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## Financial Accounting

## Integrated Workbook

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This document references IFRS® Accounting Standards and IAS® Standards, which are authored by the International Accounting Standards Board (the Board), and published in 2024.

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# Chapter 1

## Introduction to financial reporting

### Outcome

By the end of this session you should be able to:

- define financial reporting
- identify and define types of business entity
- identify users of the financial statements and their information needs
- identify the purpose of the main financial statements
- define the elements of the financial statements
- define and explain accounting concepts and characteristics

and answer questions relating to these areas.

**The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 1 of your Study Text**

# Overview


Qualitative characteristics
Definintion of financial reporting
Concepts and conventions
The accounting environment
User groups
Financial v management accounting
Types of business entity
Elements of the financial statements

# 1 Definition of financial reporting

## 1.1 Overview of accounting

The accounting system of a business entity records transactions and summarises the transactions to report financial performance and position of the entity.

Accounting consists of two elements:

**Recording**
Transactions must be recorded as they occur in order to provide up-to-date information.

**Summarising**
The transactions for a period are summarised in order to provide information about the entity to interested parties.

The summarised information is then presented in the form of financial statements.

## Notes

## 1.2 Financial statements

## Notes

# 2 Financial accounting and management accounting

The key distinctions between financial accounting and management accounting can be summarised as follows:

**Financial accounting**

Production of summary financial statements for external users.

- Usually prepared annually.
- Generally required by law.
- Reflects past performance and position.
- Information calculated and presented in accordance with international accounting standards.

