Lisbon School of Economics & Management
Universidade de Lisboa

Financial Accounting II

UNDERGRADUATE COURSES: MANAGEMENT, ECONOMICS AND FINANCE

2025/2026 – 1S

1

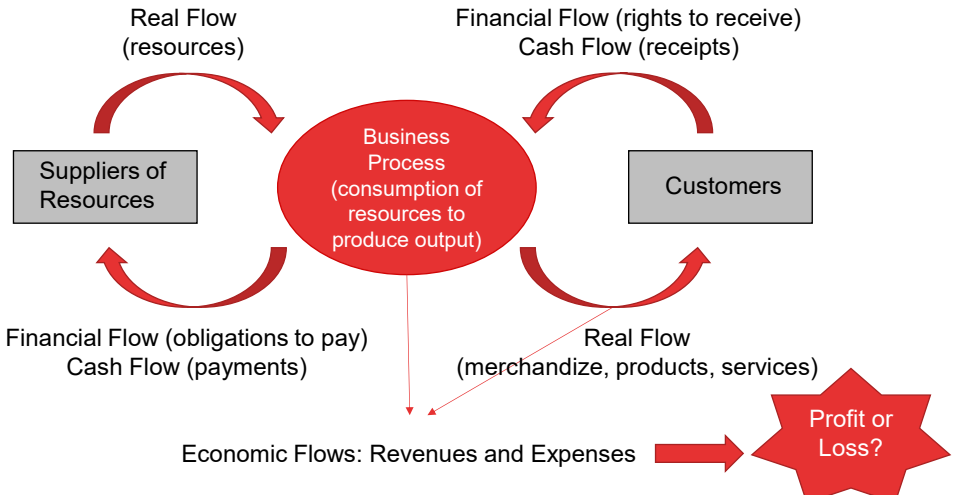
FINANCIAL ACCOUNTING

Readings: Chapter 1

2

3

The Firm's Business Process and Flows



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Financial Accounting: what is it?

- Financial Accounting is a specialized language that translates firm's transactions into patrimonial events
- Financial Accounting is a process of collecting information on firm's transactions which are recorded to allow for the creation of periodic reports: financial statements – a complete set includes:
- Statement of Financial Position / Balance Sheet
- Income Statement / Statement of Profit or Loss
- Statement of Cash Flows / Cash Flow Statement
- Statement of Changes in Equity
- Notes

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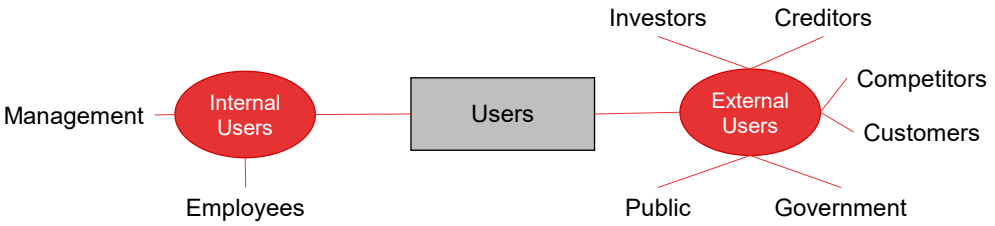
Reporting: why do we need it?

Agency relationship → *Reporting* to capital providers (shareholders, lenders)
Reporting to other stakeholders



Users need the reported information to be ***useful*** in order to make decisions about their interests (current or prospective) in the company

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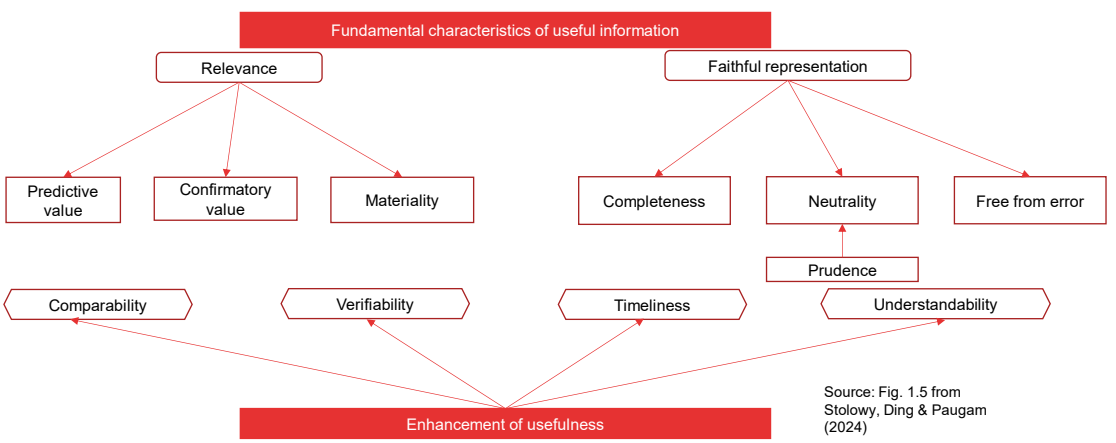
Qualitative characteristics of useful financial statements (IASB, Conceptual Framework §2.1)



Source: Fig. 1.5 from Stolowy, Ding & Paugam (2024)

6

TOPICS ON FINANCIAL ACCOUNTING

REVISIONS OF FINANCIAL ACCOUNTING

Readings: Chapter 2, 3, 4 and 16

7

8

Statement of Financial Position or Balance Sheet

Assets (resources)	=	Liabilities and Shareholders' equity (obligations toward third parties and shareholders)

Assets *minus* Liabilities = Net Assets = Shareholders' equity (or Net Worth)

Equity is "the residual interest in the assets of the entity after deducting all its liabilities" (IASB, Conceptual Framework §4.63)

A balance sheet is a snapshot of the status of the financial position of a business at a given point in time

8

9

Presentation of the Statement of Financial Postition

- List of resources and obligations may be presented either in increasing or decreasing order of liquidity and maturity.
- The ordering preference must apply homogenously to both assets, on the one hand, and liabilities and shareholders' equity, on the other.
- Example: if the goal is to focus attention on potential for future value creation, shareholders' equity is presented at the top of the list of obligations (Continental European presentation).

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Book value of shareholders' equity and market value of the shares

Book value = Shareholders' equity: accounting concept based on the current historical value of resources and obligations to third parties

Accounting adopts the rule: lower of cost or market

Market value: reflects the expectations regarding potential future earnings, after paying third parties for the cost of funding them

10

11

Double entry accounting and the balance sheet equation

Assets = Liabilities *plus* Shareholders' equity

or

Assets *minus* Liabilities = Shareholders' equity

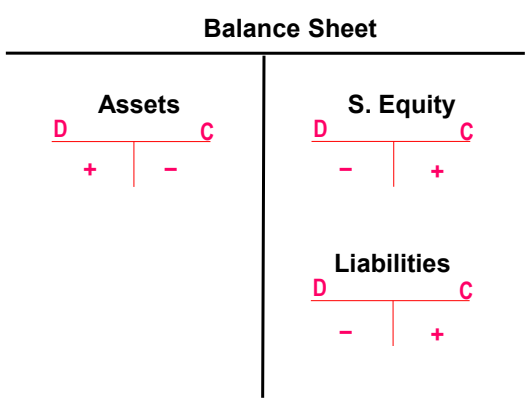
Double entry accounting:

- Impacts the basic equation in at least two opposite ways that will keep the equation balanced

11

12

Revisiting the double entry method



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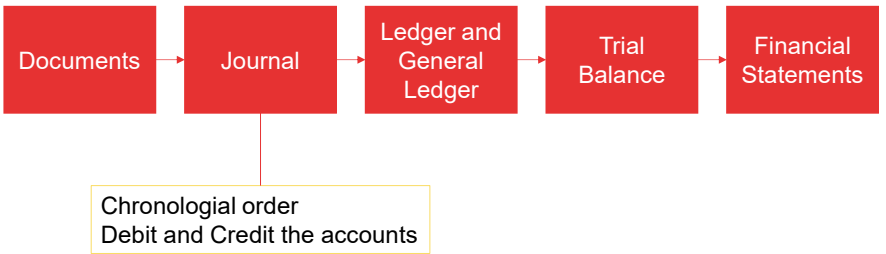
13

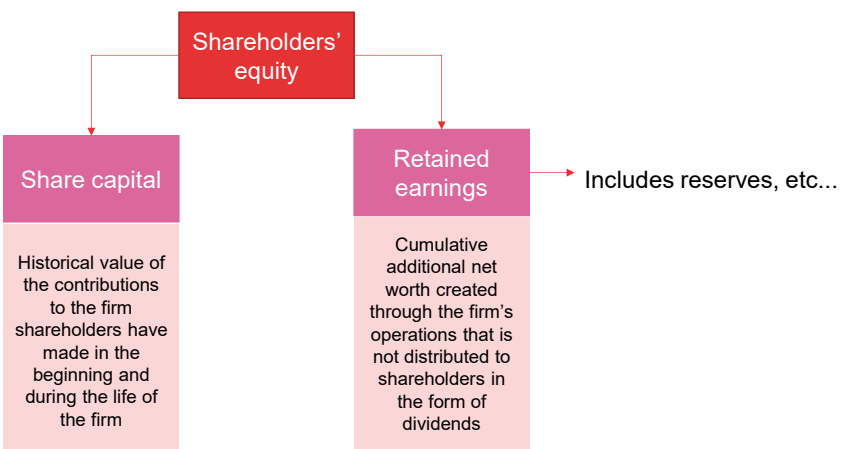
Revisiting the accounting process



13

14

Shareholders' equity



14

15

Earnings

Revenues (or "income") are "increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims" (IASB, Conceptual Framework §4.68)

Expenses are "decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims" (IASB, Conceptual Framework §4.69)

Earnings (or net income) = Total revenues *minus* Total expenses

Shown in Income Statement /or Statement of Profit & Loss /or P&L

15

16

Earnings and shareholders' equity

Earnings (or net income) of the period = Shareholders' equity at the end of the period *minus* Shareholders' equity at the beginning of the period

(All things being otherwise equal)

16

17

Income Statement (or "Statement of Profit & Loss", or "P&L")

The income statement is the "film" of the business during a given period

Accrual principle: "An entity shall prepare its financial statements, except for cash flow information, using the accrual basis of accounting" (IASB, IAS 1 §27), meaning:

Revenues are recognized when earned and expenses are recognized when incurred, independently of cash inflows (receipts) and cash outflows (payments)

17

18

Accrual principle in action – examples

Example 1: January's electricity → invoice received in February

In January: accrue the expense, meaning, recognize the expense on P&L and the liability (creditors for accruals of expenses) on the Balance Sheet

In February: upon receipt of the invoice make the payment and cancel de liability

