

Improving the Accounting of Current Assets in Accordance With International Financial Reporting Standards

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Abstract. This article interprets the key points of the international Financial reporting standard N 2 and discusses the issues of its practical application. In order to make it better understandable to the reader, examples are given on disclosing the essence of inventories, determining the cost of finished products, goods and work in progress, estimating inventories, net selling price and inventory impairment. Their impact on the company's financial statements is also reflected in the form of an excerpt from the statement of financial position and the income statement.

Keywords: depreciation, finished products, wages, inventories, work in progress, normal production capacity, depreciation, production overheads, goods.

Introduction

In order to provide the necessary information environment for foreign investors and expand opportunities for access to international financial markets through an accelerated transition to international financial reporting standards, as well as improving the system of training specialists in the field of accounting and auditing according to international standards, a Resolution of the President of the Republic of Uzbekistan dated 24.02 was adopted. 2020 No. PP-4611.

The Resolution establishes that joint stock companies, commercial banks, insurance organizations and legal entities classified as large taxpayers from January 1, 2021, organize accounting and, starting from the end of 2021, prepare financial statements based on IFRS.

Currently, there is a gradual increase in the number of joint-stock companies, commercial banks, insurance organizations and large taxpayers using IFRS. This is due to a number of conditions, first of all, the number of large contracts concluded with Western partners has increased, more funds are being attracted from foreign investors, and the volume of borrowed funds received from foreign financial institutions has increased.

But despite this, it should be noted that there are some problems in practical issues of applying IFRS in Uzbekistan. This:

1. Regulatory problems.
2. Problems of the technical basis of accounting and the level of qualifications of accounting personnel.
3. The problem of organizing training and retraining of accounting personnel.
4. A problem expressed in internal differences in accounting systems: differences in accounting principles; lack of a clear division of accounting into financial, managerial and tax; differences in approaches to reflecting certain types of assets and liabilities.

5. Problems associated with the international standards themselves: the generalized nature of IFRS; insufficient recognition of IFRS in global capital markets; constant updating of IFRS.

In this regard, in this article we wanted to reveal the essence of IFRS 2 “Inventories” and give some explanations of the organization of inventory accounting according to international standards and the preparation of financial statements, showing their practical application with specific examples.

Methods. When conducting research work on this topic, the conceptual foundations of international financial reporting standards, regulatory frameworks for accounting regulation in Uzbekistan and abroad were studied, scientific works of foreign and domestic economists on inventory accounting based on IFRS were used using methods of data collection, generalization, grouping, comparisons, induction and deduction, comparison and reflection in financial reporting.

Results. Inventories are short-term assets, otherwise known as current assets, and they are regulated by the second international reporting standard, IAS 2, called “Inventories.” Also, while studying this topic, we may come across another standard that we will need, this is IAS 23 “Borrowing Costs”. After all, we can purchase inventories not only with our own sources of financing, but also using borrowed funds, and looking ahead, interest on borrowed funds, that is, on loans and borrowings received, the organization does not have the right to include in the cost of purchased inventories, and the 23rd standard tells us this .

First we would like to study the concept of reserves and their classification. Indeed, in order to correctly reflect indicators in reporting, in the profit and loss statement, in the statement of financial position, you need to understand the essence of these objects.

When we look at IFRS 2, we see that inventories are three types of assets, which are:

- intended for sale (resale) under normal operating conditions of the enterprise - goods and finished products;
- those in the production process for such sale - costs of work in progress;
- in the form of objects of labor consumed in the production process or in the provision of services - raw materials and materials.

To sum up this definition, what do we have? That inventories are current assets, out of three groups of these assets that are reported on the statement of financial position. If we remember the definition of short-term assets, we will remember a synonym for this term. In another way, short-term assets are called current assets, which means they turn over, that is, they have a turnover period for a period of less than one year or twelve months. That is, in fact, inventories consume their value in one production process of the company.

Analyses. Let's look at a few examples that will allow us to understand the essence of inventories and their types presented in the statement of financial position.

Before us is a company whose main activity is the retail sale of food products. In this case, the main type of company inventory is goods intended for sale. Or the main activity of the company is the production and sale of confectionery products. The company's reserves include three types of assets:

- finished products – confectionery;
- work in progress - if at the end of the reporting period the confectionery products have not gone through all stages of production;
- raw materials and materials from which finished products will be produced.

