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IAS® Standard 34 Interim Financial Reporting

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CASE STUDY - IAS 34 INTERIM FINANCIAL REPORTING

Introduction

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

The Case Information

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

- Sales

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

- Only at the end of the second quarter and at the end of the year physical inventory count is carried out in the company. The gross profit margin of the company is usually at the level of 25% of the gross sales. The gross profit realized at the end of the second quarter is 27%. At the end of the year, the gross profit was 26%.

- The company's largest customer placed orders that will result in sales revenue of CU 400,000 in the first quarter, CU 300,000 in the second quarter, CU 420,000 in the third quarter and CU 250,000 in the fourth quarter. The company gives a 5% discount to its customer if it exceeds the annual purchase worth CU 1,000,000 of goods. The customer exceeded this amount last year and is expected to exceed it this year.

- At the end of the second quarter, a net realizable value adjustment of CU 120,000 is required for inventories due to market conditions. This market-driven situation disappeared at the end of the year.
- At the end of the third quarter, the market value of inventories decreased by CU 55,000. This inventories value increases by CU 60,000 at the end of the fourth quarter.
- CU 50,000 was paid in the 2nd quarter for a promotional event to take place in the 3rd quarter.
- At the beginning of the first quarter, factory annual maintenance and necessary replacements (such as factory chimney air filter) were carried out and CU 90,000 was paid.
- If the targeted sales figures are reached, the company gives a bonus to the managers. Target sales figures are CU 4,000,000 per year and expected sales targets are expected to be met from Q1. The amount of bonus to be distributed to managers at the end of the year is CU 100,000.

Discussion Questions

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

SOLUTION OF CASE STUDY – IAS 34 INTERIM FINANCIAL REPORTING

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

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

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

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

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

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

β Cost of Goods Sold

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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