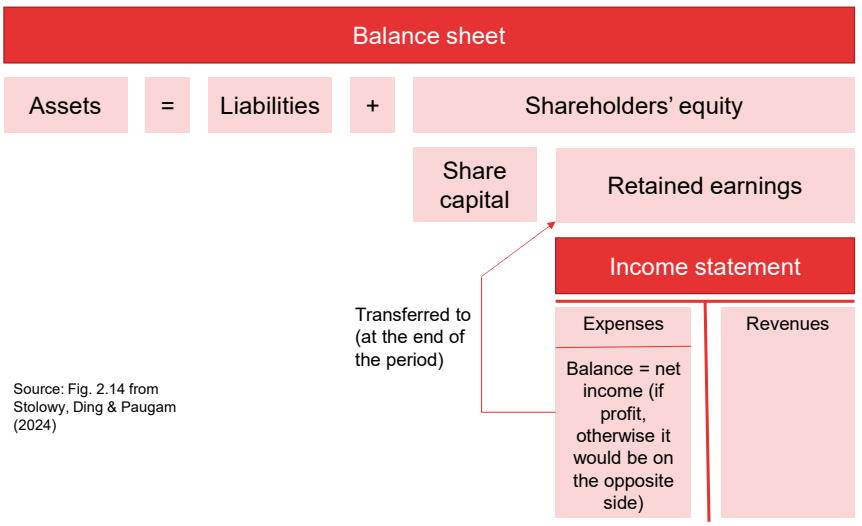
Example 2: Payment in Y1 of insurance (50% consumed in Y1, 50% consumed in Y2)

- Year 1: recognize the payment of the full amount, recognize 50% of the amount as an expense on P&L and defer the other 50%, meaning, it will show as an asset (prepaid expense) on the Balance Sheet
- Year 2: upon receipt of the invoice recognize the expense on P&L and cancel the asset (prepaid expense)

18

19

Links between the balance sheet and the income statement



Source: Fig. 2.14 from Stolowy, Ding & Paugam (2024)

19

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Profit appropriation – three possibilities

- Distribute the profit entirely to the shareholders as dividends (except when there is part that according to the law may not be distributed, ex: "statutory reserves")
- Distribute the profit partially to the shareholders as dividends leaving the rest as "a reserve"
- No profit distribution (shareholders reinvest their claim in its entirety in the business)

20

21

Cash versus profit

- Revenues double each period; Expenses are 90% of revenues
- Customers pay two periods after the sales
- Payment to suppliers one period after the delivery
- Conclusion: business profitable but dangerous cash situation

Period	1	2	3	4	5
Revenues	100	200	400	800	1.600
Expenses	90	180	360	720	1.440
Net income	10	20	40	80	160
Beg. cash	0	0	(90)	(170)	(330)
Cash inflow	0	0	100	200	400
Cash outflow	0	90	180	360	720
Ending cash	0	(90)	(170)	(330)	(650)

21

22

Statement of cash flows

Required financial statement in certain countries

Necessity to understand the evolution of cash during the year

Statement of cash flows' structure:

Net cash provided by/used in **operating** activities	A
Net cash provided by/used in **investing** activities	B
Net cash provided by/used in **financing** activities	C
Net increase/decrease in **cash and cash equivalents**	D = A+B+C
Cash and cash equivalents at beginning of year	E
Cash and cash equivalents at end of year	F = D+E

The statement of cash flows classifies cash flows in three categories of activities: operating, investing and financing

22

23

Classification of cash flows

Activities	Cash inflows (receipts)	Cash outflows (payments)
Operating activities	• Cash received from the sale of goods and rendering of services to customers • Cash received for royalties, fees and commissions earned, and other revenues • Interest received on loans granted and financial investments	• Payment for purchase of goods and services • Salaries, fringe benefits, and social expenses • Royalties, fees, and commissions paid • Taxes paid • Interest paid on borrowings
Investing activities	• Proceeds from the sale of non-current assets (intangible, tangible, financial, i.e., securities which are not cash equivalents) • Receipt of repayment of loans and advances	• Cash used for purchase of non-current assets (intangible, tangible, financial, i.e., long-term securities which are not cash equivalents) • Loans and advances made
Financing activities	• Proceeds from issuing new shares • Proceeds from selling own shares • Proceeds from issuing new debt	• Repurchase of own shares • Repayment of debt • Payment of dividends

23

24

Differences in classification of five flows of cash

	Interest paid	Interest received	Dividends paid	Dividends received	Taxes paid
IASB	OPE or FIN	OPE or INV	OPE or FIN	OPE or INV	OPE or INV or FIN
FASB (USA)	OPE	OPE	FIN	OPE	OPE

OPE = operating activities; INV = investing activities; FIN = financing activities

24

25

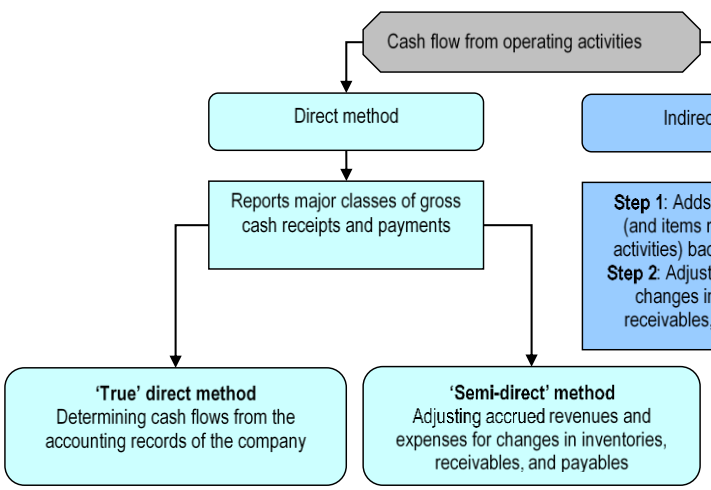
Calculating cash flows from operating activities

- Cash flows from operating activities (= “Operating cash flows” = “Cash flows from operations”)
- Two methods:
  - Direct
  - Indirect
- Most standards recommend the direct method while allowing the indirect method
- The vast majority of businesses report cash flows from operating activities using the indirect method, which is much simpler

25

26

Reporting cash flows from operating activities



Source: Fig. 16.1 from Stolowy, Ding & Paugam (2024)

26

27

Statement of cash flows – direct method

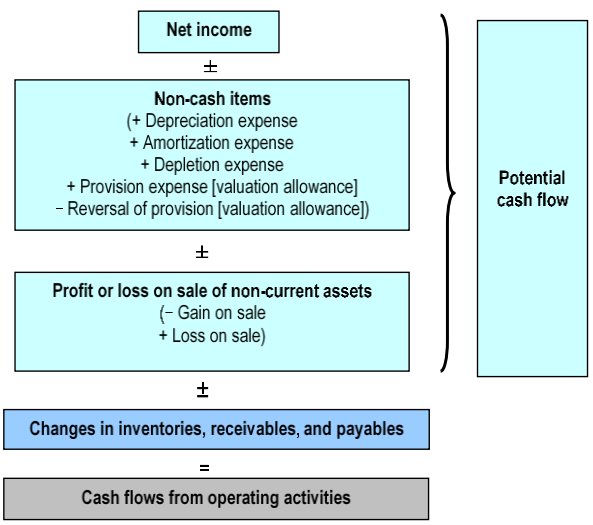
Cash flows from operating activities		
Cash received from customers		80
Cash paid to suppliers and employees		−30
Net cash from operating activities	*(1)*	*50*
Cash flows from investing activities		
Purchase of property, plant and equipment		−15
Proceeds from sale of equipment		5
Net cash used in investing activities	*(2)*	*−10*
Cash flows from financing activities		
Proceeds from issuance of share capital		35
Proceeds from long-term borrowings		10
Dividends paid		−20
Net cash from financing activities	*(3)*	*25*
Net increase in cash and cash equivalents	**(4)=(1)+(2)+(3)**	**65**
Cash and cash equivalents at beginning of year	(5)	5
Cash and cash equivalents at end of year	(6)	70
Change in cash	**(7)=(6)−(5)**	**65**
Control	**(4)=(7)**	

Source: Table 3.1 from Stolowy, Ding & Paugam (2024)

27

28

Statement of cash flows – indirect method



Source: Figure 16.4 from Stolowy, Ding & Paugam (2024)

28

29

Statement of cash flows – indirect method

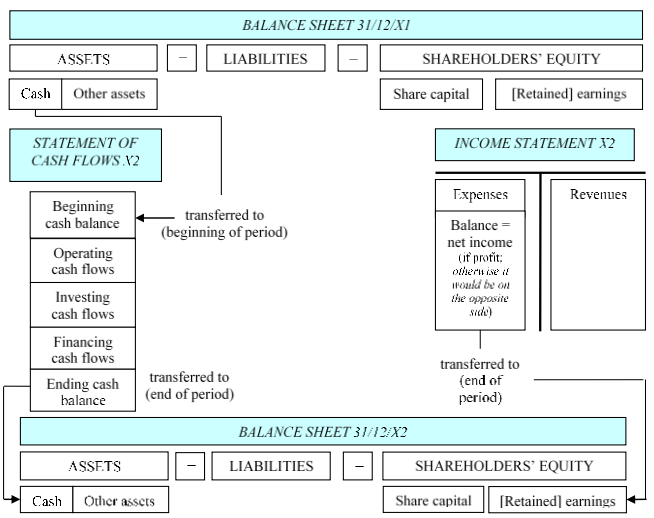
Net income		9
Adjustments to reconcile net income/loss to net cash provided by/used in operating activities		
Depreciation expense	60	
Gain on sale of non-current assets	−3	
Potential cash flow		66
Adjustments to acknowledge changes in operating assets and liabilities		
Change in trade receivables	19	
Change in inventories	−44	
Change in prepaid expenses	3	
Change in trade payables	8	
Change in income taxes payable	−2	
Total adjustments		−16
Net cash provided by/used in operating activities		50

Source: Table 16.10 from Stolowy, Ding & Paugam (2024)

29

30

Links between statement of financial position, income statement and statement of cash flows



Source: Figure 3.2 from Stolowy, Ding & Paugam (2024)

30

TOPICS ON FINANCIAL ACCOUNTING

SHAREHOLDERS' EQUITY

Readings: Chapter 11

31

32

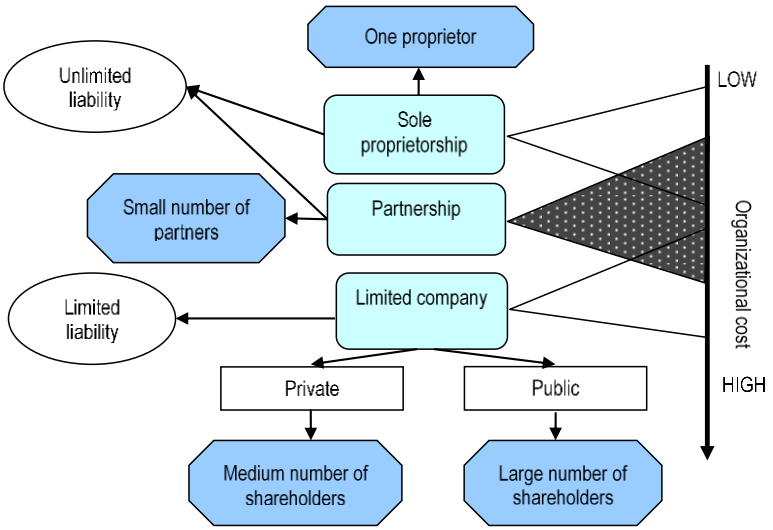
Sources of seed financial resources

Capital provided	Shareholders (or stockholders) / Partners provide capital to the firm in exchange for a claim on the future returns (positive or negative) of the business, without time limit
Borrowed funds	Generally provided for a predefined and limited period of time by financial institutions in a contract specifying that the principal must be returned and interests paid regardless of the business success

