

## Financial Reporting

**Accounting** can be defined as the process of identifying, measuring and communicating economic information about an entity to a variety of users for decision making purposes.

**Financial Statements** describe financial performance and position of an entity. Also known as General Purpose Financial Reports (GPFR).

- Income statement (Profit & Loss):
  - Shows profit from operations vs profit from other activities
  - GPFR must include statement of comprehensive income (SOI) that includes changes in the values of assets or liabilities which do not affect the determination of profit or loss (i.e. revaluation of property)
- Statement of Financial Position (Balance Sheet):
  - Shows all the resources controlled by the entity and all the obligations due by the entity
  - Contains information about the investing and financing decisions made by the managers of the business entity
- Statement of Changes in Equity:
  - Reports all changes to equity that are taken directly to the equity section of the balance sheet, together with the profit or loss for the period
  - Gives total changes to the equity for the period
  - AASB101 requires:
    - Total comprehensive income for the period
    - Effects of retrospective application of restatement as per AASB108 for each equity component
    - Amounts of transactions with owners
    - Reconciliation between carrying amount at the end of the period separated for each equity component
- Cash Flows Statement:
  - Details of cash inflows and outflows in three sections:
    - Operating activities
    - Investing activities
    - Financing activities

**Financial Performance** refers to ability of a business entity to generate new resources over a period of time.

**Financial Position** is an entity's set of financial resources and obligations at a point in time.

## Types of Organisations

- Profit-making enterprises:
  - Sole Trader
    - Simplest form of organisation
    - Unlimited liability
    - Financial statements simple to prepare (no formal guidelines)
  - Partnerships
    - Advantages:
      - Ease of formation
      - Limited rules and regulations
      - Capital and expertise
      - Income tax (individual pays tax but no company tax)
    - Disadvantages:

- Limited life
  - Unlimited liability
  - Mutual agency
- Companies
  - Advantages:
    - Limited liability
    - Capital
    - Transfer of ownership
    - Professional management
    - Continuous existence
  - Disadvantages:
    - Tax
    - Increased regulation
    - Separation of ownership and control
- Not-for-profit entities:
  - Charities
  - Government
  - Cooperatives
  - Friendly societies

#### **Framework for setting accounting standards:**

- International Financial Reporting Standards
  - International Accounting Standards/ International Financial Reporting Standards
  - Australian Accounting Standards
    - Australian International Financial Reporting Standards (Australian equivalent to IFS)
- **Conceptual framework:** collection of concepts that guide the manner in which accounting is practiced
  - Objectives:
    - Fewer accounting standards
    - More consistent accounting standards
    - Improved communication
    - Defence against politicisation

**Qualitative characteristics of financial information:** attributes that make the information provided in financial statements useful to users.

- Four principal QCS: relevance, reliability, understandability, comparability
- Timeliness and cost vs benefit

#### **Key Accounting Assumptions**

- **Economic entity:** financial activities of a business can be separated from those of the business owner
- **Time period:** economic information can be meaningfully captured and communicated over short periods of time
- **Monetary unit:** accountants assume that monetary unit such as dollar is the most effective means to communicate economic activity
- **Going concern:** accountants assume that a company will continue to operate into the foreseeable future

#### **Cash vs Accrual accounting**

- **Accrual accounting:**
  - Recording revenues when earned
  - Recording expenses when incurred (matching principle)
- **Cash accounting:**

- Recording revenues and expenses at the time the cash is received or paid

### **Accounting Equation: Assets = Liabilities + Equity**

#### **Current vs non-current**

- **Current:** items expected to be realised or settled within the current operating cycle
- **Non-current:** items expected to be realised or settled over a period longer than the average operating cycle

#### **Balance Sheet Items**

- **Assets:**
  - Resources controlled by the entity
  - Result of past events
  - Future economic benefits are expected to flow to the entity
  - **Asset recognition:** recognised in financial statement only when it is probable that future economic benefits will flow and it is capable of reliable measurement
- **Liabilities:**
  - Present obligations of the entity
  - Arising from past events
  - Sacrifice of future economic benefit (i.e. outflow of resources)
  - **Liability recognition:** recognised in financial statement only when it is probable that settlement will be required and it is capable of reliable measurement
- **Equity:**
  - Residual interest in the assets of the entity after deducting all liabilities

**Income statement:** provides summary of revenues earned, expenses incurred and shows profit or loss from operations for a specific reporting period

- Income = Revenue + Gains
- Revenue = inflows from ordinary activities
- Gains = all other inflows
- Recognise revenue when:
  - The earnings process is substantially complete and measurable
  - When receipt of payment for the goods and services is reasonably certain
- Recognise expenses when:
  - It is probable that the decrease in economic benefit has occurred
  - The amount can be reliably measured

#### **Revenue vs Expenses**

- **Prepaid Revenue:**
  - Revenue received but not earned according to recognition criteria
  - Recorded initially as a liability (e.g. magazine subscription sale)
- **Accrued Revenue:**
  - Revenue that has been earned but not recognised
  - Recorded initially as an asset (e.g. credit sales)
- **Prepaid Expenses:**
  - Expenses that have been paid, but full benefits have not been consumed
  - Recorded initially as an asset (e.g. insurance paid for future)
- **Accrued Expenses:**
  - Expenses that have been incurred, but not paid or recorded
  - Recorded initially as a liability (e.g. electricity consumed not yet invoiced or paid)