

Effects of changes to international accounting standards



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This report relates to the recent changes in the International Accounting Standards. Furthermore, it underlines the primary principles that Sky Corporation must comply with.

(1)(a) REQUIRED CHANGES UNDER INTERNATIONAL ACCOUNTING STANDARDS

After the introduction of the International Accountant Standards, all public limited companies must comply with these provisions. Sky Corporation must adhere to the IAS 1, effective on all financial statements dating on and from

1st January 2005. In effect the Sky plc will have to prepare its financial statements on a going concern basis unless there is an intension to liquidate the entity, accrual basis of accounting must be used in the preparation of financial statements except for cash flow statements, presentation and classification of items must be obtained from one period to the next, material class of similar items must be presented separately and dissimilar items must be included separately unless they are immaterial, items (individually or collectively) that are likely to influence the economic decision of the user must not be omitted or misstated, assets, liabilities, income and expenses must not be offset unless approved by an IFRS, financial statements must be presented at least annually, all amounts relating to comparative information must be disclosed in financial statements.

Furthermore, Sky must adhere to the disclosure requirements on the face of or in the notes to the balance sheet BS, income statement and statement of changes in equity. Current and non-current assets and liabilities must be present as separate classification on the face of the BS. Additionally, financial statements must include specified disclosure in relation to information, judgements, estimations, uncertainties and accounting policies.

At present, Sky's accountant made a statement indicating that the financial statements in the forthcoming November 2005 accounts will comply with the principles of IAS. In addition, the company's financial statements included audited reconciliation of the 2005 Income Statement, Balance Sheet and Cash Flow to UK GAAP from IFRS detailing the impact of the Company's new

accounting policies, and unaudited quarterly 2005 Income Statements to provide comparatives for 2006.

(1)(b) MERITS AND DEMERITS OF EXTINCTION OF EXTRAORDINARY ITEMS

ISA 1 regarding the presentation of financial statements was issued in December 2003 and is applicable for annual periods beginning on or after 1 January 2005. International Accounting Standard (IAS 1) prescribes the grounds for presentation of general-purpose financial statements, to ensure comparability both with entity's financial statements of previous periods and with financial statements of other entities.

ISA 1 does not serve any application to interim financial statements prepared in accordance with the ISA 34. Under the SSAP 6 extraordinary items are material items which are transaction that fall outside the ordinary activities of the company and thus not expected to recur frequently or regularly. By excluding extraordinary items from the P&L, this will reflect on the EPS. Exclusion of extraordinary items will benefit the current operating performance. As far as Sky Communications Plc is, concern there appears to be no extraordinary items in their P&L account. Additionally, EPS will be greater than expected if extraordinary items were included since the EPS is used by investors to calculate PE ratio. The exclusion of extraordinary items could also lead to an increase in corporation tax.

(1)(c) RECOGNISED GAINS AND LOSSES AND HISTORICAL COSTS

Under the FRED 22 (revision of FRS3) which aim to reflect the international shift, makes provisions for reporting comprehensive income such as

reporting all recognised gains and losses in a sole statement instead of splitting these gains and losses between the performance statement and the STRGL. There is a need for the display of recognised gains and losses as they are part of the company's operating activities and some are financial in nature. There is a list of recognised gains and losses that should appear in the treasury section of the performance statement. According to Sky's accounts for 2004 and 2005, there were no recognised gains or losses in either year other than those included within the profit and loss account.

Primarily, statement of total recognised gains and losses are financial statements that enable users to consider all recognised gains and losses of a reporting company in assessing the company's overall performance.

Notes of historical costs are necessary as it identifies the resources acquired by the company at their original price. In effect, this identifies how the items are actually measured over a period. Additionally, it assists with the understanding of capital maintenance adjustments. Firstly, assets are recorded at the value of the consideration given to acquire them at the time of acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation. The purpose for this is to measure the process of determining the monetary amounts in which the element of the financial statements are to be recognised and carried in the balance sheet and in the income statement.