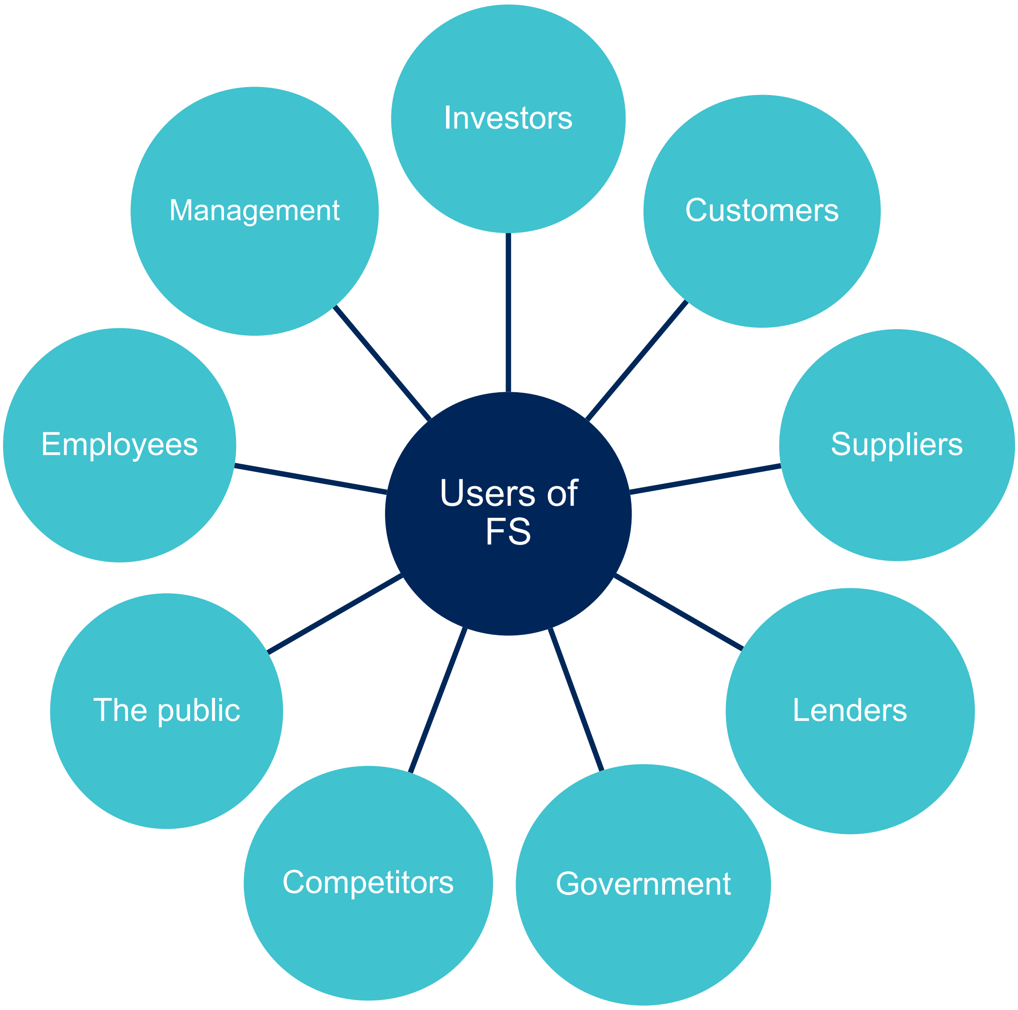
**Management accounting**

- Production of detailed accounts, used by management to control the business and plan for the future.
- Normally prepared monthly, often on a rolling basis.
- Not mandatory.

  Includes budgets and forecasts of future activities, as well as reflecting past performance.
- Information prepared and presented in order to be relevant to managers.

## Notes

## 3 Users of financial statements




## Notes

# 4 Types of business entity

A business entity is an organisation that regularly enters into transactions that are expected to provide a reward measurable in monetary terms. It is evident from everyday life that there are different types of business entity. What is less clear is that their organisational (legal) structure and therefore their accounting requirements may differ.

A sole trader –

Partnership –

Limited liability companies –

## Notes

# 5 The Framework

## 5.1 The Framework

One of the most Important documents underpinning the preparation of financial statements is the Conceptual Framework for Financial Reporting 2018 ("The Framework") which was prepared by the International Accounting Standards Board ('the Board') (Discussion of the regulatory bodies will follow in later chapters).

The Framework presents the main ideas, concepts and principles upon which all IFRS Accounting Standards, and therefore financial statements, are based. It includes discussion of:

- the **objective** of financial reporting
- the **qualitative characteristics** of useful financial information (see Section 6), and
- the **definition, recognition and measurement of the elements** from which the financial statements are constructed (see section 7).

Notes

### 5.2 The objective of financial reporting

The main objective is to provide financial information about the reporting entity to users of the financial statements that is useful in making decisions about providing resources to the entity, as well as other financial decisions. To provide useful information to the stakeholders of an entity the financial statements must fairly present its financial position and performance. Whilst this has never been formally defined it embodies the concepts that the financial statements:

## Notes

# 6 Qualitative characteristics

## 6.1 Qualitative characteristics of useful financial information

The Framework says that there are two fundamental qualitative characteristics and four enhancing qualitative characteristics of useful financial information as follows:

- **Fundamental qualitative characteristics**
  - **Relevance**
  - **Faithful representation**
- **Enhancing qualitative characteristics**
  - 

    Users must be able to compare financial statements over a period of time in order to identify trends in financial opposition and performance. Users must also be able to compare financial statements of different entities to be able to assess their relative financial position and performance.
  - 

    Verification can be direct or indirect. Direct verification means verifying an amount through direct observation i.e. counting cash at a specific date. Indirect verification means checking the inputs to a mode, formula or other technique and recalculating the outputs using the same methodology.
  - 

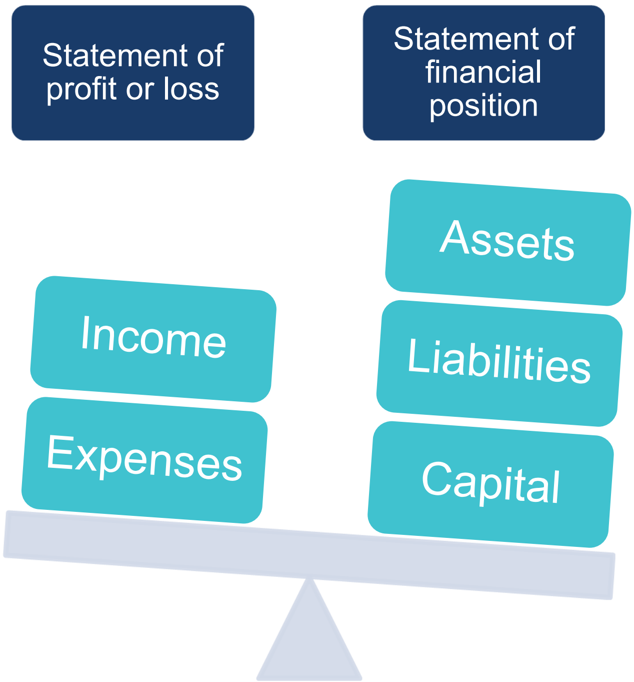
    Timeliness means having information available to decision makers in time to be capable of influencing their decisions. Generally, the older the information, the less useful it becomes.
  - 

    Information needs to be readily understandable by users. Information that may be relevant to decision making should not be excluded on the grounds that it may be too difficult for certain users to understand.

