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IAS® Standard 34 Interim Financial Reporting

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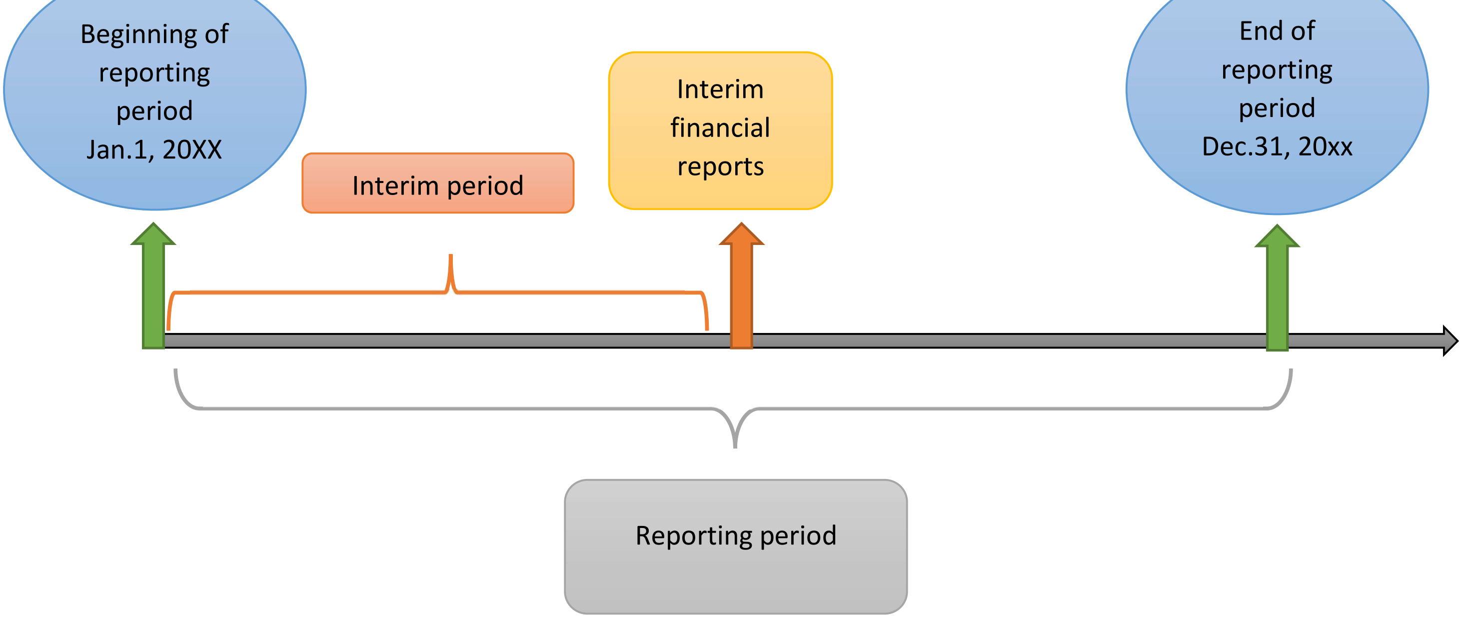
IAS® Standard 34 Interim Financial Reporting

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. Figure 1 shows the period of interim financial reports.

Figure 1. Period of Interim Financial Reports



Using the interim financial results, it is possible for users of the financial statements to make estimations about the annual results of the entities. Another benefit of interim financial reports for users is that they provide the opportunity to see seasonal effects and trends that are not observed in annual financial statements. Thus, information about the future performance of the entities is provided to the users of the financial statements. Interim financial statements are usually issued on a quarterly (three months) or semi-annually (six months) basis.

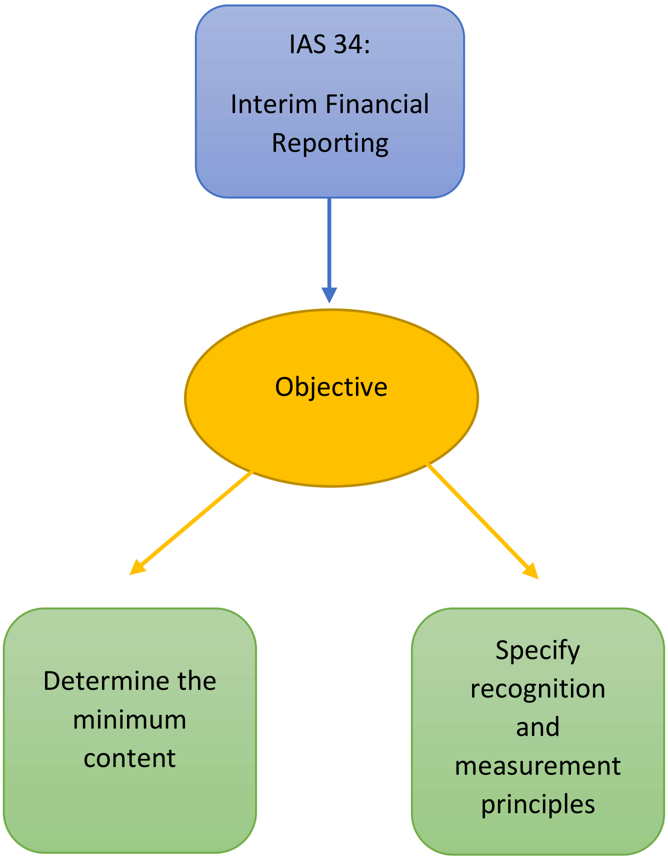
SCOPE AND KEY DEFINITIONS

The IAS 34 has two main purposes:

- Determine the minimum content that interim financial reports should have and
- To specify the recognition and measurement principles in the condensed or detailed financial statements issued in the interim period.