The cost of goods, raw materials and materials purchased for cash is equal to the company's actual costs for the acquisition of these assets. In this case, the cost of inventories consists of the total amount of

the purchase price (excluding refundable taxes), customs duties (import duties), transport, forwarding and other expenses directly related to the acquisition of inventories.

Please note that there are no interest costs among the costs. That is, if we purchase inventory using borrowed funds, we do not have the right to include interest on loans and borrowed funds in the cost of short-term assets. This is prohibited by Standard 23 called Borrowing Costs.

Let's look at an example to illustrate what we just said above. The company purchased imported goods worth 10 million USD. Customs duties associated with the purchase amounted to 10% of the purchase price. Transport costs paid by the company for the delivery of goods amounted to 0.5 million.

The cost of goods is equal to:

$$10 \text{ million USD} + 1 \text{ million USD} + 0.5 \text{ million USD} = 11.5 \text{ million c.u.}$$

It is this amount that will appear in the statement of financial position, which is reflected in the following table.

Impact of the inventory purchase transaction on the statement of financial position (excerpt), CU million.

Assets	Amount	Capital and liabilities	Amount
Reserves	11,5		
Cash	(11,5)		

The cost of goods, raw materials and supplies received by the organization free of charge, as a contribution to the authorized capital, or in other ways, is formed similarly to the initial cost (cost) of fixed assets.

We remind you that if inventories are received by an organization free of charge, they are measured at fair value. If inventories are received as a contribution to the share capital, the fair value is again used, but not the value of the asset, but the fair value of the shares transferred. If inventories arrive with a significant delay, more than 3-6 months, then any delay requires discounting the cost of inventories.

Sometimes there are costs that cannot be included in the cost of assets. This is a rule in IFRS 2.

So, according to IFRS 2, four types of costs are not included in the costs of purchasing inventories:

- trade discounts (discounts);
- refunds and reductions in payments;
- exchange rate differences arising in connection with changes in exchange rates on accounts denominated in foreign currency;
- Administrative expenses.

If we have these expenses, then we must remove them from the cost of inventory. Let's look at an example that will help us understand the essence of costs not included in the cost of inventory.

1. The company purchased imported goods worth 10 million USD. According to the agreement, the company received a discount of 10% of the cost of the goods for prepayment of the purchase.

The company transferred 10 million USD to the supplier. Wherein:

The discount amount is $10 \text{ million} \times 10\% = 1 \text{ million USD}$;

Supplier's accounts receivable 1 million.u.

The cost of goods is 10 million. - 1 million c.u. = 9 million c.u.

And as a result, when generating the statement of financial position, we will see the following three indicators reflected in the following table.

Table 2

Impact of the inventory purchase transaction on the statement of financial position (excerpt), CU million

Assets	Amount	Capital and liabilities	Amount
Reserves	9,0		
Cash	(10,0)		
Accounts receivable	1,0		

The next example is where we will use another standard, because the issue of accounting for exchange rate differences is a question from IFRS 21. So, the company purchased imported goods worth 10 million euros. On the delivery date, the euro exchange rate was 1.15 euros/cu. After 2 days, at the time of payment for the goods, the euro exchange rate dropped to 1.1 euro/cu. The depreciation of the euro generates income for the company. Instead of 11.5 million USD, we will pay 11.0 million USD. Wherein:

The cost of the goods is 10 million euros x 1.15 = 11.5 million.

Payment amount 10 million euros x 1.1 = 11 million.e.

Exchange rate difference 11.5 million c.u. - 11 million c.u. = 0.5 million c.u.

The impact of the transaction on the income statement can be seen in the following table.

Table 3

Impact of the transaction on the income statement (extract), mln..

Other income	0,5
Profit for the period	0,5

And the impact of the transaction on the statement of financial position can be seen below.

Table 4

Impact of the transaction on the statement of financial position (extract), CU million.

Assets	Amount	Capital and liabilities	Amount
Reserves	11,5	Retained earnings (uncovered loss)	0,5
Cash	(11,0)		

The next issue that we would like to consider further is the formation of the cost of manufactured finished products, works and services. According to IFRS 2 “Inventories”, the cost of finished products, work, and services consists of direct production costs, fixed production overhead costs and variable production overhead costs. We would like to note that the cost of production includes only costs related to

production, and administrative costs do not relate to production and therefore are not included in the cost of production.