32

33

Forms of business organization



Source: Figure 11.1 from Stolowy, Ding & Paugam (2024)

33

34

Share capital – Definition

Shares or “stock certificates” represent the capital and are attributed to investors according to the proportion of resources they provide

Each shareholder has the right to:

- Vote in general assembly meetings (influence management’s decisions)
- Receive dividends and a proportionate share of any eventual liquidation surplus, **and**
- Have first pass at acquiring additional shares (proportionately to the current holding) in case there is an issue of new shares

34

35

Share capital – Nominal or par value

By-laws specify the face value (nominal value or par value) of each share, thus conditioning the number of shares that constitute the original capital

Capital = number of shares *multiplied by* par value

- General rule: shares cannot be issued below par value
- The share market value has no relation with its par value

35

36

Share capital – Terminology

Authorized capital: maximum amount of capital the entity may issue according to its by-laws

Subscribed or issued capital: the part of the authorized capital that the shareholders agree to pay for

Called-up capital: the fraction of the subscribed capital that the board decides to collect from the shareholders

Paid-in capital or contributed capital: part of the capital that has been paid

Uncalled capital: part of the subscribed capital that has not been yet called up

Capital receivable: part of the subscribed capital that has been called up and remains unpaid

Outstanding capital: subscribed capital (at par) *minus* the par value of the shares bought back by the company (treasury shares or own shares)

36

37

Share capital – Formulas

Outstanding shares ≤ Issued shares ≤ Authorized shares

Subscribed capital = Paid-in capital + Capital receivable + Uncalled capital

37

38

Share capital – Categories of shares

Ordinary shares → Residual claim after preferred shareholders

≠

Preferred shares →

Shares carrying special rights, such as:

- Pecuniary advantage, such as fully or partially guaranteed dividend, larger dividend, priority dividend, cumulative dividend, etc...
- Different voting rights, such as double or no voting rights.

Dividends **vs** Voting Rights

38

39

Real-life example
RWE (Germany – IFRS Standards – 2018)

Excerpts from Note 20 to the consolidated financial statements						
Subscribed Capital	31 Dec. 2018		31 Dec. 2017		31 Dec. 2018	31 Dec. 2017
	Number of shares		Number of shares		Carrying amount	
	in '000	in %	in '000	in %	€ million	€ million
Common shares	575,745	93.7	575,745	93.7	1,474	1,474
Preferred shares	39,000	6.3	39,000	6.3	100	100
	614,745	**100.0**	**614,745**	**100.0**	**1,574**	**1,574**
Common and preferred shares are no-par-value bearer share certificates. Preferred shares have no voting rights. Under certain conditions, preferred shares are entitled to payment of a preference dividend of €0.13 per preferred share, upon allocation of the company's profits.						

39

40

Share premium

Shares are issued at par at incorporation or, subsequently, above their par to reflect the fact the market values the future consequences of investment already realized

Share premium: difference between the issue price and the par value

The share premium is reported as part of shareholders' equity

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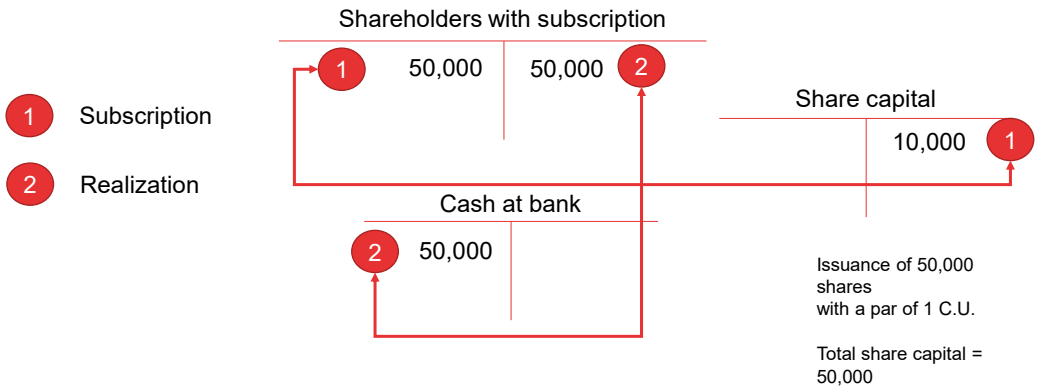
41

Accounting for share capital at incorporation



41

42

Reporting share capital (IAS 1)

Disclosed either in the Statement of Financial Position or the Statement of Changes in Equity, or in the Notes

a) For each class of share capital:
the number of shares authorized
the number of shares issued and fully paid, and issued but not fully paid
par value per share, or that the shares have no par value
a reconciliation of the number of shares outstanding at the beginning and at the end of the period
the rights, preferences and restrictions attaching to that class
shares in the entity held by the entity or by its subsidiaries or associates **and**
shares reserved for issue under options and contracts for the sale of shares

b) A description of the nature and purpose of each reserve within equity

42

43

Reporting share capital (IAS 1)

An entity shall disclose in the Notes:

The amount of dividends proposed or declared before the financial statements were authorized for issue but not recognized as a distribution to owners during the period, and the related amount per share **and**

The amount of any cumulative preference dividends not recognized

43

44

Real-life example
Philips (Netherlands – IFRS Standards – 2018)

Common shares
As of December 31, 2018, authorized common shares consist of 2 billion shares (…) and the issued and fully paid share capital consists of 926,195,539 common shares, each share having a par value of EUR 0.20 (…).
Preference shares
As a means to protect the company and its stakeholders against an unsolicited attempt to obtain (de facto) control of the Company, the General Meeting of Shareholders in 1989 adopted amendments to the Company's articles of association that allow the Board of Management and the Supervisory Board to issue (rights to acquire) preference shares to a third party. The 'Stichting Preferente Aandelen Philips' has been granted the right to acquire preference shares in the Company. Such right has not been exercised as of December 31, 2018 and no preference shares have been issued. Authorized preference shares consist of 2 billion shares as of December 31, 2018.

Dividend distribution 2018
In June 2018, Philips settled a dividend of EUR 0.80 per common share, representing a total value of EUR 738 million including costs. Shareholders could elect for a cash dividend or a share dividend. Approximately 46% of the shareholders elected for a share dividend, resulting in the issuance of 9,533,233 new common shares. The settlement of the cash dividend involved an amount of EUR 400 million (including costs). A proposal will be submitted to the 2019 Annual General Meeting of Shareholders to pay a dividend of EUR 0.85 per common share, in cash or shares at the option of the shareholders, against the net income of the Company for 2018.

44

45

Profit appropriation

All required reserve accounts must be funded before dividends can be paid out

The amount of earnings available for distribution is:

Earnings available for distribution = Annual earnings *minus* the sum of the allocations to reserve accounts

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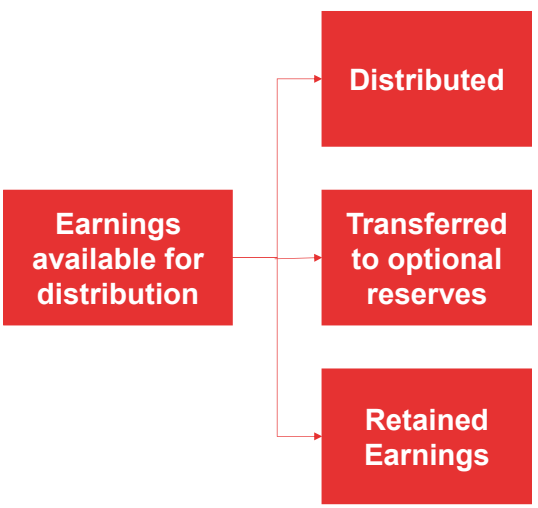
46

Earnings available for distribution



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47

Real-life example
J. Martins (Portugal – IFRS Standards – 2020)

"17.3. **Retained earnings**. As at 31 December 2020, the total amount of retained earnings was EUR 2,048,985 thousand (2019: EUR 1,829,805 thousand), resulting from profit generated in the financial year, in the amount of EUR 436,502 thousand (2019: EUR 754,395 thousand) and the remaining in the previous years. Of this amount EUR 316,778 thousand (2019: EUR 317,290 thousand) are not able to be distributed, as provided in articles 32, 218, 295, 296 and 324 of the Commercial Companies Code."

47

48

Dividends

Dividends: Distribution of earnings to the shareholders

Allocated proportionately to the rights attached to the shares

Management proposes dividend payout for approval by the General Assembly

48

49

Real-life example
J. Martins (Portugal – IFRS Standards – 2020)

"17.4. **Dividends**. According with the decision made at the 25 June 2020 General Shareholders Meeting, the amount of EUR 130,086 thousand was distributed to Jerónimo Martins shareholders in July 2020. Additionally, it was approved the distribution of free reserves in the amount of EUR 86,724 thousand, at the 26 November 2020 Extraordinary General Shareholders Meeting, which were paid in December 2020. According with the decision made at the 11 April 2019 General Shareholders Meeting, the amount of EUR 204,241 thousand was distributed as dividends to Jerónimo Martins shareholders in May 2019. In accordance with the results appropriation proposal described in point 8 included in the Management Report chapter, which is integrated in the consolidated annual report, the Board of Directors proposes to the shareholders the distribution of the amount EUR 180,989 thousand, which corresponds to a dividend per share of EUR 0.288 (excluding own shares in the portfolio)."

49

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Reserves

Description of reserve	Possibility of distribution	Comments
Legal reserve	Restricted	This reserve is considered an integral part of the capital exactly like the original capital at par and cannot be distributed under any circumstances.
Statutory reserve	Restricted	Only a modification of the by-laws could allow the distribution of such reserves.
Regulated reserve	Unrestricted	The fiscal deduction that was obtained in exchange for the constitution of the reserve could be reversed if this reserve were distributed.
Revaluation reserve	Restricted	In some countries, it is however an unrestricted reserve to the extent that it corresponds to subsequently realized assets.

50

51

Reserves (cont.)

Description of reserve	Possibility of distribution	Comments
Capital redemption reserve (Reserve for treasury stock)	Restricted	The purpose of this reserve is to maintain the 'permanent capital' (capital and non-distributable reserves) even though the corporation holds some of its own shares.
Optional reserves	Unrestricted	However, they are generally created for a special purpose.
Profit/loss brought forward	Unrestricted	Is the difference between the period earnings and the sum of all additions to reserves incurred during the period. It is part of retained earnings.
Share premium	Restricted/Unrestricted	Although this is not strictly a reserve, it still is wealth belonging to shareholders. Some countries treat it as restricted while others consider it unrestricted and allow its distribution to all shareholders.