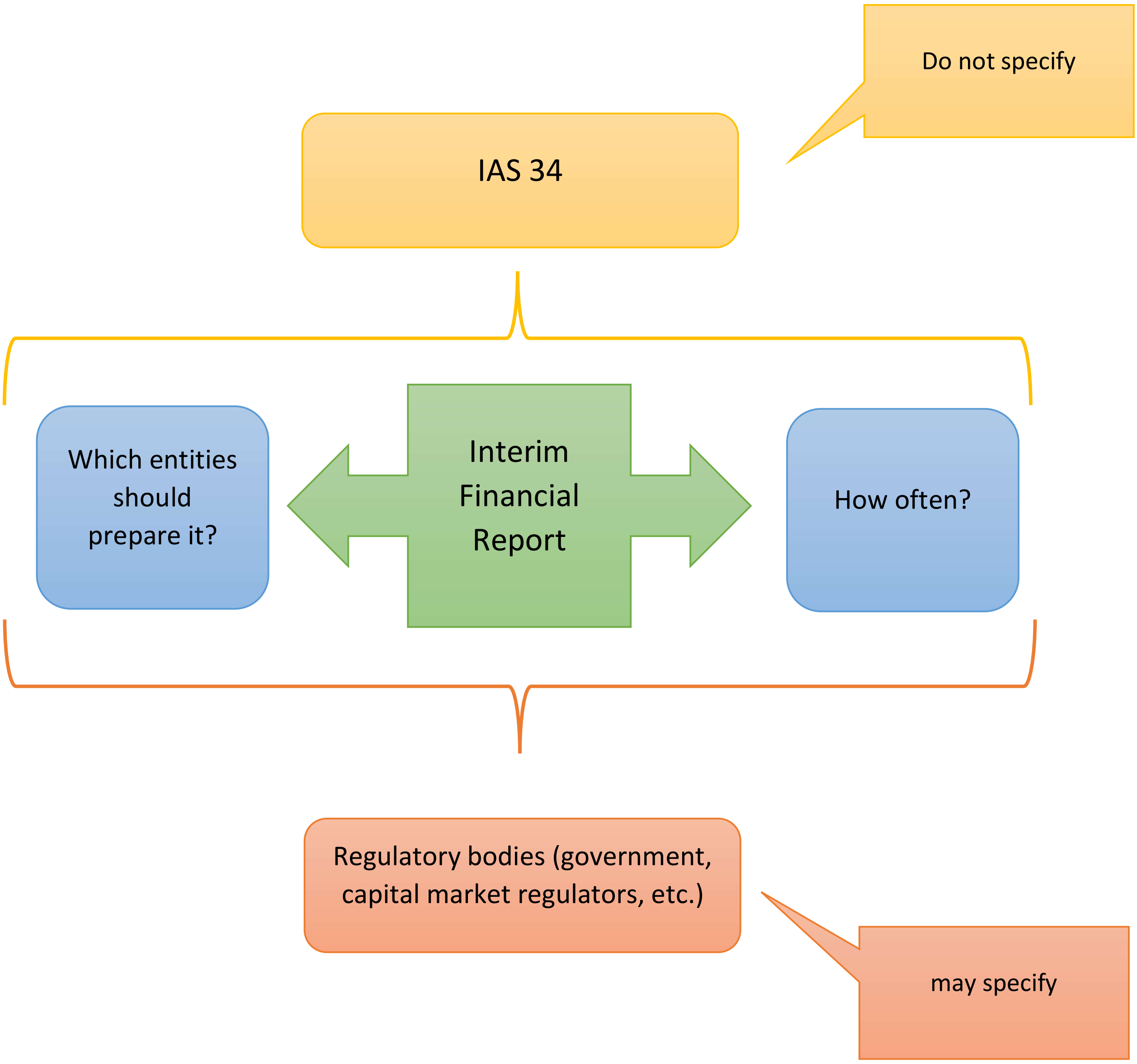
Figure 2 presents the objectives of interim financial reports.

Figure 2. Objectives of Interim Financial Reports



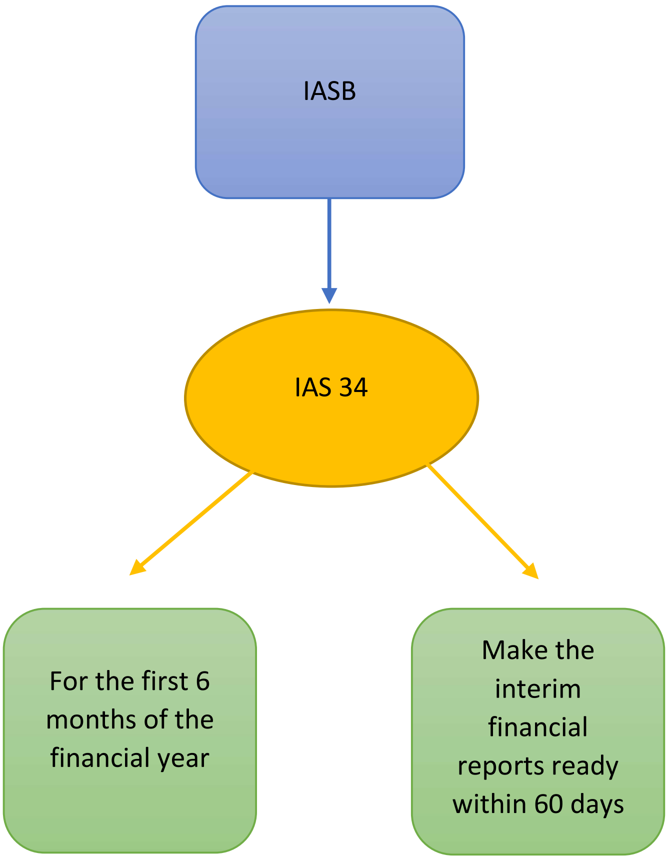
Entities that will apply this standard must be required to do interim reporting or have voluntarily chosen to do interim financial reporting. The standard does not specify which or how often entities are required to prepare and issue interim financial reports. However, although the standard does not specify entities that are required to prepare interim financial reports, there may be regulatory bodies that require the preparation of interim financial reports. Entities that need to prepare interim financial reports are generally those whose debt and equity instruments have been publicly traded. Therefore, the government, capital market regulators, stock exchanges and accounting regulators may require entities to prepare interim financial reports. Figure 3 presents the entities that are required to prepare and issue interim financial reports or how often they are required to issue interim financial reports.

Figure 3. Preparation and publication of interim financial statements



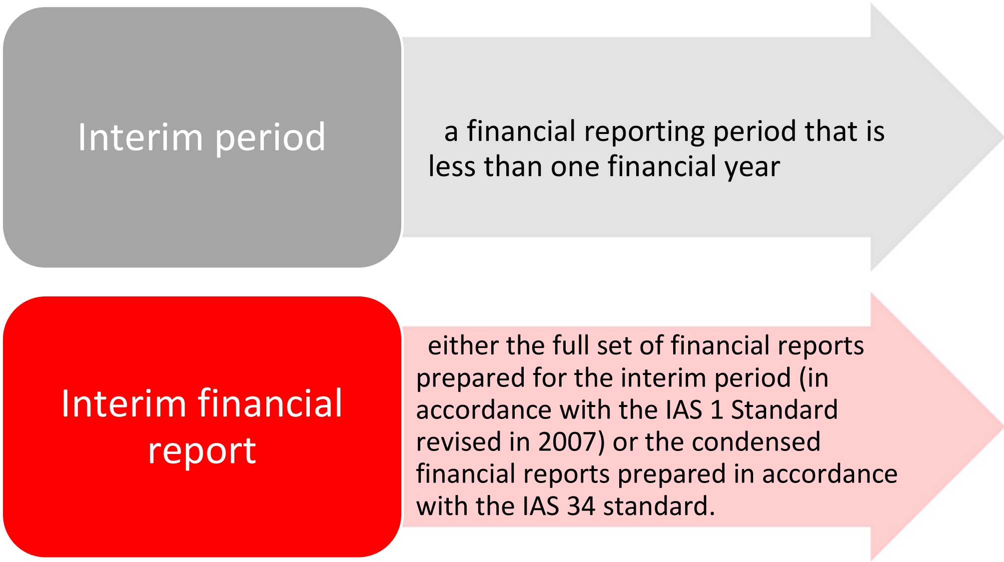
The International Accounting Standards Board (IASB) is not mandating to prepare interim financial reports but encourages publicly traded companies to prepare interim financial reports. Two issues that the IASB encourages are: preparation of interim financial statements for the first 6 months of the financial year and to make the interim financial reports ready within 60 days at the latest after the end of the interim period. Figure 4 summarizes the IASB's approach to interim financial reporting.