Direct production costs are costs directly related to the production of a particular product, work, or service.

And they:

- are always variable;
- are fully included in the cost of products, works, services.

For example, a company produces one type of product. Direct production costs may include: material costs, employee wages, if their value depends on the quantity of products produced, equipment depreciation, if the company uses the production method of depreciation, electricity costs, if they depend on production volumes, etc.

In addition to the above direct costs, there are also constant overhead production costs. These are indirect production costs that remain relatively unchanged from period to period, regardless of production volume, and are included in the cost of production, taking into account the value of normal production capacity.

The question arises, how to understand normal production capacity? Normal production capacity is the expected volume of production, based on the average of several periods or seasons of operation, in the normal course of business, taking into account loss of capacity as a result of scheduled maintenance.

Let us show an example that will allow us to understand the essence of fixed overhead costs included in the cost, taking into account normal production trends. The company produces one type of product. Fixed manufacturing overhead costs may include:

- Wages of employees, if its value does not depend on the quantity of products produced.
- Depreciation of equipment if the company uses the straight-line depreciation method.
- Electricity costs, if they do not depend on production volumes, and others.

We show the order of distribution of fixed overhead production costs in the following figure.

Variable manufacturing overhead is an indirect manufacturing cost; - the amount of expenses changes from period to period and depends on the volume of production; - are fully included in the cost of production, i.e. distributed based on actual production output.

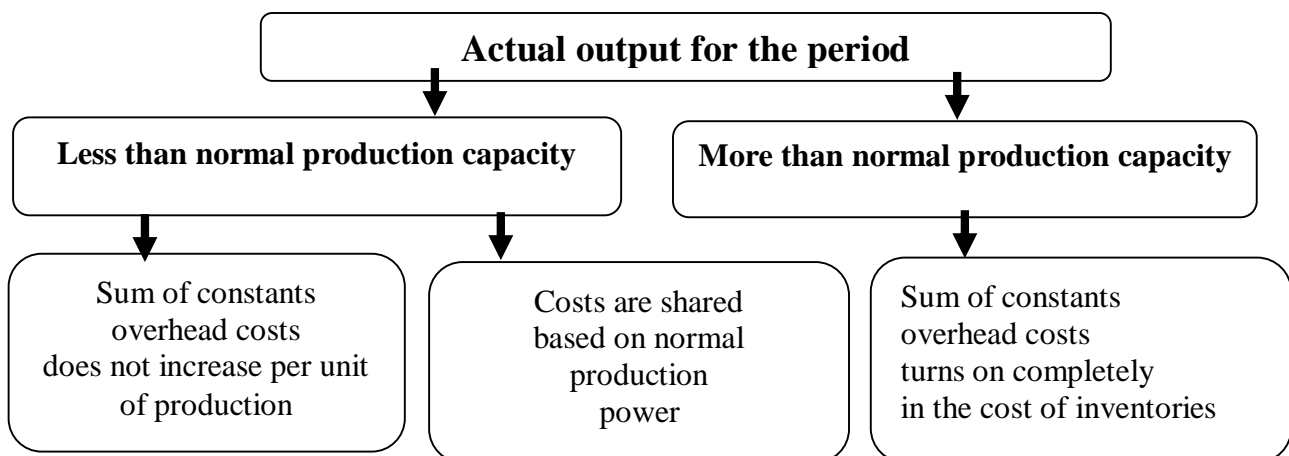


Figure 1. The order of distribution of fixed overhead production costs

To make it clear, let's look at some examples.

1. The company produces one type of product. For the period, depreciation of equipment in the amount of CU 100 was accrued using the straight-line method. Normal monthly production capacity is 2000 pcs. products. The actual quantity of products produced during the period is 2200 units.

Because actual output is greater than normal production capacity, the entire amount of depreciation will be included in the cost of inventory.

Amount of depreciation per 1 unit. products according to the standard:

$$100 \text{ USD} : 2,000 \text{ pcs.} = 0.05 \text{ c.u.}$$

Amount of depreciation per 1 unit. products in fact:

$$100 \text{ USD} : 2,200 \text{ pcs} = 0.045 \text{ USD}$$

2. The company produces one type of product. For the period, depreciation of equipment in the amount of CU 100 was accrued using the straight-line method. Normal monthly production capacity is 2,000 products. The actual number of products produced during the period is 1,000 units.