(1)(d) CLASSIFICATION OF PREFERENCE SHARES AND DIVIDENDS

According to the IAS 1 preference shares are reclassified to borrowings and the preference dividends are reclassified to finance costs. However, when <https://assignbuster.com/effects-of-changes-to-international-accounting-standards/>

preference shares are non-redeemable, the appropriate classification is determined by the rights attached to the preference shares. Classification is dependent upon an assessment of the substance of the contractual arrangements, equity instrument and the definition of financial liability. Furthermore, the classification of preference shares as an equity instrument or a financial liability is unaffected by a history of making distributions and an intention to make distribution in the future.

Under IAS 10, a company must not recognise a liability for dividends in respect of dividends declared after the balance sheet date as it is not a current liability at the balance sheets date under IAS 37. In the event that a company purchases its preference shares for cancellation for more than their carrying amount (premium) then this should be treated as preferred dividend in the calculation of EPS.

(2)(a) OBJECTIVES OF IAS 7 AND DISTINCTION BETWEEN IAS 7 & FRS1

The structure of the IAS 7 had an influence on the revision of FRS 1. The objective of IAS 7 is that a cash flow statement of a company must correspond to the requirements and identifications under IAS1. In addition, the cash flow must identify movement in cash and cash equivalents during the financial period (cash equivalents are short term and highly liquid investments). Furthermore, there must be a provision identifying and classifying the changes in cash and cash equivalents to operating, investing and financing activities.

In a number of cases, there are conflicting factors between the framework of the Financial Reporting Standards and the International Accounting

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Standards. In the event of conflict, the framework of the International Accounting Standards prevails over the Financial Reporting Standards.

IAS 7 requires companies to present cash flow statements as part of a company's financial statement. International Accounting Standards (IAS 7) is a mechanism that provide additional information on the company's business activities, assess the present liquidity of the business activities, demonstrate substantial cash flow sources, assist with the estimation of future cash flows and finally will identify cash flow accumulated from trading activities rather than sources of finance.

(2)(b) PREPARATION OF A CASH FLOW STATEMENT UNDER A DIRECT METHOD UNDER IAS7 & FRS1

The following is a cash flow for Sky plc prepared in accordance with the direct method IAS 7:

	(£000' s)
Cash Flows from Operating Activities:	
Net Profit before Tax	11, 600
Adjustment for:	
Depreciation	6, 000

Loss on Sale Non-current Assets	25
Interest Expense	<u>2,150</u>
Operating Profit before Working Capital Changes	19,775
Increase in Inventory	(2,000)
Increase in Receivables	(2,500)
Decrease in Payables	<u>(900)</u>
Cash Generated from Operations	14,375
Interest Paid (A2)	(2,150)
Dividends Paid (A3)	(2,000)
Tax Paid (A4)	<u>(2,250)</u>

)

Net Cash Flow from	
Operating Activities	7, 975

Cash Flows from Investing
Activities:

Purchase of Non-current	(8,
Assets (A5)	825)

Proceeds of Sale Non-	
current Assets	<u>300</u>

Net Cash used in Investing	(8,
Activities	525)

Cash Flows from Financing
Activities:

Proceeds, Issue of Shares	
(A6)	50

Proceeds, Issue of 10%	
Loan Notes (A7)	<u>1, 500</u>

Net Cash Flow from	
Financing Activities	<u>1, 550</u>

Net Increase in Cash and
Cash Equivalents (A8) 1, 000

Cash and Cash Equivalents
1/8/04 (A9) 1, 250

Cash and Cash Equivalents
31/7/05 (A10) 2, 250

Cash and Cash
Equivalents:

(£000'

s)

30 July

2004 2005

Cash at Bank	1, 250	2, 250
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Notes for Guidance

(1) Net profit before tax is taken from the extract of the income statement.

(2) Depreciation is shown as a note to the income statement.

(3) Loss on sale of the non-current asset; proceeds minus (cost less depreciation to date) see note A1 below.

(4) Interest expense is shown on income statement.

Changes in Working Capital Structure:

Inventory, receivables and payables are differences in opening and closing balances shown on the balance sheet.

Note (A1) (€000's)

Proceeds of Sale 300

Non-current Assets (Cost
500 - Depreciation to Date 325
175)

Loss on Sale 25

Disposal Account

(€000's) Non-Current Assets

Asset	Depreciation	
a/c	500	175
	Provision	
	Proceeds Cash	300
	Profit and Loss	
	— a/c	<u>25</u>
	<u>500</u>	<u>500</u>

Notes: (A2, A3 and A4)

The interest paid is the net interest cost shown on the income statement and is the 10% charge on loan notes shown on the balance sheet for June 2000.