Figure 4. IASB's Approach to Interim Financial Reporting



For a better understanding of the standard, it is necessary to know the meaning of the two terms; interim period and interim financial report. An interim period is a financial reporting period that is less than one financial year. Interim financial report refers to either the full set of financial reports prepared for the interim period (in accordance with the IAS 1 Standard revised in 2007) or the condensed financial reports prepared in accordance with the IAS 34 standard (IAS 34, 4). Figure 5 presents the key definitions in IAS 34.

Figure 5. Definitions in IAS 34

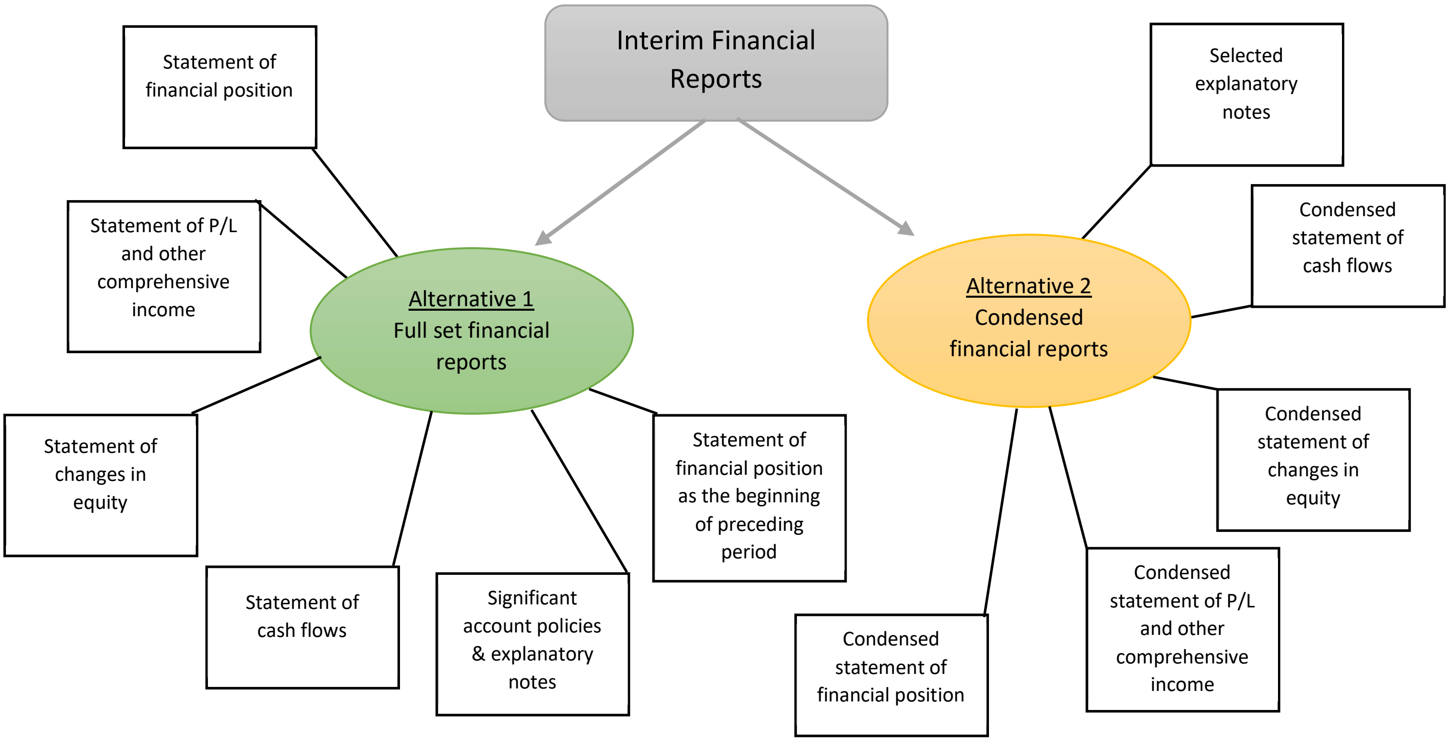


Enterprises preparing interim financial reports have two alternatives in determining the content of the information to be presented in these reports; preparing a full set of financial reports or preparing a condensed financial report.

If the entity chooses to prepare its interim financial reports in accordance with IAS 1, the interim financial report should cover the statement of financial position, statement of profit or loss and other comprehensive income, statement of changes in equity, statement of cash flows, significant accounting policies and other explanatory notes, and a statement of financial position as at the beginning of the preceding period (if there is an accounting policy applied retrospectively, financial statement items have been adjusted retrospectively or financial statement items have been reclassified).