The reduction in output is due to, say, an employee strike. Let's give some clarification here. IAS 2 tells us that when producing less than the normal volume, the company does not have the right to write off all depreciation amounts to the cost of inventory, artificially inflating the cost. That is, we will write off the undistributed amount as expenses of the current period in the income statement.

The solution to this problem is as follows. Because actual output is less than normal production capacity, not the entire amount of depreciation will be included in the cost of inventory.

Amount of depreciation per 1 unit. products according to the standard:

$$100 \text{ USD} : 2000 \text{ pcs.} = 0.05 \text{ c.u.}$$

The amount of depreciation that falls into the cost of production:

$$0.05 \text{ USD} \times 1,000 \text{ pcs.} = 50 \text{ USD}$$

$$\text{Amount of unallocated depreciation: } 100 \text{ cu.} - 50 \text{ USD} = 50 \text{ USD}$$

3. The company produces 1 type of product. The amount of expenses for the period of the company was:

Material costs - 200 USD

Employees' wages (time-based) - 100 USD

Depreciation of equipment (linear method) - 50 USD

Utilities (depending on production volumes) - 20 USD

The company produces on average 10 pieces. products for the period.

The actual quantity of products produced in the current period was 5 units. Products are sold at a 100% markup.

Here we will give some clarification that when actual output is less than the normal output, fixed overhead costs (wages, depreciation) when charged to cost are divided by the planned output.

Solution. The cost of 1 product will include:

$$200 \text{ USD} : 5 \text{ pieces.} = 40 \text{ USD}$$

$$100 \text{ USD} : 10 \text{ pieces.} = 10 \text{ USD}$$

$$50 \text{ USD} : 10 \text{ pieces.} = 5 \text{ USD}$$

$$20 \text{ USD} : 5 \text{ pieces.} = 4 \text{ USD}$$

Total 59 USD cost of 1 product

Next, we will calculate the cost of fixed overheads, which are unallocated. That is, the amount that we will reflect in the income statement. We distributed these costs based on operating and normal production capacity, based on 10 pcs. products. Some of the salaries and depreciation were not distributed

Unallocated costs were:

Salary - 100 USD - 50 USD = 50 USD

Depreciation - 50 USD - 25 USD = 25 USD

Total 75 USD

Revenue from sales of products is 59 USD. $\times 5 \times 2 = 590$ USD

Cost of sales 59 USD $\times 5$ pcs. = 295 USD

The impact of the transaction on the income statement is as follows.

Table 5

Impact of the transaction on the income statement (excerpt), cu.

Sales proceeds	590,0
Cost of sales	(295,0)
Unallocated fixed manufacturing overhead	(75,0)
Total profit for the period	220,0

Interpreting the essence of IFRS 2 “Inventories”, we can say that it gives an interesting concept called “Net realizable price” and in relation to inventories it must be applied if the inventories remain in the statement of financial position at the end of the reporting period.

Let's look at how this is provided for in International Standard No. 2. When we carefully read the standard, we will see the following aspect: the valuation of inventories in the statement of financial position at the end of the reporting period is carried out at the lower of two values: on the one hand, the cost of inventories and on the other hand, the net selling price of inventory is the market value less costs to sell.

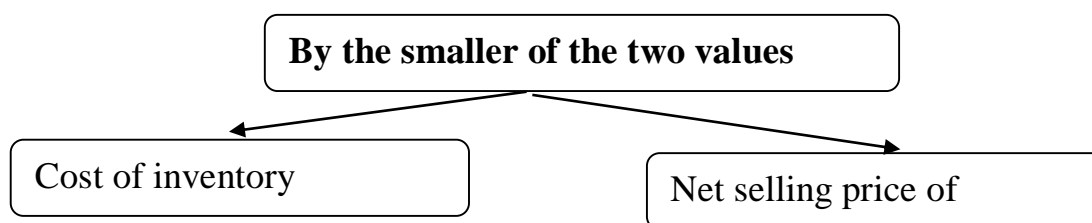


Figure 2. Valuation of reserves

What will we do based on the requirements of standard 2? We will compare the cost price with its net realizable value. If the cost price is lower than the net selling value, then we will not do anything in the reporting; we have reflected it at cost and will continue to do so. If the cost is higher than the net realizable value of the inventory, we need to recognize an impairment of the inventory.

