leases, where a reporting entity records assets held under a finance lease in the SOFP, although it’s not owned by them.

In substance, the degree of control means it’s “their” asset although legally it quite possibly never is.