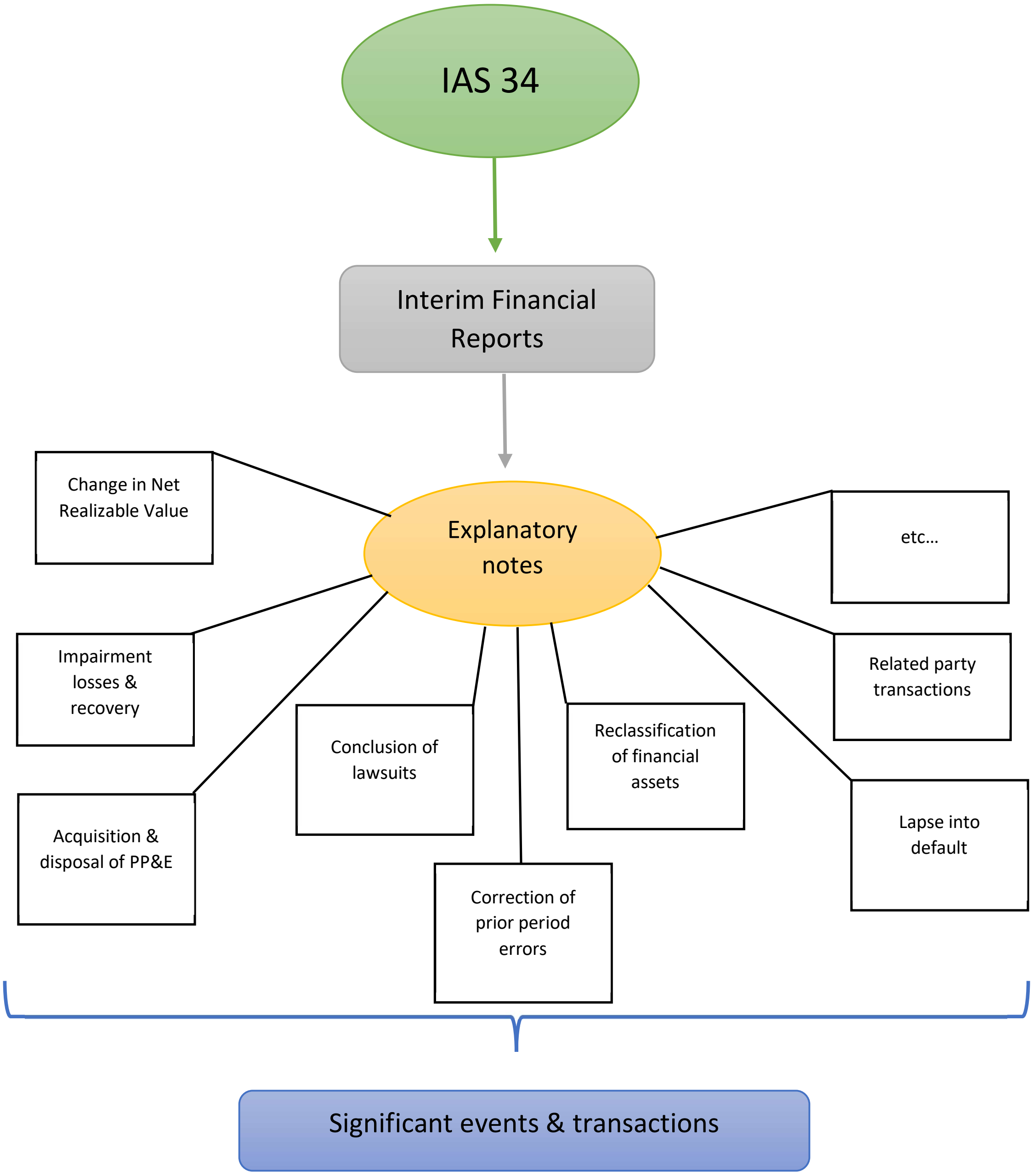
IAS 34 also allows for condensed presentation of interim financial information. A condensed interim financial report consists of a condensed statement of financial position, a condensed statement of profit or loss and other comprehensive income, a condensed statement of changes in equity, a condensed statement of cash flows and selected explanatory notes. Condensed financial statements should include the titles and totals of the most recent year's financial statements. In addition, the explanatory notes that should be included in the summary financial statements are specified in the IAS 34 Standard. Figure 6 shows alternatives of financial report sets according to IAS 34.

Figure 6. Alternatives of Financial Report Sets According to IAS 34



Although it is mandatory to include explanatory notes in interim financial reports, as stated before, the IAS 34 Standard allows less explanatory notes than required in full set financial reports. Significance of the events and transactions is the point to be considered when determining what the explanatory notes will consist of in the interim financial reports. Examples of important events and transactions may be; changes in the net realizable value of inventories, impairment losses and recovery of losses, acquisition and disposal of property, plant and equipment, conclusion of lawsuits, correction of prior periods errors, reclassification of financial assets, lapse into default, related party transactions and other events and transactions in IAS 34 (15B). Examples of explanatory notes are summarized in Figure 7.

Figure 7. Examples of Explanatory Notes



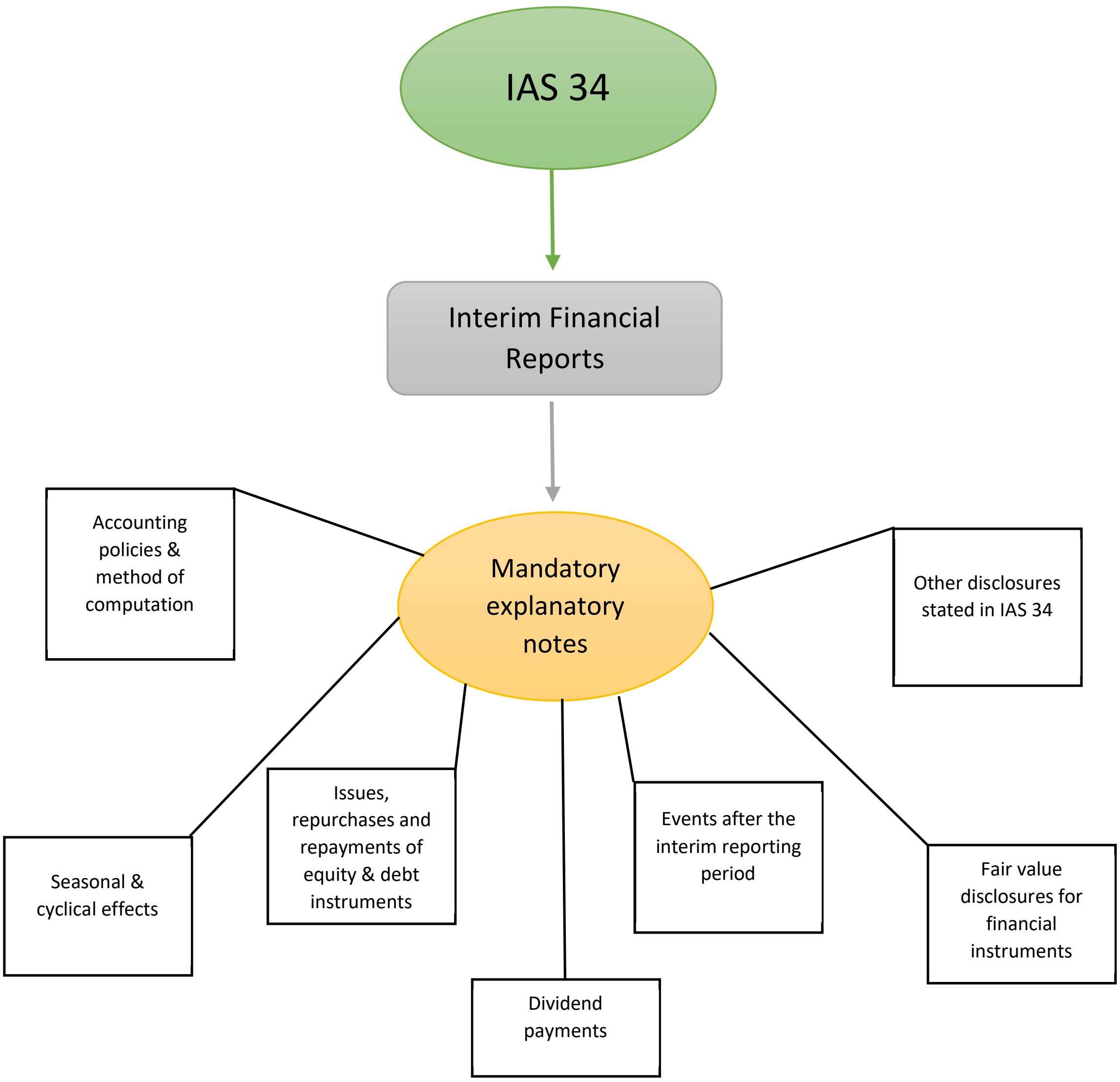
In addition to the summary explanatory notes, some mandatory information is also included in the interim financial reports. This information are (IAS 34, 16A):