The dividend and tax paid in the year are those shown on the 1999 balance sheet extract under the heading Current Liabilities.

		Dividen	
		ds	
		Account	
		2,	2,
2004/		1Augu	Balanc 0
2005	Bank	st	e b/d 0
		2004	0
			0
			2,
		31 July P/L	1
		2005 App	5
			0
31		<u>2</u>	
July	Balance	<u>1</u>	—
2005	c/d	<u>5</u>	—
		<u>0</u>	

<u>4,</u>	<u>4,</u>
<u>1</u>	<u>1</u>
<u>5</u>	<u>5</u>
<u>0</u>	<u>0</u>

Taxatio

(£000 n

's) Accoun

t

	2,		2,	
2004/	2	1Augu	Balanc 2	
2005	5	st	e b/d 5	
	0	2004		
	<u>2,</u>		<u>2,</u>	
31	Balanc 9	31 July	P/L 9	
July	e c/d 5	2005	App 5	
2005	<u>0</u>		<u>0</u>	
	<u>5,</u>		<u>5,</u>	
	<u>2</u>		<u>2</u>	
	<u>0</u>		<u>0</u>	
	<u>0</u>		<u>0</u>	

1Augu Balanc 2,
st e b/d 9

	5
2005	0

(A5) Purchase of Non-Current Assets

	(£000'
	s)
Balance on Balance Sheet	72,
2004	500
Less Net Book Value of	
those Disposed (£0. 5m -	<u>325</u>
0. 175m)	
	72,
	175
Less Depreciation for the	
Year	<u>6, 000</u>
	66,
	175
Balance Sheet 31 July	<u>75,</u>
2005	<u>000</u>
Difference is Purchases	£ <u>8,</u>

825

(A6 & A7)

Proceeds from the issue of shares and loan notes are the increases shown on the difference between the two balance sheet figures for 2004 and 2005.

(A8)

This is the net effect from operating activities £7, 975, net cash used in investing activities (8, 525) and the net cash flow from financing activities 1, 550.

(£000's i.	7, 975
) e.:	
	(8,
	525)
	<u>1, 550</u>
	£ <u>1,</u>
	<u>000</u>

(A9)

This is the bank figure under current assets 2004 balance sheet.

(A10)

Bank balance on 2005 balance sheet.

(2)(c) ASSESSMENT OF THE COMPANY'S LIQUIDITY IN ACCORDANCE WITH THE INFORMATION ON THE CASH FLOW.

Having examined the accounts and financial statements of Sky plc, there is clear evidence reflecting on the company's liquidity level. Firstly, the measurement of the liquidity ratio revealed that the company was in healthy liquid position.

Current Ratio= Current Assets / Current Liabilities

Current Ratio of Sky = current assets £1, 830m/ current liabilities £1, 481m= 1. 24 times

The current ratio measures a company's ability to meet its financial obligations as they fall due. A normal current ratio is two. Sky's current ratio is relatively stable considering the type of industry of Sky plc.

Acid Ratio= Current Assets- stock/current liabilities

Acid Ratio of Sky= Current Assets £1, 830m- Stock £627m/ Current liabilities £1, 482m= 0. 81 times

The acid ratio clearly indicate that Sky has a high levels of stock and this also demonstrates that the current ratio overstated Sky's ability to meet its financial obligations because of the inclusion of the stock in the numerator.

The information provided in the cash flow, demonstrated clear evidence of liquidity in the flowing of cash. For example, there was a dramatic net increase in cash and cash equivalents of £1, 000m over a year. Furthermore,

this indicate that the company's economic activities are performing well in comparison to the previous year.

However, amount £8525m was invested in investing activities, this figure being greater than the company's net cash flow from operating activities amounting to £7975m. Nevertheless, the short fall in the financing of investing activity was meet by new issue of shares £50m and issue of bank loans £1500m. Inevitably, the bank loan increases company's debt and the gearing level of the company. Nevertheless, over a year company's bank balance increased from £1250 to £2250m.

In conclusion, the accounts of Sky plc indicate substantial development but there are great expenditure resulting from investment in activities. However, there is not a real concern over the liquidity of the company nor any chances of bankruptcy.

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