51

52

Real-life example
ENI (Italy – IFRS Standards – 2018)

Legal reserve [€959 million] This reserve represents earnings restricted from the payment of dividends pursuant to Article 2430 of the Italian Civil Code. The legal reserve has reached the maximum amount required by the Italian Law.

52

53

Legal Reserve – Portuguese law

Minimum 5% of profit, until legal reserves represents 20% of share capital

The firm's by-laws may determine a higher percentage and minimum amount for the legal reserve

The legal reserve may only be used for:

-Covering losses of the period that cannot be covered by other reserves

-Covering accumulated losses from previous periods that cannot be covered by either the profit of the period or by other reserves

-Incorporation in the capital

53

54

Reporting retained earnings and reserve

Balance sheet may be presented before or after appropriation

In the after appropriation method, the earnings of the year are not reported explicitly in the balance sheet. The earnings of the period are added to the retained earnings or to the reserves

	Retained earnings and reserves (up to end of previous period)
+	Net income (after tax) of the year
–	Dividends declared
–	Transfers to specifically identified reserves
=	Retained earnings and reserves (at year end)

Source: Table 11.1 from Stolowy, Ding & Paugam (2024)

54

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Presentation of shareholders' equity in the balance sheet

	Year X1	Year X2
Method 1 (After appropriation)		
Share capital	100	100
Share premium	18	18
Retained earnings (ending balance)	50	90*
Shareholders' equity	168	208
Dividends payable (liabilities)	0	30
Total shareholders' equity and liabilities	168	238

*[50 (beginning balance) + 70 (income of the period) − 30 (dividends payable)]

Income of period X1

Dividends have not been paid out by the reporting date

Most frequently used method in Europe

Method 2 (Before appropriation)		
Share capital	100	100
Share premium	18	18
Retained earnings (beginning balance)	0	50
Net income of the period (to be appropriated)	50	70
Shareholders' equity	168	238

Source: Table 11.2 from Stolowy, Ding & Paugam (2024)

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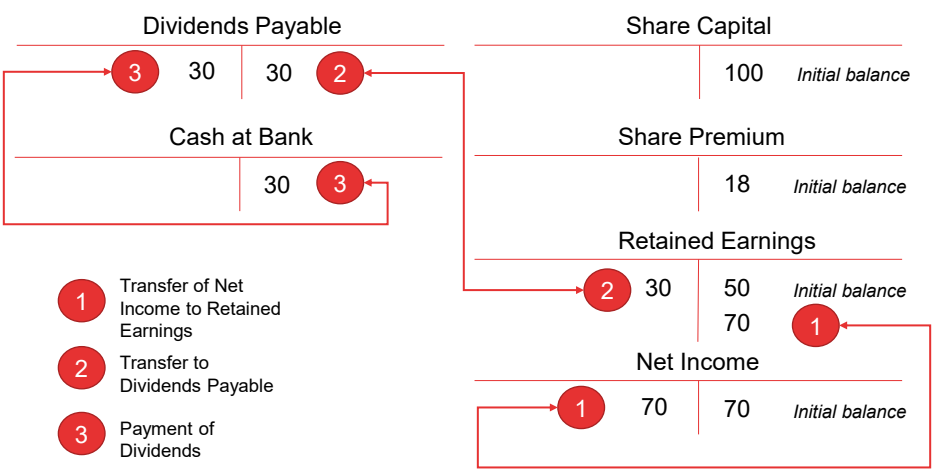
Accounting for profit appropriation

Method 2

Recordings that take place in Year X3 after the general assembly has approved the appropriation



1 Transfer of Net Income to Retained Earnings

2 Transfer to Dividends Payable

3 Payment of Dividends

Source: Based on Figure 11.3 from Stolowy, Ding & Paugam (2024)

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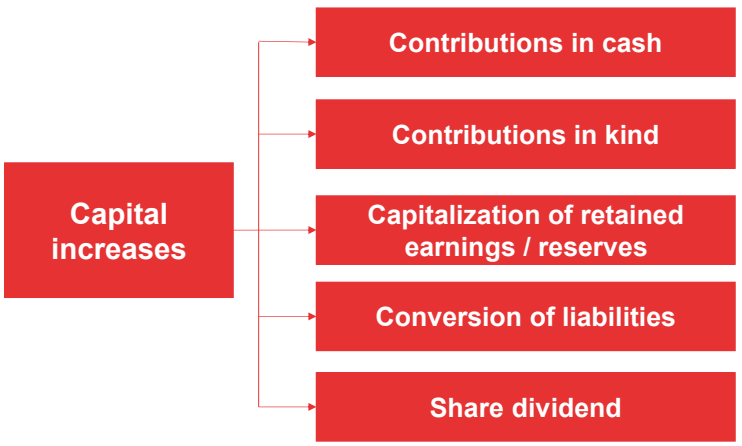
57

Issuance of shares for capital contributions



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58

Different types of capital increases

Types of increases	Objetives	Procedure	Impact on the Balance Sheet
In Cash	To obtain additional long-term financial resources without term limits	Issuance of new shares (at par or above par)	Increase of current assets and Increase of the capital account
Capitalization of Reserves	Reconcile the level of legal capital with the actual value of the assets and/or Strengthen the capital as a gesture of responsibility towards the firm's trading partners	Distribution of shares or Increase of the par value	Reduction of the reserves and Increase of Capital

Source: Table 11.4 from Stolowy, Ding & Paugam (2024)

58

59

Different types of capital increases (cont.)

Types of increases	Objetives	Procedure	Impact on the Balance Sheet
In Kind	Reinforce the growth potential of the firm by adding new tangible and intangible assets that will enhance the firm's future development	New shares are valued close to their fair market value	Increase in non-current assets and Increase of capital
Conversion of Liabilities	Reimburse debt without impacting on cash	New shares are valued close to their fair market value	Decrease in Liabilities and Increase of capital
Share Dividend	Reinforce the capital structure without strapping either the firm or the shareholders for cash	New shares are valued close to their fair market value	Reduction of Dividends Payable and Increase of capital

Source: Table 11.4 from Stolowy, Ding & Paugam (2024)

59

60

Accounting for a share issuance in cash – Example 1

Shareholders' equity = 250,000 C. U.

Share capital = 100,000 C. U. represented by 100,000 shares (par = 1 C.U.)

Capital increase of 50,000 C. U. (nominal value) by share issuance to be subscribed by new shareholders. Issue price equal to the book value of each share. Payment in cash.

Solution:

- Issue price = 250,000 C. U. / 100,000 = 2.50 C.U.
- Share premium per share = 2.50 C.U. – 1 C.U. = 1.50 C.U.
- Number of shares to be issued = 50,000 shares
- Subscription of shares = 50,000 shares x 2.50 C.U. = 125,000 C.U.
- Share premium = 50,000 shares x 1.50 C.U. = 75,000 C.U.

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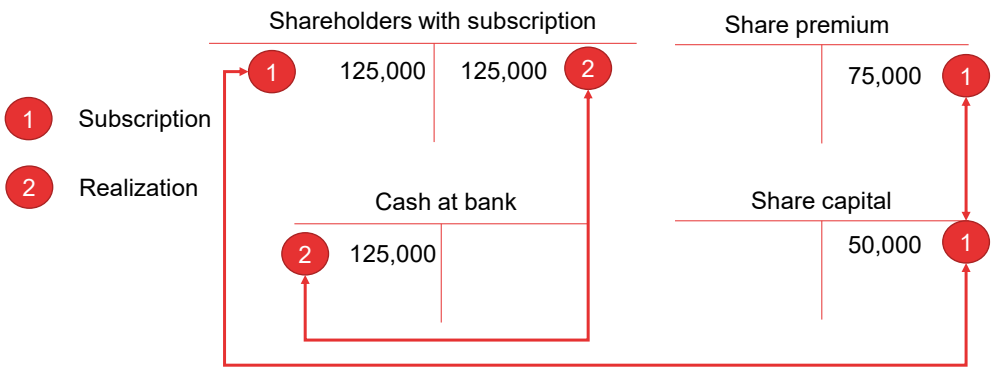
Accounting for a share issuance in cash – Example 1 (cont.)



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Accounting for a share issuance in cash – Example 2

Share capital = 500,000 C. U. represented by 100,000 shares (par = 5 C.U.)

Capital increase by share issuance of 1,000,000 shares. Issue price equal to 6.50 C.U. per share. Public subscription with payment of 50%

Shares were subscribed in excess: 1,250,000 shares → rationing of shares among subscribers

62

63

Accounting for a share issuance in cash – Example 2 (cont.)

Solution:

- Nominal value of capital increase = 1,000,000 x 5 C.U. = 5,000,000 C.U.
- Share premium per share = 6.50 C.U. – 5 C.U. = 1.50 C.U.
- Share premium = 1,000,000 x 1.50 C.U. = 1,500,000 C.U.
- Subscription of shares = 1,000,000 x 6.50 C.U. = 6,500,000 C.U.
- Surplus subscription = 250,000 x 6.50 C.U. = 1,625,000 C.U.
- Total subscription = 6,500,000 + 1,625,000 = 8,125,000 C.U.
- Amount received on subscription date = 8,125,000 x 50% = 4,062,500 C.U.

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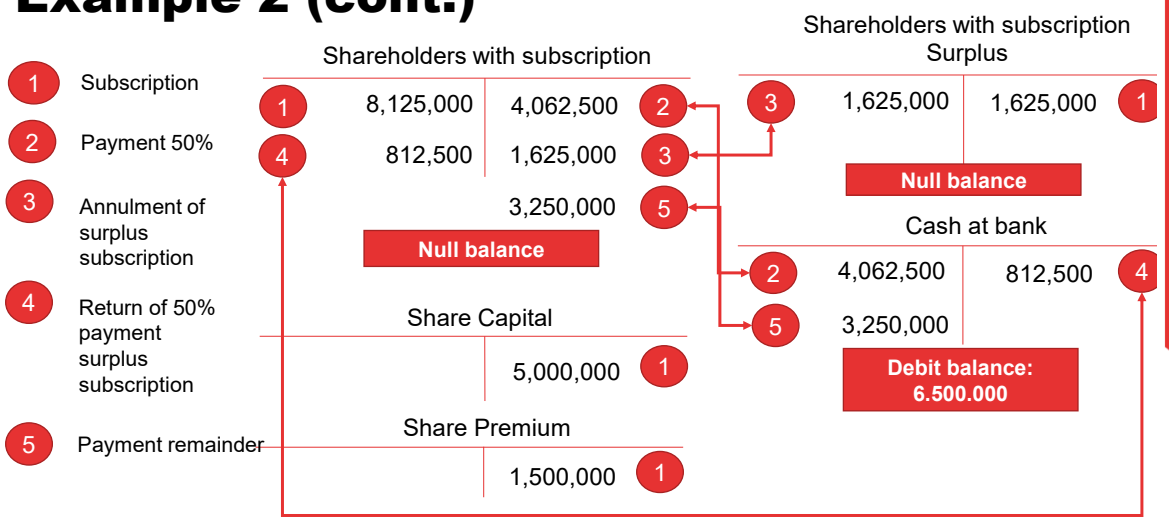
Accounting for a share issuance in cash Example 2 (cont.)