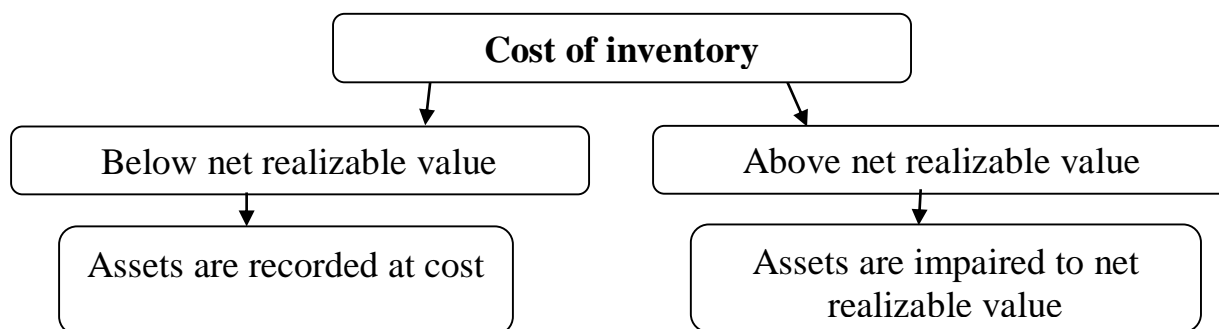


Figure 3. Valuation of inventories in the statement of financial position

To make it clear, let's give the following example. The statement of financial position of the company at the end of the period presents goods whose cost is equal to 100 thousand. According to the company's estimates, the fair value of these inventories is CU 110 thousand, while the average cost of sales based on historical data is 10% of revenue.

Solution.

Sales costs amount to 110 thousand.e. $\times 10\% = 11$ thousand.e.

The net selling price is 110 thousand. - 11 thousand USD = 99 thousand.u.

As a result, the company receives an impairment loss

100 thousand.e. - 99 thousand.e. = 1 thousand.e.

The impact of the transaction on the income statement is as follows.

Table 6

Impact of the transaction on the income statement (excerpt), thousand units.

Impairment expenses	(1,0)
Loss for the period	(1,0)

Next we can see how the operation affects the financial position of the company.

Table 7

Impact of the transaction on the statement of financial position (excerpt), thousand units.

Assets	Amount	Capital and liabilities	Amount
Reserves	99,0	Retained earnings (uncovered loss)	(1,0)
Cash	(100,0)		

The question arises: will we check assets for impairment every reporting period? Agree that this is very labor-intensive and we may have a large range of reserves. There are three groups of assets: finished goods, goods, work-in-process costs, raw materials and supplies. This is very irrational. Therefore, the standard tells us that we test assets for impairment only when there are indications of impairment. And if we study them, they are as follows:

-general drop in prices on the market;

- physical damage to inventories and/or obsolescence;
- decision to produce and sell inventory at a loss, as part of a marketing strategy (dumping), etc.

In these situations, which are listed above, we compare the cost of inventories before their sale with the net realizable price, and if any impairment losses occur, immediately recognize them in the income statement.

The question arises: how to devalue inventories? The standard also clarifies the rules for recognizing these impairment losses. Let's look at them carefully.

The rules for impairment of inventories are as follows:

- depreciation is prohibited in general for the inventory item, as well as for enlarged groups of inventories (finished products, raw materials, goods, work in progress);
- impairment is made for each type of inventory;
- depreciation of raw materials and supplies is not carried out if products made from them are sold at cost or higher.

Discussion

And so, summing up our research, we can say that, interpreting the essence of IFRS 2, we learned a clear definition of inventories, which consist of three types of assets, have a turnover period of less than one year and consume their value in one production process of the company; how inventories are valued, the formation of the cost of manufactured finished products, works and services, the attribution of production fixed and variable overhead costs to the cost of finished products and the impact of unallocated fixed overhead costs on the income statement.

While revealing the essence of IFRS 2 “Inventories”, we learned about the net realizable price of inventories, which is not in our national accounting standard. Net realizable price is the amount that an organization will receive in net cash from the sale of inventories, and if this amount is less than the cost of those inventories that are reflected in the statement of financial position, the company is obliged to recognize an impairment charge, and therefore is obliged to reduce financial result for the current period.

As a conclusion, we can say that the introduction of accounting and preparation of financial statements in accordance with IFRS improves the company’s image and helps management make management decisions more quickly, since they provide more transparent and structured information.

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