- Entity uses the same accounting policies and method of computation used in the preparation of the last annual financial statement (If there is a change, it is necessary to explain the change and its effects on the financial statement),
- Information on the seasonal and cyclical effects of interim activities,
- Explanations on issues, repurchases and repayments of equity and debt instruments,
- Dividend payments (aggregate or per-share basis),
- Events that occurred after the interim reporting period and not included in the interim financial statements,

- Fair value disclosures required for financial instruments,
- and other disclosures stated in paragraph 16A of IAS 34.

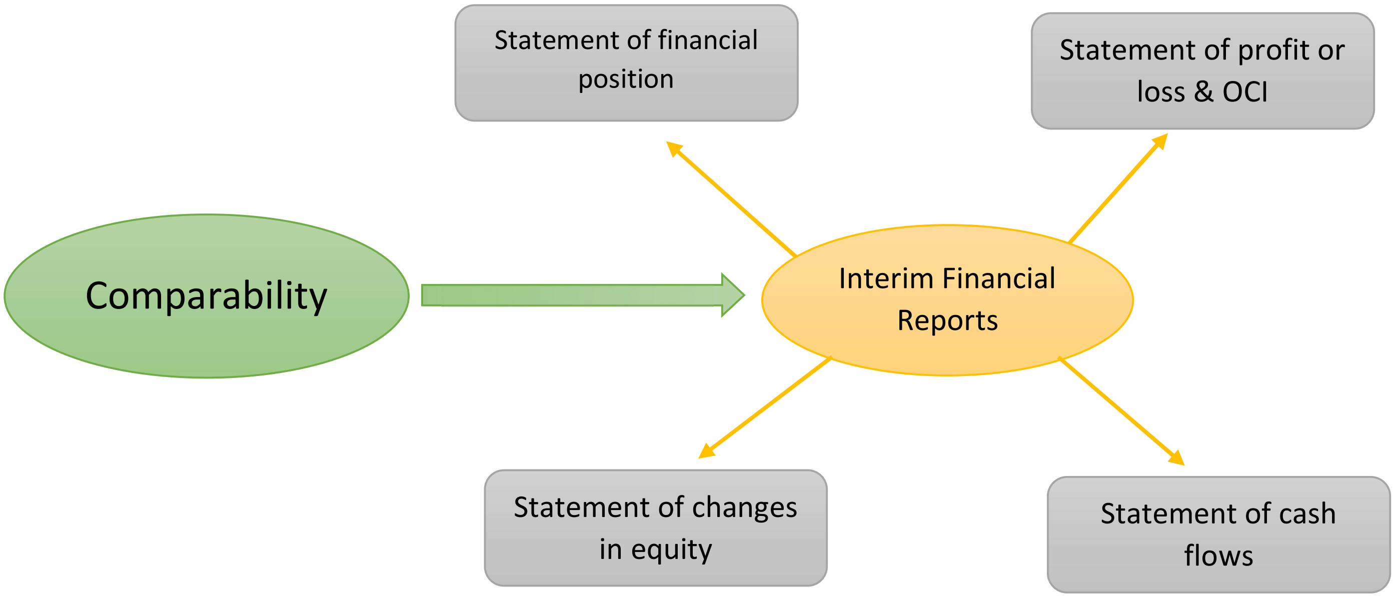
Figure 8 shows the mandatory information that must be included in interim financial reports.

Figure 8. Mandatory Information That Must Be Included in Interim Financial Reports



Comparability is very important for users of financial statements. To see the change in the financial position and financial performance of the entities, it is beneficial to present the financial statements of the current period and the previous period at the same time. IAS 34 requires interim financial statements to be comparable. Condensed or complete comparable financial statements that interim financial reports should include are statement of financial position, statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows. Figure 9 shows the statements that interim financial statements must include in order to be comparable.

Figure 9. Statements that must be Included in Interim Financial Reports for Compatibility



For example, an entity prepares interim financial statements quarterly and will present the financial statements of the 2nd quarter ending in June, 2022. The financial statements to be presented by the entity consist of the statement of financial position, the statement of profit or loss and other comprehensive income, the statement of cash flows and the statement of changes in equity.

Entities should present comparable statements of financial position. The entity presents two statements of financial position: the statement of financial position for the current interim period and another statement of financial position for the end of the previous financial year.

Interim Statement of Financial Position As of June 30, 2022	Statement of Financial Position As of December 31, 2021

Entity should present a comparable statement of profit or loss and other comprehensive income. Entity presents four statements of profit or loss and other comprehensive income: an interim statement of profit or loss and other comprehensive income for first six months of 2022, an interim statement of profit or loss and other comprehensive income for second quarter of 2022, an interim statement of profit or loss and other comprehensive income for first six months of 2021 and an interim statement of profit or loss and other comprehensive income for second quarter of 2021.

Interim Statement of Profit or Loss and Other Comprehensive Income January 1 – June 30 2022	Interim Statement of Profit or Loss and Other Comprehensive Income April 1 – June 30 2022	Interim Statement of Profit or Loss and Other Comprehensive Income January 1 – June 30 2021	Interim Statement of Profit or Loss and Other Comprehensive Income April 1 – June 30 2021

Entity should present a comparable statement of changes in equity. Entity presents two statements of changes in equity: a statement of changes in equity for the current interim period and another interim statement of changes in equity as of June 30, 2021.