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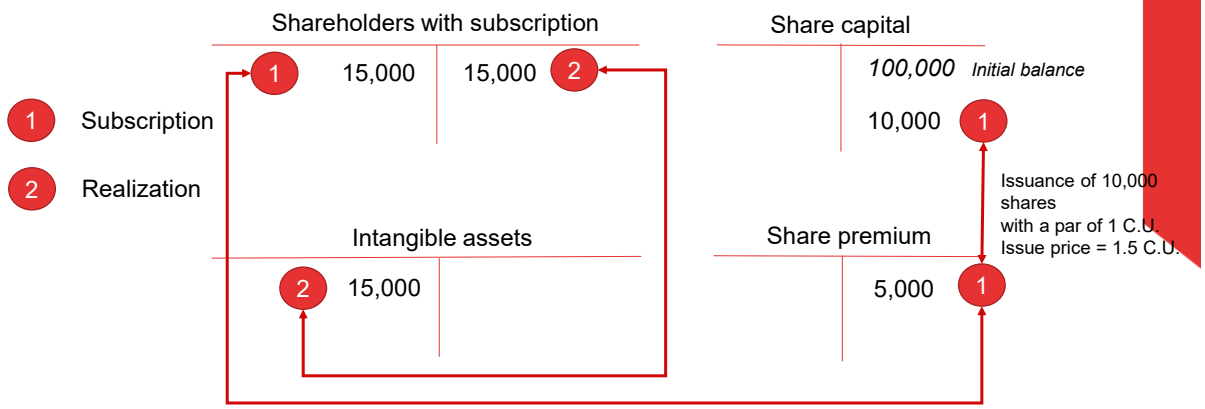
Accounting for a share issuance in kind (patent)



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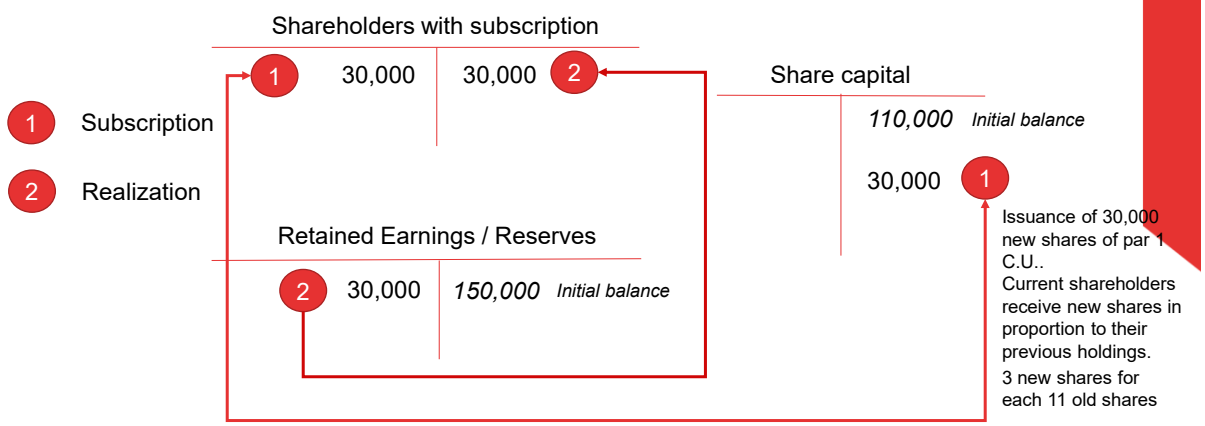
Accounting for a share issuance by capitalization of reserves



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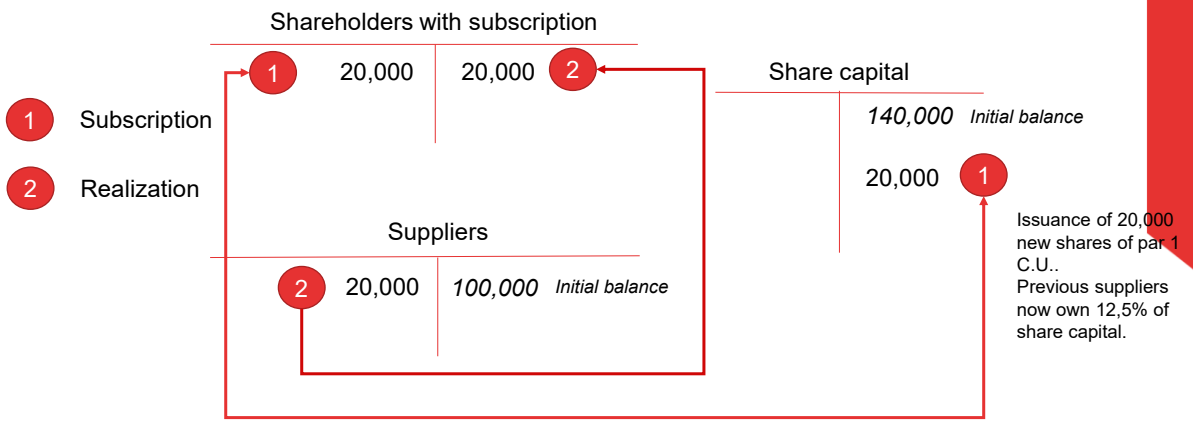
Accounting for a share issuance by conversion of liabilities (suppliers)



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68

Accounting for share issuance costs

Three different ways to record share issuance costs:

Considered to be a period cost and recognized in the corresponding income statement

Capitalized as an intangible asset and amortized (in general over a maximum of 5 years)

Written-off against equity (i.e., the total accumulated share premium, in practice) (solution admitted in IAS 32, 2018, § 37)

68

69

Capital reduction

Reasons for capital reduction:

To take into account the reality created by accumulated losses

To distribute cash to shareholders. Reducing the number of shares outstanding increases the residual claim on firm value for each shareholder (accretion). After a firm has repurchased its own shares, it must cancel those shares to reduce capital

69

70

Different types of capital reductions

Types of reductions	Objetives	Procedure	Impact on the Balance Sheet
Cover accumulated Losses	Clean up financial statements since reserves are insufficient and future earnings prospects are not good. Signals ability to assume responsabilities is reduced.	Decrease in the par value of the existing shares and zero out accumulated losses.	Balanced out share capital against accumulated losses.
Retirement of Shares – either on private firms (shareholder leaving) or on public firms (market reasons)	Private firms: shareholders wants to leave and can't find an interested third party. Public firms: OWN SHARES (see slide 75).	Private firms: proportional reduction of share capital and retained earnings/reserves and decrease in cash. Public firms: see slide 75.	Reduction of the share capital and reserves/ retained earnings and Decrease of cash.

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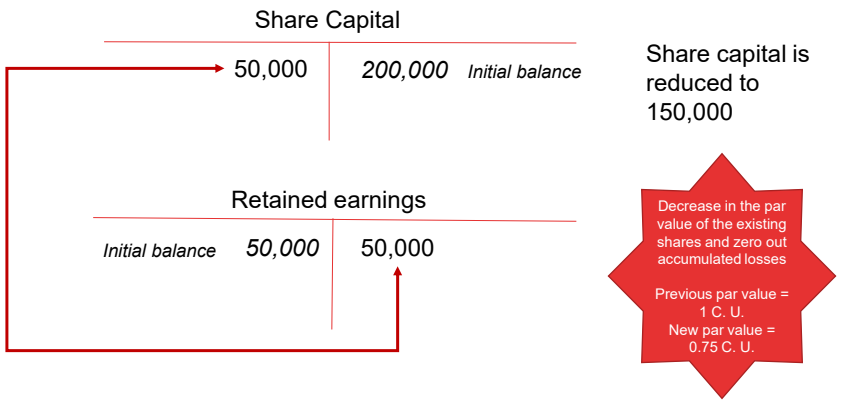
Accounting for capital reduction to cover for accumulated losses



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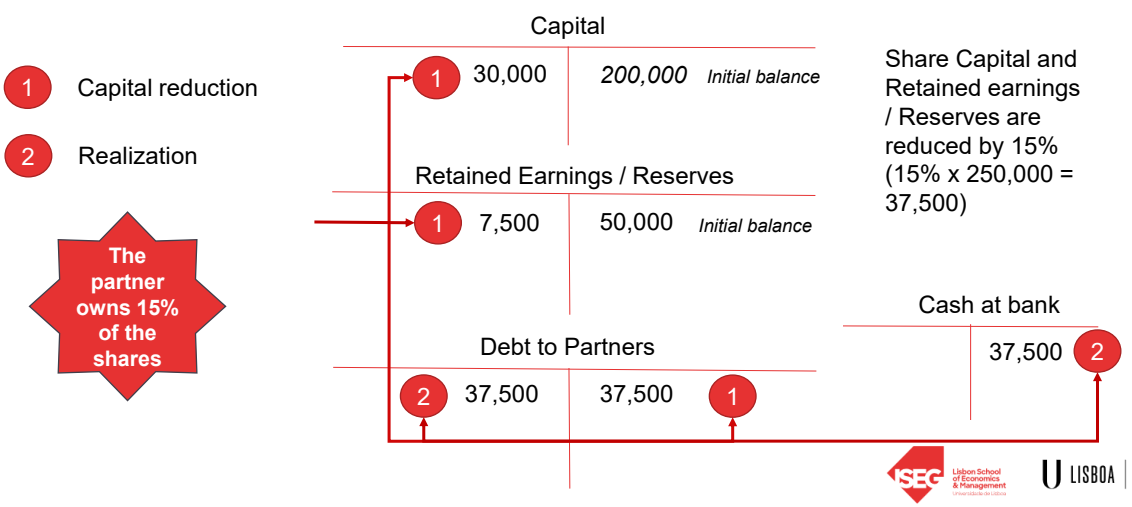
Accounting for capital reduction due to partner leaving (private firm)



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73

Why repurchase own shares (or treasury stock)?