# 7 The elements of the financial statements

## 7.1 Elements

In order to appropriately report the financial performance and position of a business entity the financial statements must summarise five key elements:




## Notes

## 7.2 Definitions

Asset –

Liability –

Capital/Equity – a special kind of liability due to the owner(s) and is **'the residual interest in the assets of the entity after deducting all its liabilities'** (Framework, Para 4.63)

Income – **'increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims'** (Framework, 4.68)

Expense – **'decreases in assets, or increases in liabilities, that result in a decrease in equity, other than those relating to distributions to holders of equity claims'** (Framework, para 4.69)

## Notes

# 8 Components of the financial statements

## 8.1 Statement of financial position

- 

## 8.2 Statement of profit or loss and other comprehensive income

- 

## 8.3 Statement of changes in equity

- 
- This is required only for limited company financial statements, and not unincorporated businesses such as sole traders and partnerships.

## 8.4 Statement of cash flows

- 
- This is required only for limited company financial statements, and not unincorporated businesses.

## 8.5 Notes to the financial statements

- Additional information disclosed with the financial statements to provide additional information supporting the financial statements. These notes are normally more extensive and detailed for limited company financial statements.

## Notes

# 9 Other accounting concepts

## 9.1 Other accounting concepts

Other concepts on which you can find more detail within the Study Text include:

➢

An item is regarded as material if its omission or misstatement is likely to change the perception or understanding of the user of that information.

➢

If information is to be presented faithfully the economic substance of transactions must be accounted for, and not just their strict legal form.

➢

Financial statements are presented on the basis that the entity will continue to trade for the foreseeable future.

➢

This means that financial accounting information presented in the financial statements relates only to activities of the business and not to those of the owner.

➢

This means that transactions are recorded when revenues are earned and when expenses are incurred. This pays no regard to the timing of cash receipts and payments.

Notes

➢

Prudence is the exercise of caution when making judgements under conditions of uncertainty. For example, ensuring that assets and income are not overstated, and that liabilities and expenses are not understated.

➢

Users of the financial statements need to be able to compare the performance of an entity over a number of years and so classification and presentation of items included in financial statements must be retained from one accounting period to the next.

➢

Offsetting is the netting off of transactions and balances when recording and presenting financial information. This should not be done. The full effect of transactions and balances should be recorded and presented.

➢

Duality recognises that each transaction has two effects. Both effects should be recorded in the accounting records by posting an equal number of debits and credits in the general ledger.

➢

Historical cost is the monetary value of the transaction at the date it was entered into. The current value of an item will bear no relation to its historical cost. Consider a building purchased by an entity many years ago – it is likely to have a significantly higher current value than its original historical cost. In contrast, an office machine, for example a photocopier, is likely to have a significantly lower current value than its original cost.