Interim Statement of Changes in Equity As of June 30, 2022	Interim Statement of Changes in Equity As of June 30, 2021

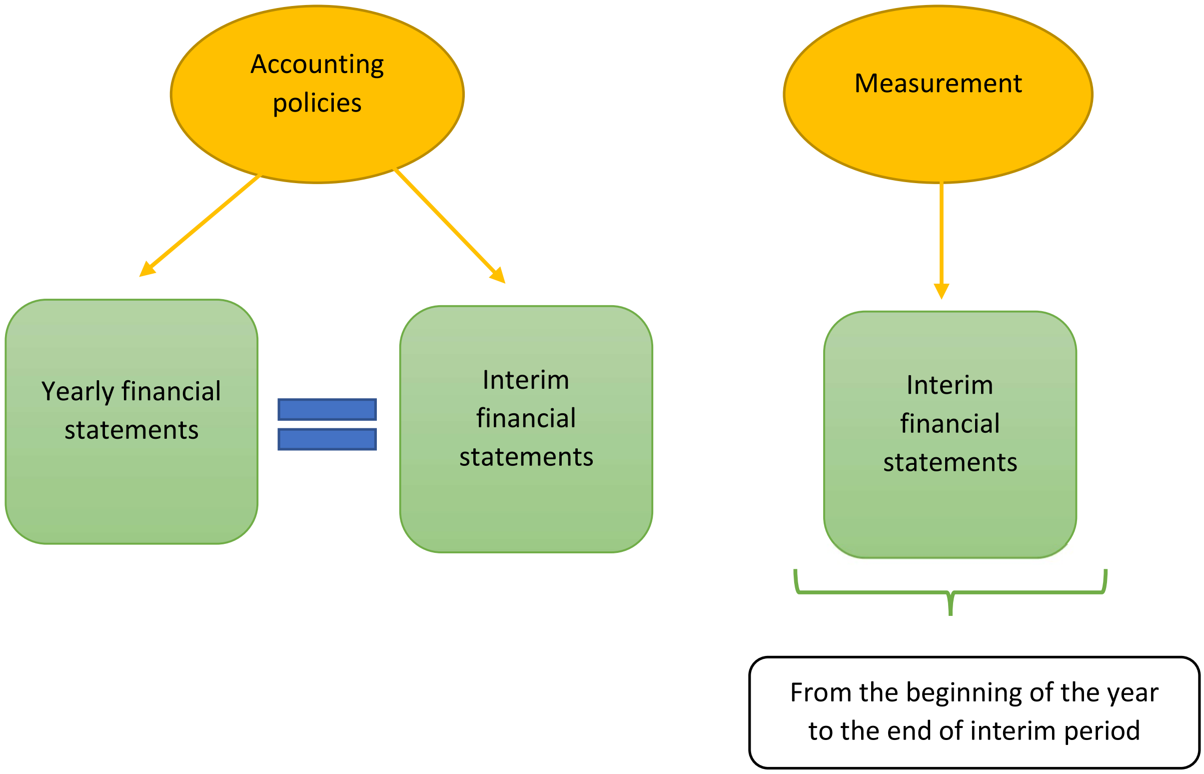
Entities should present comparable statements of changes of cash flow. Entity presents two statements of cash flows: a statement of cash flows for the first six months of 2022 and a statement of cash flows for the first six months of 2021.

Interim Statement of Cash Flows January 1 – June 30 2022	Interim Statement of Cash Flows January 1 – June 30 2021

RECOGNITION AND MEASUREMENT

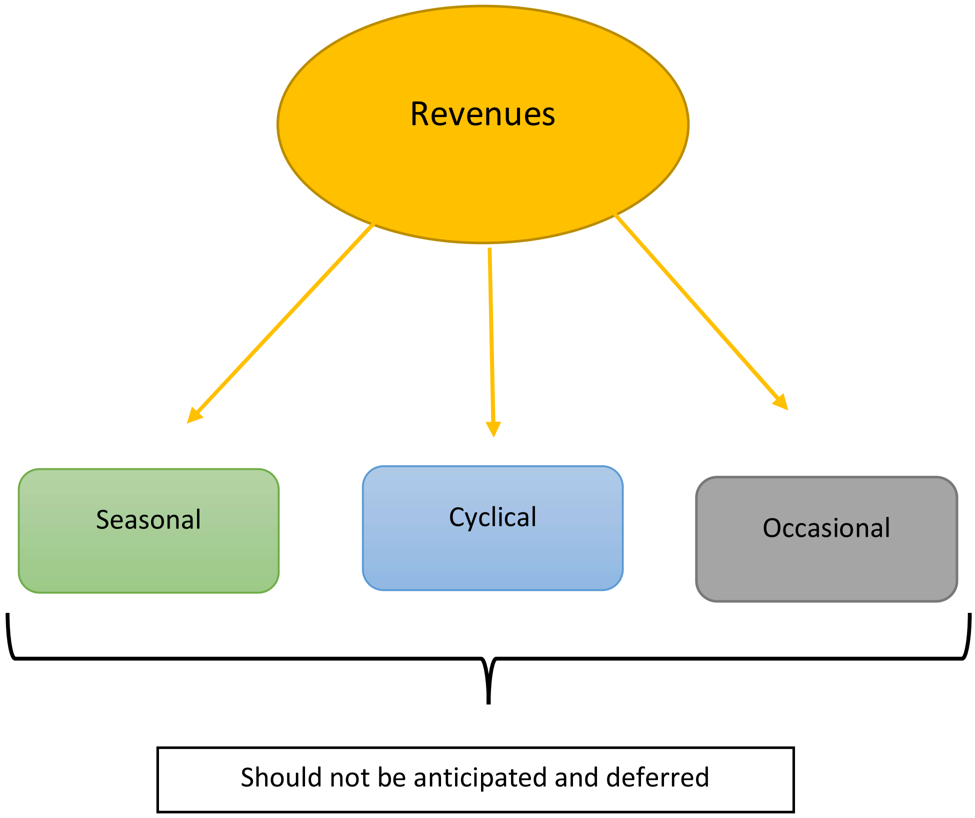
An entity should apply the same accounting policies in preparing its interim financial statements as it does in its annual financial statements. The exception to this situation is the changes in accounting policies after the preparation of the last annual financial statements. Regardless of the entity's reporting frequency (monthly, quarterly, semi-annually or annually), measurement should be made for the period from the beginning of the year to the end of the interim period. This means that measurements such as net realizable value, impairment or fair value will be applied as if they were annual, even if they were made at the end of the interim period. Changes in measurement amounts may occur at the end of the next interim period. These changes are considered as changes in estimation in that period. In addition, if there are any annual expenses (for example: tax expense), the entity should recognize the related expense in the interim financial statements based on the best estimation of weighted average. Figure 10 summarizes accounting policies and measurement in IAS 34.