Reduce capital by cancelling repurchased shares → increase market value (higher earnings per share)

Employee profit-sharing plan (shares or stock options) (in case of no additional autorized shares and no intent to dilute existing shares)

Smooth market value (signaling firm is undervalued)

Prevent hostile takeover by reducing floating stock

To mitigate liquidity constraints for existing shareholders (firm acts as broker)

73

74

Accounting for retirement of shares to reduce share capital

1 Purchase of own shares

2 Reduction of capital by cancelling the shares

Reduce capital by cancelling repurchased shares

Share Capital

2	40,000	*200,000*	*Initial balance*

Share Premium / Retained Earnings / Reserves

2	20,000	*100,000*	*Initial balance*

Own Shares

1 60,000	60,000	2

Cash at bank

60,000	1

Share Capital and Share Premium / Retained earnings / Reserves are reduced by 20%

300,000 x 20% = 60,000

74

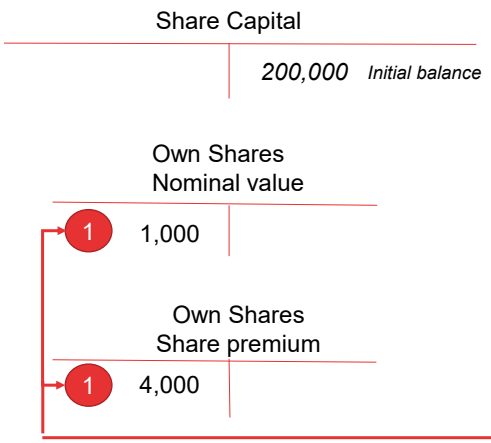
75

Accounting for the purchase of own shares

Purchase own shares for other reasons

1 Purchase of own shares

Some countries require the constitution of a "reserve for own shares" until they are sold → the case of Portugal



Share capital represented by 200,000 shares → Nominal value = 1 C.U.

1,000 own shares purchased for 5 C.U.

75

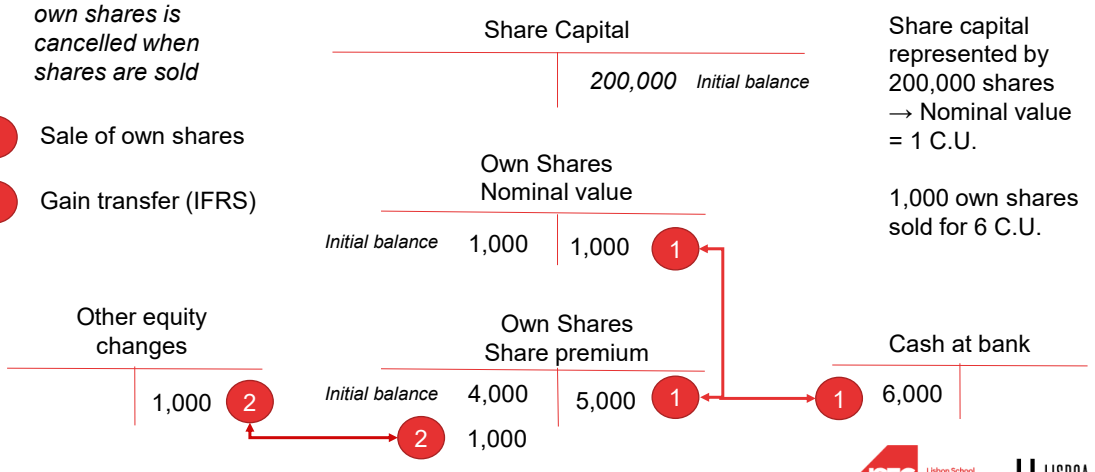
76

Accounting for the sale of own shares

The reserve for own shares is cancelled when shares are sold

1 Sale of own shares

2 Gain transfer (IFRS)



Share capital represented by 200,000 shares → Nominal value = 1 C.U.

1,000 own shares sold for 6 C.U.

76

77

Comprehensive income

No definition of 'comprehensive income' *per se* by the IASB

'Total comprehensive income': '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'

'Other comprehensive income': 'Items of income and expense (including reclassification adjustments) that are not recognized in profit or loss as required or permitted by other IFRSs)' (IAS 1 § 7)

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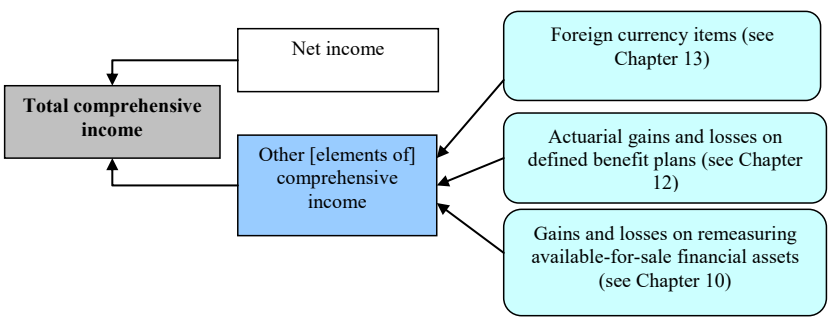
Components of total comprehensive income



Source: Figure 6.5 from Stolowy, Ding & Paugam (2024)

78

79

Comprehensive income in IAS 1

	20X7	20X6
Profit for the year [from the income statement]	121,250	65,500
Other [elements of] comprehensive income:		
Exchange differences on translating foreign operations	5,334	10,667
Available-for-sale financial assets [change in value]	(24,000)	26,667
Cash flow hedges	(667)	(4,000)
Gains on property revaluation	933	3,367
Actuarial gains (losses) on defined benefit pension plans	(667)	1,333
Share of other comprehensive income of associates	400	(700)
Income tax relating to components of other comprehensive income	4,667	(9,334)
Other comprehensive income for the year, net of tax	(14,000)	28,000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	107,250	93,500
Total comprehensive income attributable to:		
Owners of the parent	85,800	74,800
Non-controlling [or minority] interests	21,450	18,700
	107,250	93,500

Source: Table 6.9 from Stolowy, Ding & Paugam (2024)

79

80

XYZ Group – Statement of changes in equity for the year ended 31 December X8 (in thousands of C.U.) (source: IAS 1)

	Share capital	Retained earnings	Translation of foreign operations	Available-for-sale financial assets	Cash flow hedges	Revaluation surplus	Total	Non-controlling interests	Total equity
Balance at 1 January 20X6	600,000	118,100	(4,000)	1,600	2,000	-	717,700	29,800	747,500
Changes in accounting policy	-	400	-	-	-	-	400	100	500
Restated balance	600,000	118,500	(4,000)	1,600	2,000	-	718,100	29,900	748,000
Changes in equity for 20X6									
Dividends	-	(10,000)	-	-	-	-	(10,000)	-	(10,000)
Total comprehensive income for the year	-	53,200	6,400	16,000	(2,400)	1,600	74,800	18,700	93,500
Balance at 31 December 20X6	600,000	161,700	2,400	17,600	(400)	1,600	782,900	48,600	831,500
Changes in equity for 20X7									
Issue of share capital	50,000	-	-	-	-	-	50,000	-	50,000
Dividends	-	(15,000)	-	-	-	-	(15,000)	-	(15,000)
Total comprehensive income for the year	-	96,600	3,200	(14,400)	(400)	800	85,800	21,450	107,250
Transfer to retained earnings	-	200	-	-	-	(200)	-	-	-
Balance at 31 December 20X7	650,000	243,500	5,600	3,200	(800)	2,200	903,700	70,050	973,750

Source: Table 11.3 from Stolowy, Ding & Paugam (2024)

80

TOPICS ON FINANCIAL ACCOUNTING

GRANTS AND SUBSIDIES

Readings: Chapter 6 (8)

81

82

Grants and subsidies – IAS 20

Government direct financial support to businesses for special purposes

Categories of government assistance:

-Grants related to assets (or “investment grants”)

-Grants related to income

-Forgivable loans (loans that will not need to be reimbursed if certain conditions are met)

82

83

Grants related to assets (IAS 20)

Two methods of presentation in financial statements of grants related to assets are regarded as acceptable alternatives:

-Method 1: recognizes the grant as deferred income that is recognized in profit or loss on a systematic basis over the useful life of the asset.

-Method 2: deducts the grant in calculating the carrying amount of the asset. The grant is recognized in profit or loss over the life of a depreciable asset as a reduced depreciation expense

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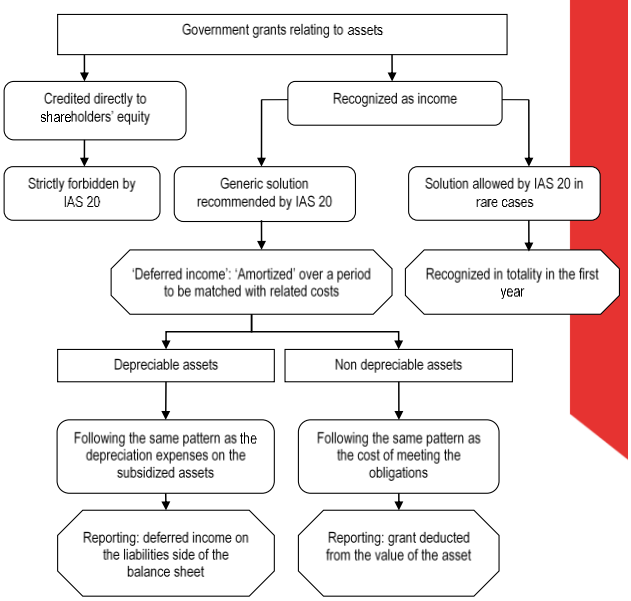
Accounting and reporting for investment grants in IAS 20



Source: Figure 6.6 from Stolowy, Ding & Paugam (2024)

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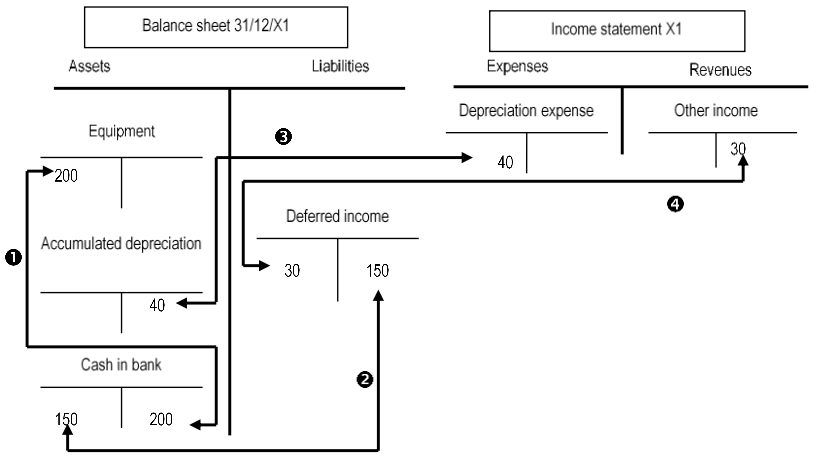
Accounting for an investment grant (IAS 20 generic solution)



Source: Figure 6.7 from Stolowy, Ding & Paugam (2024)

❶ Purchase of the equipment on cash.
❷ Receipt of the investment grant, which is recorded as a deferred income on the liabilities side of the balance sheet.
❸ Depreciation of the equipment over 5 years (annual depreciation allowance is 200 CU/5 = 40 CU per year).
❹ Every year, during 5 years, the deferred income is transferred to the income statement, following the pattern of the depreciation of the fixed asset (150/5 = 30).