## Notes

## Further practice

# Chapter 2

## The regulatory framework

### Outcome

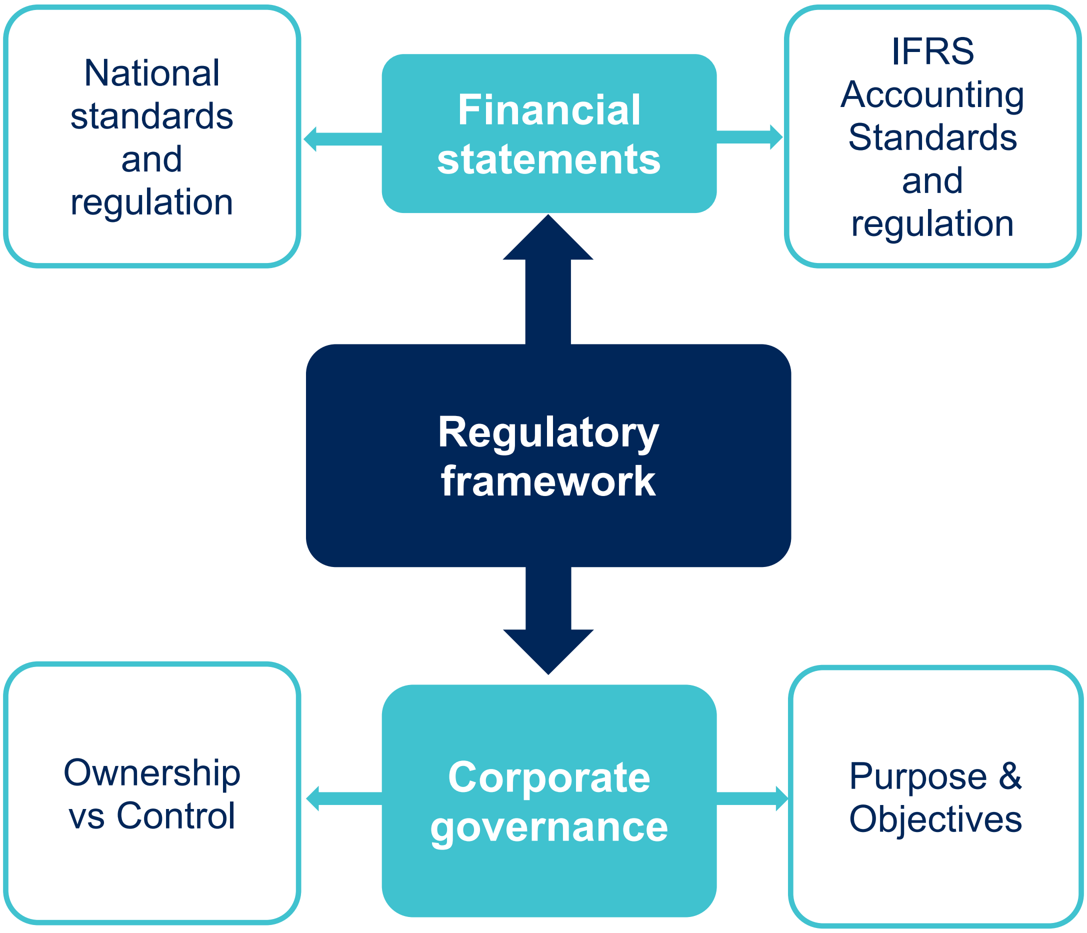
By the end of this session you should be able to:

- understand the role of the financial reporting regulatory system
- understand the role of International IFRS Accounting Standards
- explain what is meant by corporate governance
- describe the duties and responsibilities of company directors

and answer questions relating to these areas.

**The underpinning detail for this Chapter in your Integrated Workbook can be found in Chapter 2 of your Study Text**

# Overview


National standards and regulation
Financial statements
IFRS Accounting Standards and regulation
Regulatory framework
Ownership vs Control
Corporate governance
Purpose & Objectives

# 1 The regulatory framework

## 1.1 Why do we need regulation?

Regulation is needed because:

- it ensures the financial statements can be relied upon by a variety of users when making decisions, and
- it promotes consistency and comparability of accounting information to help users interpret the financial statements.