Figure 10. Summary of Accounting Policies and Measurement in IAS 34



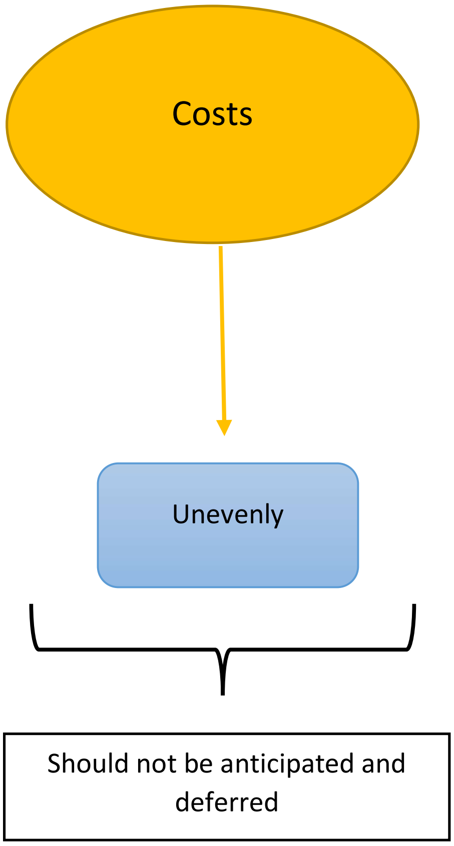
While preparing interim financial statements, there are points that may create confusion regarding the accounting and measurement processes. Revenues received seasonally, cyclically or occasionally are examples of this. Revenues must be recognized in the periods in which they arise. Seasonal effects should be reflected in the interim financial statements in the period they arise. For example, it is unacceptable to distribute or defer the revenues of a ski centre with a high income during the winter months. Cyclical incomes, such as interest income, is accrued up to the date of the interim financial report and recognized in interim financial statements. On the other hand, there may also be occasional revenues. For example, even when the time when dividend income will arise predictable, it is not recognized until announced by the distributing entity. Entities should not anticipate and defer such revenues. Accounting treatment of IAS 34 related to revenues is summarized in Figure 11.

Figure 11. Accounting Treatment of IAS 34 Related to Revenues



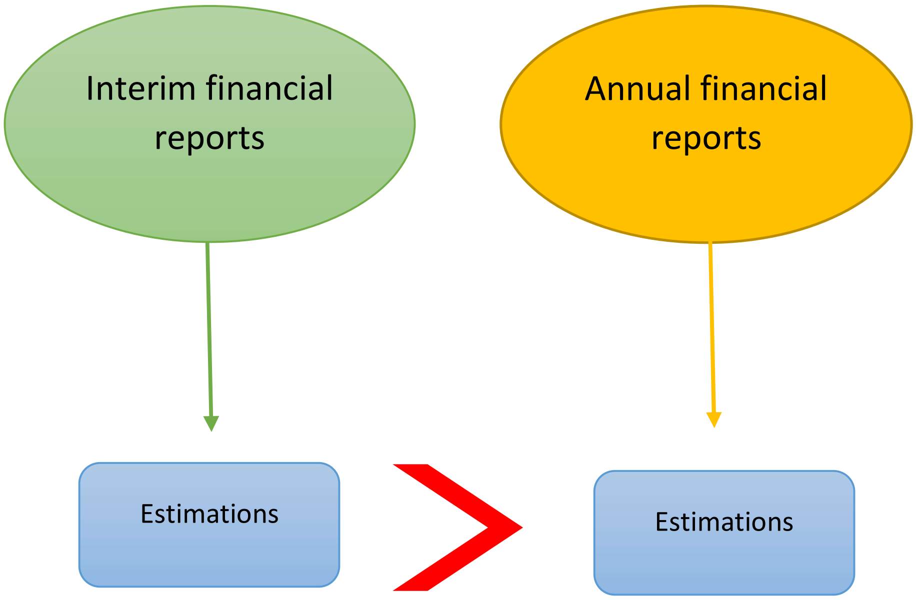
A situation similar to the revenues in the preparation of interim financial statements is experienced in the costs that arise unevenly during the year. Costs that arise unevenly should not be deferred or anticipated even for the purpose of preparation of interim financial reports, unless anticipation or deferral would be appropriate at the end of the financial year. For example; an entity prepares interim financial reports on a quarterly basis. The entity launched a new product at the beginning of the year and the product is expected to be sold throughout the year. Marketing activities for the product were initiated and completed in the first quarter of the year. In this case, the cost of marketing activities should not be allocated to the year and should be recognized as an expense in the statement of profit or loss and other comprehensive income in the period in which they occur (first quarter). If the incurred costs do not meet the criteria for being an asset at the end of the interim period, they should be reported as expenses. Expenses should not be deferred even if there is information expected to be obtained in the future that they will meet the asset criteria. Accounting treatment of IAS 34 related to costs is summarized in Figure 12.

Figure 12. Accounting Treatment of IAS 34 Related to Costs



The fact that seasonal, cyclical, and occasional revenues and unevenly costs are often not allowed to be deferred or forecasted does not mean that estimations will not be made in interim financial reports. In the IAS 34 Standard, it is stated that the measurement should be based on reasonable estimates when preparing both annual and interim financial reports, and it is also stated that interim financial reports will require more estimations than annual financial reports. For example, while preparing interim financial reports, it is possible to determine the inventory value from the sales margin instead of performing a full inventory count. Another example can be given for provisions. While determining the provision amount to be reported in the interim financial statements, entities can update the previous period's provision amounts for interim period instead of seeking expert opinion from outside the company. The excess of estimates included in the interim financial statements compared to the annual financial statements is shown in Figure 13.