85

86

Grants related to assets (NCRF 22)

Government grants related to tangible and intangible assets, should be **initially recognized** in the statement of financial position as part of shareholders' equity, and

Subsequently:

-Depreciable assets: recognized in profit or loss on a systematic basis over the useful life of the asset

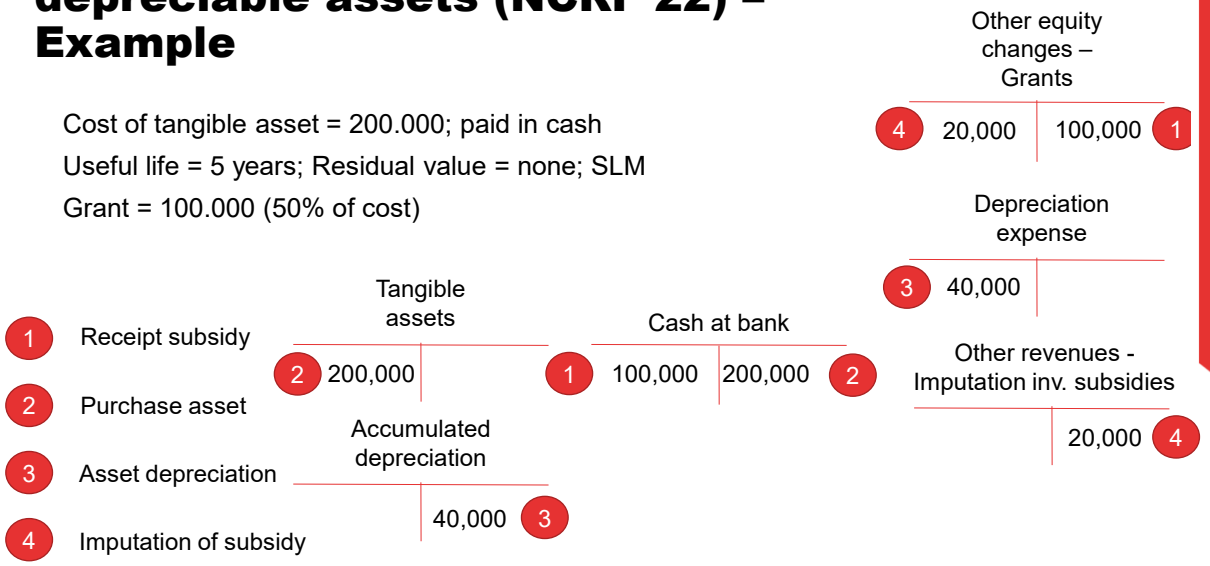
-Non-depreciable assets: recognized as part of shareholders' equity, except when an imparment loss needs to be recognized and part of the grant is transferred from shareholders' equity to profit or loss to compensate for the impairment loss.

86

87

Accounting for a grant related to depreciable assets (NCRF 22) – Example

Cost of tangible asset = 200.000; paid in cash
Useful life = 5 years; Residual value = none; SLM
Grant = 100.000 (50% of cost)



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88

Comparison of the use of different recognition methods (IAS/IFRS, NCRF)

	NCRF	IFRS (deferred income)	IFRS (deducted value asset)
Cash	(100,000)	(100,000)	(100,000)
Tangible asset:			
Gross Value	200,000	200,000	100,000
Acc. depreciation	(40,000)	(40,000)	(20,000)
Net value	160,000	160,000	80,000
Liabilities	–	80,000	–
Other equity changes	80,000	–	–
Depreciation expense	(40,000)	(40,000)	(20,000)
Other rev - imputation	20,000	20,000	–
Impact on earnings	**(20,000)**	**(20,000)**	**(20,000)**

88

89

Real-life example
Bayer (Germany – IFRS Standards – 2018)

Bayer, the Germany-based international chemicals and health care group, states in the Notes to its 2018 annual report that grants and subsidies from third parties that serve to promote investment are reflected in the statement of financial position under other liabilities and amortized [i.e., transferred] to income over the useful lives of the respective investments or in line with the terms of the grant or subsidy. The deferred income included €30 million (2017: €48 million) in grants and subsidies received from governments, of which €3 million (2017: €17 million) was reversed to profit or loss.

89

90

Grants related to income

Grants related to income (or “operating grants”) are included in the income statement when received or alternatively, as a deduction of the related expense

Ex. Grants for creating jobs or capacity development (skills)

90

91

Forgivable loan or repayable grant

Can be waived under certain conditions (ex: effective job creation)

Or, repayable in case of success (ex: R&D grant)

Accounting treatment: potential debt (ex. “conditional advances received from the state”) until the condition has been met or it is established the conditions will not be met

If repayment is required → treat as normal loan

If repayment is waived, meaning conditions are met → recognize as operating revenue, or exceptional revenue recorded when the loan is forgiven

91

TOPICS ON FINANCIAL ACCOUNTING

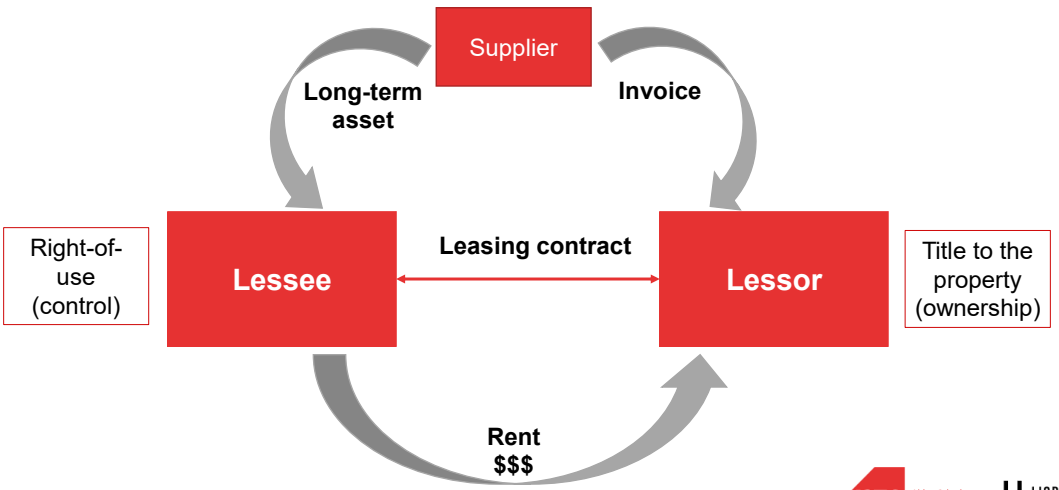
LEASING

Readings: Chapter 12 (8)

92

93

Leased assets



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Leased assets

IFRS 16 *Leases* - effective for annual periods beginning on or after 1 January 2019

Supersedes IAS 17

IAS 17: distinction between finance leases and operating leases → NCRF 9 follows IAS 17

IFRS 16: single lessee accounting model (equivalent to finance leases)

94

95

Leases (IFRS 16)

IFRS 16 applies to all leases, with two exceptions:

(a) short-term leases

(b) leases for which the underlying asset is of low value

A short-term lease is defined as a "lease that, at the commencement date, has a lease term of 12 months or less. A lease that contains a purchase option is not a short-term lease" (IFRS 16)

95

96

Leases (IFRS 16)

"An underlying asset can be of low value only if:

(a) the lessee can benefit from use of the underlying asset on its own or together with other resources that are readily available to the lessee; and

(b) the underlying asset is not highly dependent on, or highly interrelated with, other assets" (§ B5)

"Examples of low-value underlying assets can include tablet and personal computers, small items of office furniture and telephones" (§ B8)

If the lessee uses the exceptions of the standard, the accounting treatment of the leased asset will be similar to the one in place for operating leases in IAS 17 (see second slide on NCRF 9)

96

97

Leased assets – Initial measurement

IFRS 16 § 22: “at the commencement date, a lessee shall recognize a right-of-use asset and a lease liability”

IFRS 16 § 23: at the commencement date, a “lessee shall measure the right-of-use asset at cost”. The cost shall comprise (§ 24):

-The amount of the initial measurement of the lease liability

-Any lease payments made at or before the commencement date, less any lease incentives received

-Any initial direct costs incurred by the lessee, **and**

-An estimate of the costs of dismantling and removing the asset incurred by the lessee

97

98

Leased assets – Initial measurement (cont.)

The lease liability will be measured by the present value of the lease payments that are not paid at the commencement date

The lease payments shall be discounted using the interest rate implicit in the lease or the lessee’s incremental borrowing rate in case the former cannot be determined

98

99

Example – Initial measurement

Leasing contract with the following conditions:

Term: 15 years

Annual rent: 150,000 C.U. (1st payment on signature date)

Initial direct costs: 30,000 C.U.

Implicit rate: 4%

Lease liability calculated as annual rent (150,000) discounted at the implicit rate (4%) for the term of the contract (1 - 14 years) = 1,584,468 C.U.

ROU = lease liability + 1st payment rent + initial direct costs = 1,584,468 + 150,000 + 30,000 = 1,764,468 C.U.

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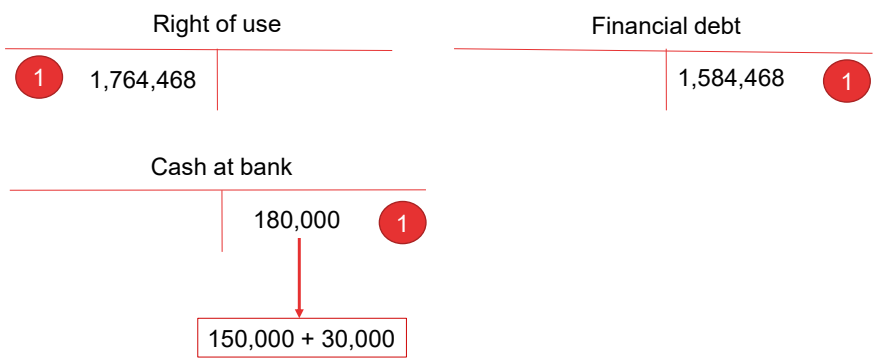
Example – Initial recording



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Leased assets – Subsequent measurement

IFRS 16 § 29 and 30: right-of-use shall be measured applying, in general, a cost model:

Cost – Accumulated depreciation – Accumulated impairment losses

- IFRS 16 § 34-35: Exceptions: fair value for "Investment Properties" (shall) or revaluation model for Tangible Assets (may)

101

102

Leased assets – Subsequent measurement

IFRS 16 § 36: After the commencement date, the lease liability (amortized cost) is measured by:

-increasing the carrying amount to reflect interest on the lease liability;

-reducing the carrying amount to reflect the lease payments made; **and**

-remeasuring the carrying amount to reflect any lease modifications or to reflect fixed lease payments.