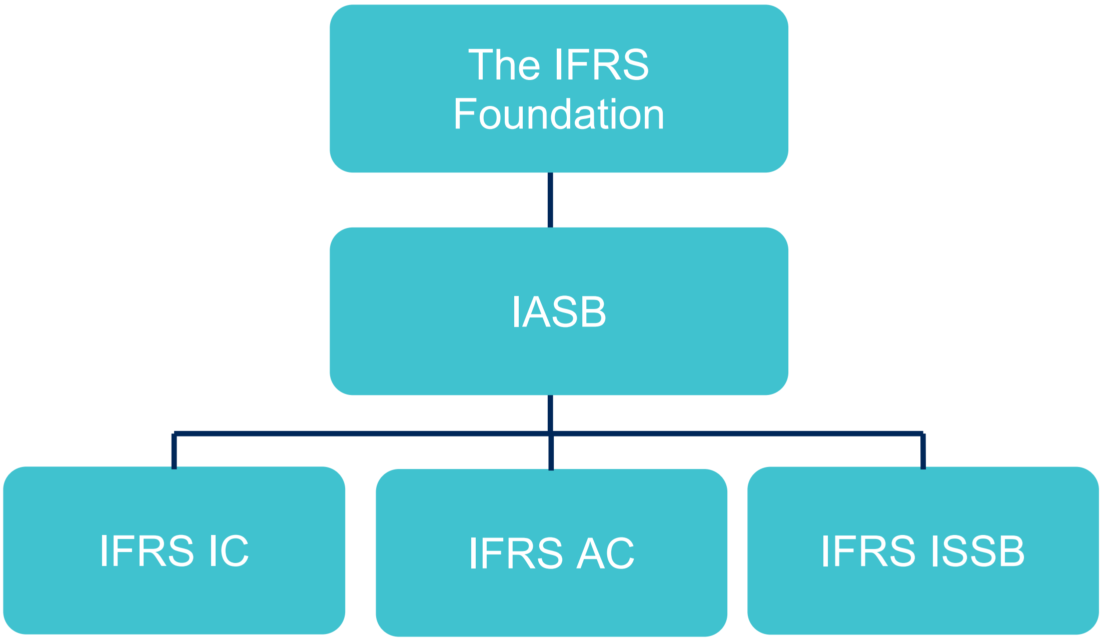
## 1.2 Elements of regulation

A regulatory framework may consist of any, or all, of the following elements:

## Notes

# 2 International Financial Reporting Standards (IFRS Accounting Standards)

There are four separate but related bodies which control the setting of IFRS Accounting Standards as presented below:




IFRS Foundation –

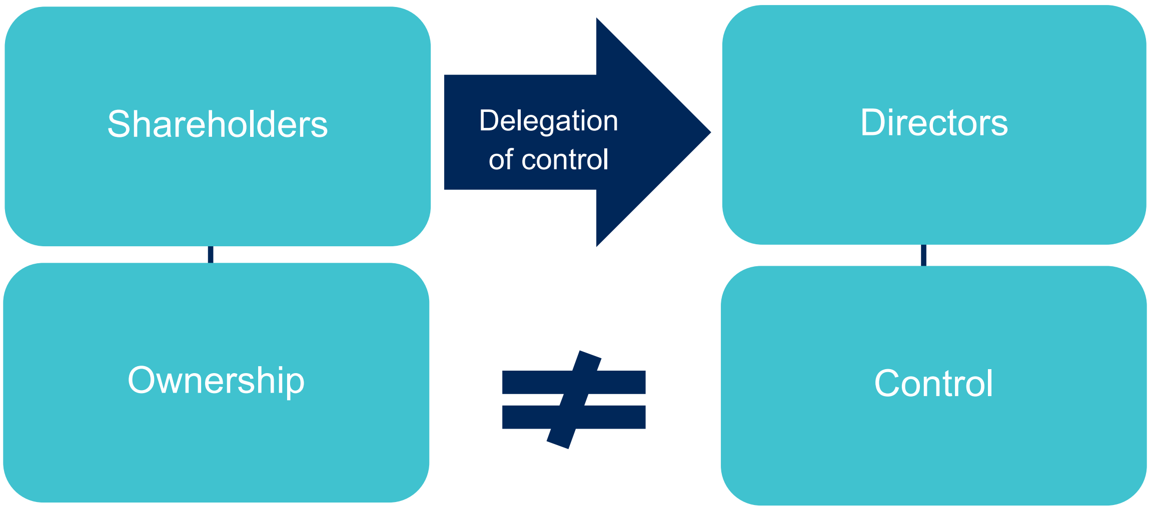
IASB –

IFRS IC –

IFRS AC –

IFRS ISSB –

# 3 Company ownership and control




There is a separation between ownership of a company (by shareholders) with management and control of a company (by directors and managers).

For some smaller and medium sized companies, the owners may also be the directors/managers of the company. Typically large, listed companies are owned by a wide range of individuals and organisations. They will not have any direct involvement in the day-to-day running of the company but will elect directors to run the company on their behalf.

Most limited companies (with exceptions for small companies meeting specified criteria) are required to have their annual financial statements audited by an independent and appropriately qualified external auditor. The auditor will express an opinion on whether the financial statements show ‘a true and fair view’ or are ‘fairly stated’. This helps to provide credibility to the financial statements prepared by the directors and presented to the shareholders as a statement their stewardship of the company’s assets and assists shareholders to make informed decisions regarding their investment in the company.

## Notes

# 4 Corporate governance

## 4.1 What is corporate governance?

The Cadbury Report 1992 provides a useful definition:

An appropriate expansion to this definition might include:

## Notes

## 4.2 Purpose and objectives of corporate governance

The basic purpose of corporate governance is to monitor those parties in a company who control the resources and assets on behalf of the owners. The primary objective of sound corporate governance is to contribute to improved corporate performance and accountability in creating long-term shareholder value.

Ways to monitor those parties (normally directors) in a company who control the resources owned by investors include the following:

## Notes

Ways to contribute to improved corporate performance and accountability in creating long-term shareholder value include:

## Notes