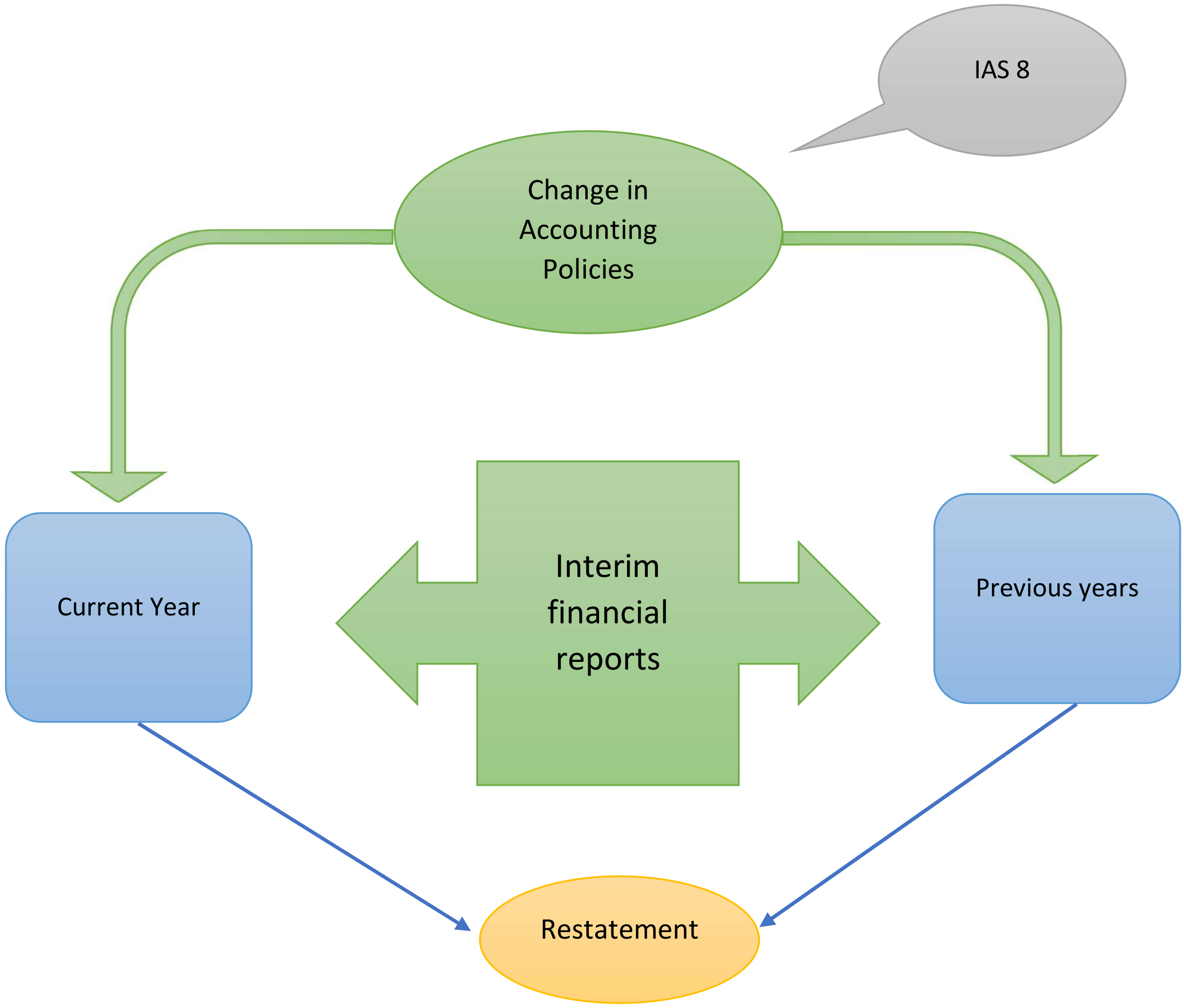
Figure 13. Estimations in Interim Financial Reports and Annual Financial Reports



RESTATEMENT OF PREVIOUSLY REPORTED INTERIM PERIODS

If there has been a change in the accounting policies of the entity, the financial statements should be restated retrospectively within the scope of IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors Standard (if transition is not specified by a new IFRS). In such a case, the entity should make a retrospective restatement of the current year's interim financial statements. Restating only for the current year is not sufficient, comparable interim financial statements of previous years must also be restated. It may not be practical to determine the cumulative effect of the accounting policy change for all prior periods at the beginning of the year. In this case, the interim financial statements for the current year and previous years are then restated from the earliest date on which the new accounting policy can be applied retrospectively. Figure 14 presents the relation between IAS 34 and IAS 8.

Figure 14. Relation Between IAS 34 and IAS 8



EXAMPLE

Expenses to be considered while preparing the interim financial reports of an entity are as follows.

- The entity's largest customer placed orders that will result in sales revenue of CU 2,000,000 in the first quarter, CU 2,400,000 in the second quarter, CU 1,500,000 in the third quarter and CU 1,800,000 in the fourth quarter. The business gives a 10% discount to its customer if it exceeds the annual purchase worth CU 7,000,000 of goods. The customer exceeded this amount last year and is expected to exceed it this year.
- For a trade show event that will take place in the second quarter, the trade fair fee CU 40,000 was paid in the first quarter.
- CU 60,000 was paid in the second quarter for an advertising event to take place in the fourth quarter.
- In the beginning of the second quarter, CU 72,000, the property tax charge for the next 12 months, was paid.
- The air filter of the factory was changed at the beginning of the second quarter. This transaction takes place annually and CU 24,000 was paid.
- The business gives a bonus to its managers if the determined sales target is achieved. If total annual sales are CU 60,000,000, managers will receive bonus CU 200,000 at the end of the year. It has been predicted since the first quarter that the annual sales target will be achieved.

The effects of the above events on the interim financial statements of the entity will be as follows.

	Quarter 1 (CU)	**Quarter 2 (CU)**	**Quarter 3 (CU)**	**Quarter 4 (CU)**	**Yearly (CU)**
Sales Revenue	12,000,000	15,000,000	18,000,000	15,000,000	60,000,000
Sales Discounts*	(200,000)	(240,000)	(150,000)	(180,000)	(770,000)
Marketing Expense[β]	-	(40,000)	-	-	(40,000)
Advertising Expense[α]	-	-	-	(60,000)	(60,000)
Property Tax Expense[£]	-	(18,000)	(18,000)	(18,000)	(54,000)
Maintenance Expense[℧]	-	(6,000)	(6,000)	(6,000)	(18,000)
Bonus Expense[Φ]	(40,000)	(50,000)	(60,000)	(50,000)	(200,000)

***** The customer has reached the purchase amount required for the discount in the last quarter. However, since firm orders will exceed CU 7,000,000, the obligation to the customer is likely to be fulfilled. A discount of 10% from sales revenue is required of the customer's purchases each quarter.

- Quarter 1: CU 2,000,000 * 10% = CU 200,000
- Quarter 2: CU 2,400,000 * 10% = CU 240,000
- Quarter 3: CU 1,500,000 * 10% = CU 150,000
- Quarter 4: CU 1,800,000 * 10% = CU 180,000

β The payment for the trade show event is reported as a prepaid expense in the first quarter and as an expense in the quarter in which it occurs.

α The payment for the advertising event is reported as a prepaid expense in the second quarter and as an expense in the quarter in which it occurs.

£ The property tax expense will be recorded as a prepaid expense in the second quarter. For the next 12 months, an equal amount will be recognized as property tax expense each month.

- Quarterly Expense = CU 72,000 / 4 = CU 18,000

Ʊ The air filter replacement will be recorded as a prepaid expense in the second quarter. For the next 12 months, an equal amount will be recognized as maintenance expense each month.

- Quarterly Expense = CU 24,000 / 4 = CU 6,000

ф The bonus to be given to the managers is accounted for in proportion to the sales revenue of each quarter.

- Quarter 1: (CU 200,000 / CU 60,000,000) * 12,000,000 = CU 40,000
- Quarter 2: (CU 200,000 / CU 60,000,000) * 15,000,000 = CU 50,000
- Quarter 3: (CU 200,000 / CU 60,000,000) * 18,000,000 = CU 60,000
- Quarter 4: (CU 200,000 / CU 60,000,000) * 15,000,000 = CU 50,000