102

103

ROU asset depreciation

When lease contract includes purchase option at the term of the contract → depreciation from the commencement date until the end of the useful life of the asset

Otherwise → depreciation from the commencement date to the earliest date between the end of the useful life and the end of the lease term

103

104

Example of accounting for leased assets (example based on IAS 17 and still valid with IFRS 16)

- Value of the equipment 600 CU
- Total payments (5 x 150 + 10) 760 CU

$$\text{Value of the leased equipment} = \text{Lease payment} \times \sum_{t=1}^{5} \frac{1}{(1+i)^t} + \frac{\text{Purchase option}}{(1+i)^5}$$

$$= 150 \times \sum_{t=1}^{5} \frac{1}{(1+i)^t} + \frac{10}{(1+i)^5}$$

rate of interest **i** = 8.357%.

Contract period = 5 years
Annual lease payment = 150 C.U.
Purchase option (end) = 10 C.U.
Useful life equipment = 8 years

104

105

Repayment schedule of the debt

Year	Beginning lease liability	Interest expense	Repayment of liability	Lease payment	Ending lease liability
	(1)	(2)=(1) × 8.357%	(3)=(4)−(2)	(4)	(5)=(1)−(3)
Year 1	600.00	50.14	99.86	150.00	500.14
Year 2	500.14	41.80	108.20	150.00	391.94
Year 3	391.94	32.75	117.24	150.00	274.70
Year 4	274.70	22.96	127.04	150.00	147.66
Year 5	147.66	12.34	137.66	150.00	10.00
Purchase	10.00		10.00	10.00	0.00
Total		160.00	600.00	760.00	

Source: Table 12.7 from Stolowy, Ding & Paugam (2024)

105

106

Depreciation schedule of the leased equipment (SLM)

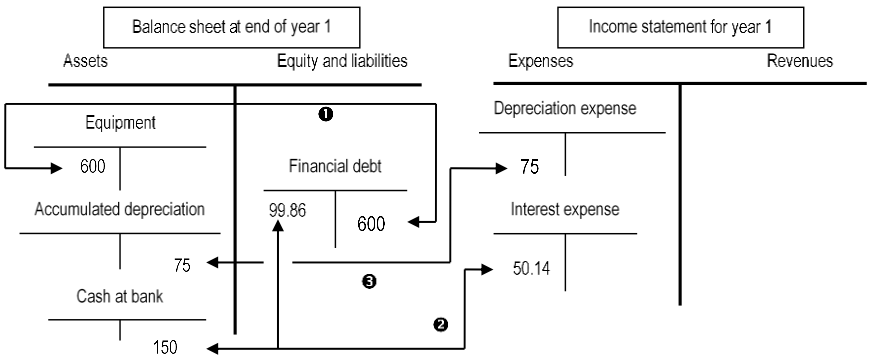
Year	Depreciable basis	Depreciation expense	Book value
Year 1	600	75	525
Year 2	600	75	450
Year 3	600	75	375
Year 4	600	75	300
Year 5	600	75	225
Year 6	600	75	150
Year 7	600	75	75
Year 8	600	75	0

Source: Table 12.8 from Stolowy, Ding & Paugam (2024)

106

107

Accounting for leased equipment



❶ The leased equipment is recorded as both an asset and a liability (for the same amount).
❷ The lease payment (150) is split between interest expense and repayment of the financial debt (figures are derived from Table 12.8).
❸ The leased asset is depreciated over eight years (figures are derived from Table 12.9).

Source: Figure 12.8 from Stolowy, Ding & Paugam (2024)

107

108

Sale and leaseback

A sale and leaseback transaction takes places when 'an entity (the seller-lessee) transfers an asset to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor' (IFRS 16, IASB 2018, § 98).

Underlying reasons, such as:

-providing liquidity to the business;

-increasing the costs deducted from income (when rent > depreciation);

-allowing the effective deductibility of the value of the land that is sold and leased back (the rent becomes deductible while it could not be depreciated when owned outright).

108

109

Reporting of leased assets (IFRS 16)

IFRS 16 § 47: a "lessee shall either present in the statement of financial position, or disclose in the Notes":

-Right-of-use assets (ROU) separately from other assets

-Lease liabilities separately from other liabilities

IFRS 16 § 52: a "lessee shall disclose information about its leases for which it is a lessee in a single note or separate section in its financial statements" – example of information to be disclosed: depreciation of ROU by class of asset, interest expense on lease liabilities, etc…

109

110

Real-life example Publicis (France – IFRS Standards – 2018) (1/3)

Consolidated balance sheet (excerpts)		
(in millions of euros)	December 31, 2018	December 31, 2017
Assets		
Goodwill, net	8,751	8,450
Intangible assets, net	1,125	1,124
Right-of-use assets related to leases	1,732	–
Property, plant and equipment, net	611	590
(…)		
Non-current assets	**12,646**	**10,527**
(…)		
Current assets	**14,434**	**13,253**
Total assets	**27,080**	**23,780**
Equity and Liabilities		
(…)		
Total equity	**6,853**	**5,958**
Long-term borrowings	2,425	2,780
Long-term lease liabilities	1,648	–
(…)		
Non-current liabilities	**4,903**	**3,614**
(…)		
Short-term borrowings	449	350
Short-term lease liabilities	393	–
(…)		
Current liabilities	**15,324**	**14,208**
Total equity and liabilities	**27,080**	**23,780**

110

111

Real-life example
Publicis (France – IFRS Standards – 2018) (2/3,

Notes
New standards and interpretations applied early
• IFRS 16 'Leases'
The Group decided to early apply IFRS 16 'Lease Contracts' from January 1, 2018. The Group rents its offices in most of the cities in which it operates. In addition, as part of its advertising network activity, the Group has entered into advertising outdoor contracts.
Finally, the rental agreements within the scope of application of IFRS 16 also concern vehicles and computing equipment. Previously, each lease contract was qualified either as finance lease, or as operating lease, with accounting treatment appropriate for each category. In application of IFRS 16, all lease contracts are now recognized in right-of-use assets and in lease liabilities by a debt corresponding to the discounted value of future payments. Lease term is defined on a contract-by-contract basis and corresponds to the firm period of the commitment taking into account any optional periods that are reasonably certain to be exercised. (…)

Lease contracts
Leases are recognized on the Balance sheet at the outset of the lease at the present value of future payments. These leases are recognized under "Lease liabilities" on the liabilities side, offset by "Rights-of-use under leases" on the assets side. They are amortized over the term of the lease, which is typically the fixed period of the lease unless there is a stated intention to renew or terminate. In the Income Statement, depreciation and amortization expenses are recognized in the operating margin and interest expenses under net financial income (expenses). The tax effect of this restatement for consolidation purposes is accounted for through the recognition of deferred tax assets or liabilities.
Leases of low-value assets or short-term leases are immediately expensed in profit or loss.

111

112

Real-life example
Publicis (France – IFRS Standards – 2018) (3/3,

Note 25 Lease contracts
Analysis of right-of-use assets by category of underlying property

(in millions of euros)	Real estate	Concession agreements	Others assets	Total
December 31, 2017				
First application of IFRS 16	1,616	248	42	1,906
Addition of assets	364	–	2	366
Impairment losses	(30)	–	–	(30)
Lease inducements	(92)	–	–	(92)
Amortization expense	(260)	(105)	(14)	(379)
Terminations	(35)	–	–	(35)
Changes to consolidation scope	(8)	–	(16)	(24)
Translation adjustments and other	19	–	1	20
December 31, 2018	1,574	143	15	1,732

Analysis of maturities of lease liabilities

At December 31, 2018 (in millions of euros)	Total	−1 year	1–2 years	2–3 years	3–4 years	+4 years
Lease obligations	2,041	393	279	234	202	933

For 2018, the interest expense on lease liabilities was euro 58 million.

112

113

Real-life example
Air France KLM (France – IFRS Standards – 2018)

Types of non-capitalized lease contracts

The Group uses the two exemptions foreseen by the standard allowing for non-recognition in the balance sheet: short-term lease contracts and lease contracts for which the underlying assets have a low value.

- Short duration lease contracts

There are contracts whose duration is equal to or less than 12 months. Within the Group, they mainly relate to leases of:

- surface areas in our hubs with a reciprocal notice-period equal to or less than 12 months;
- accommodations for expatriates with a notice period equal to or less than 12 months;
- spare engines for a duration equal to or less than 12 months.

- Low value lease contracts

Low-value lease contracts concern assets with a value equal to or less than US$5,000. Within the Group, these include, notably, lease contracts on printers, tablets, laptops and mobile phones.

113

114

NCRF 9 (based on former international standard IAS 17)

Distinguishes between:

-Finance lease – that transfers substantially the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred;

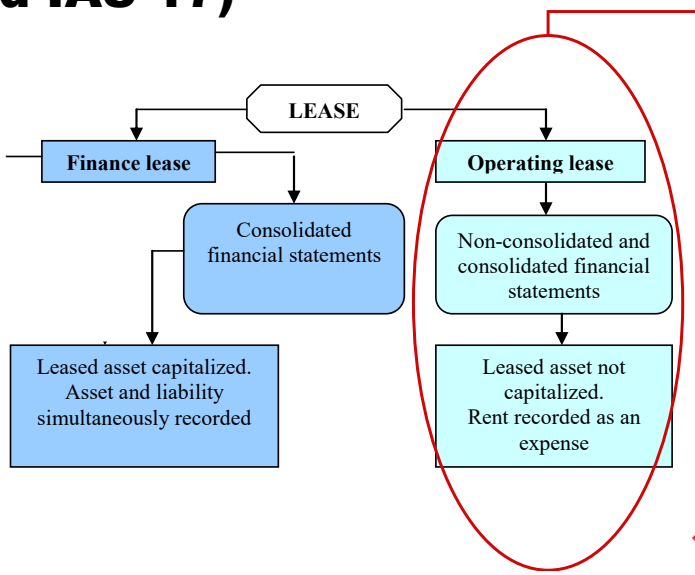
-Operating lease – that are other than finance lease

Relevant difference in comparison with IFRS 16

114

115

NCRF 9 (based on former international standard IAS 17)



115

116

Lessor

A lessor shall classify each of its leases as either an operating lease or a finance lease

Substance over form

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset; otherwise it is classified as an operating lease

116

117

Lessor- Finance lease

Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

Transfer of ownership by the end of the lease term

The price of the purchase option makes it reasonably certain, at the inception date, that the option will be exercised

Lease term is for the major part of the economic life of the asset

At the inception date, the present value of the lease payments amounts to at least substantially all of the fair value of the asset **and**

The asset is of a specialized nature

117

118

Lessor - Accounting for a finance lease

Initial measurement: recognize assets held under a finance lease in its statement of financial position and present them as a receivable at an amount equal to the net investment in the lease (using interest rate implicit in the lease)

Subsequent measurement: recognize finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the lease.

118

119

Lessor - Accounting for an operating lease

Measurement: recognize lease payments from operating leases as income on either a straight-line basis or another systematic basis

The asset subject to operating lease remains in the statement of financial position of the lessor and is depreciated according to the depreciation policy for similar assets (IAS 16 and IAS 38 are applied)

119

120

FINANCIAL ACCOUNTING II

UNDERGRADUATE COURSES: MANAGEMENT, ECONOMICS AND FINANCE

2025/2026

1S

120

121