



Accounting and Financial Reporting

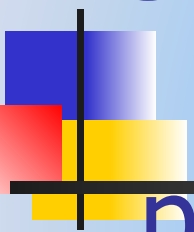
I. **PRINCIPLES OF ACCOUNTING**

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Course objectives



preparing and understanding
companies' financial statements



Assessment

Activities	Marks
Attendance lectures	1
Attendance classes	2
classwork	7
Control tasks, tests, etc.	10
science	In addition
Total	20



Science

- International Scientific Students' Congress (MHCK) – Fin. University +3 (+3-1 for 1-3 places)
- Prizes in external accounting competitions, conferences, etc. (+7)
- Articles in journals in English/Russian (+5-10)

Essential reading



Belverd E. Needles, Marian Powers, Susan V. Crosson Accounting principles

David Alexander, Christopher Nobes Financial accounting: an international introduction

Peter Atrill, Eddie McLaney Financial Accounting for Decision Makers

International standards (IAS & IFRS)

Russian accounting standards (FSA)

ACCA FA (F3) Financial accounting



Accounting process

Prime source documents



Accounting records



Financial statements



Communications Through Financial Statements

- Identify the four financial statements



Communications Through Financial Statements

- Four Major Financial Statements
 - Income Statement / Statement of Profit or loss / Statement of comprehensive income
 - Statement of Owner's (Shareholders') Equity / Statement of changes in equity
 - Balance Sheet / Statement of financial position
 - Statement of Cash Flows / CFS
 - +notes and disclosures



Income Statement / P&L

- Summarizes revenues earned and expenses incurred over a period of time
- Dated “For the Month Ended ...”
- Purpose to measure a company’s performance over a period of time
- Shows whether or not a company achieved its profitability goal



Income Statement (cont'd)

- Considered by many to be most important financial statement
- First financial statement to be prepared in a sequence
- Net income (net profit) figure used to prepare statement of owner's equity

Income Statement

Date reflects revenues and expenses incurred over a period of time

Shannon Realty
Income Statement
For the Month Ended December 31, 20xx

Revenues

Commissions earned \$3,500

Expenses

Equipment rental expense \$1,000

Wages expense 400

Utilities expense 300

Total expenses 1,700

Net income \$1,800

Net income figure used to prepare statement of owner's equity



Statement of Owner's Equity

- Shows changes in owner's equity over a period of time
- Dated "For the Month Ended ..."
- Uses net income figure from income statement
- End of period balance in Capital account used to prepare balance sheet

Statement of Owner's Equity

Date reflects changes in John Shannon, Capital, over a period of time

Shannon Realty
Statement of Owner's Equity
For the Month Ended December 31, 20xx

John Shannon, Capital, December 1, 20xx		\$ 0
Add: Investments by John Shannon	\$50,000	
Net income for the month	<u>1,800</u>	<u>51,800</u>
Subtotal		51,800
Less: Withdrawals by John Shannon		<u>600</u>
John Shannon, Capital, December 31, 20xx		<u><u>\$51,200</u></u>

Ending balance of John Shannon, Capital, used to prepare the balance sheet

Net income figure from income statement



Balance Sheet

- Shows the financial position of a company on a certain date
- Dated as of a certain date
- Also called the *statement of financial position*
- Presents view of business as holder of assets that are equal to the claims against those assets
- Claims consist of liabilities and owner's equity

Balance Sheet

Date reflects account balances as of a certain date

**Shannon Realty
Balance Sheet
December 31, 20xx**

Assets		Liabilities	
Cash	\$15,300	Accounts payable	\$ 600
Accounts receivable	1,000		
Supplies	500		
Land	10,000		
Building	<u>25,000</u>		
		Owner's Equity	
		John Shannon, Capital	<u>51,200</u>
Total assets	<u><u>\$51,800</u></u>	Total liabilities and owner's equity	<u><u>\$51,800</u></u>

Balance in Cash account used in statement of cash flows

John Shannon, Capital, from statement of owner's equity



Statement of Cash Flows

- Shows cash flows into and out of a business over a period of time
- Dated “For the Month Ended ...”
- Focuses on whether the business met its liquidity goal
- Explains how the Cash account changed during the period

Statement of Cash Flows

Shannon Realty
Statement of Cash Flows
For the Month Ended December 31, 20xx

Date reflects cash flows over a period of time

Cash flows from operating activities		
Net income		\$ 1,800
Adjustments to reconcile net income to net cash flows from operating activities		
Increase in accounts receivable	(\$1,000)	
Increase in supplies	(500)	
Increase in accounts payable	600	(900)
Net cash flows from operating activities		\$ 900
Cash flows from investing activities		
Purchase of land	(\$10,000)	
Purchase of building	(25,000)	
Net cash flows from investing activities		(35,000)
Cash flows from financing activities		
Investments by John Shannon	\$50,000	
Withdrawals by John Shannon	(600)	
Net cash flows from financing activities		49,400
Net increase (decrease) in cash		\$15,300
Cash at beginning of month		0
Cash at end of month		<u>\$15,300</u>

Begins with net income from income statement

Cash at end of month same as Cash account balance on balance sheet



Discussion

Q. The balance sheet is often referred to as the statement of financial position. What does financial position mean?

A. Financial position is the resources, or assets, owned by a business as of a certain date

These resources are offset by claims against them and stockholders' equity, as shown on the balance sheet



Towards a definition

Accounting is a science as well as an art

Accounting is concerned with the provision of information about the position and performance of an enterprise that is useful to a wide range of potential users in making decisions



The American Institute of Certified Public Accountants:

Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part, at least, of a financial character, and interpreting the results thereof

Accounting is the language of business



- (i) What he owns?
- (ii) What he owes?
- (iii) Whether he has earned profit or suffered loss over a period?
- (iv) What is his financial position? Is he better off or moving towards bankruptcy?

Decisions that users of accounting information make





Economic
(allocation of resources)



Legal
(management/stewardship)



A brief history

- stewardship function
- regular reports (financial reporting)
- accounting information is used to help make decisions about the future



The changing role of accounting

Many businesses operate globally
(different regulators, need for common
set of rules)

Social and environmental reporting

Accounting/reporting for sustainable
development, etc.



The functions of accounting

- Information for decisions
- Classification
- Measurement
- Stewardship
- Recording
- Monitoring and control
- Performance evaluation and compensation
- Communication



Users of accounting information



external



internal



Common needs of most users

- (a) to decide when to buy, hold or sell an equity investment.
- (b) to assess the stewardship or accountability of management.
- (c) to assess the ability of the entity to pay and provide other benefits to its employees.
- (d) to assess the security for amounts lent to the entity.
- (e) to determine taxation policies.
- (f) to determine distributable profits and dividends.
- (g) to prepare and use national income statistics.
- (h) to regulate the activities of entities.



Investors

- information to help them determine whether they should buy, hold or sell
- assess the ability of the entity to pay dividends



Employees

- stability and profitability of their employers
- ability of the entity to provide remuneration, retirement benefits and employment opportunities



Lenders

- whether their loans, and the interest attaching to them, will be paid when due



Suppliers and other trade creditors

- determine whether amounts owing to them will be paid when due



Customers

- continuance of an entity, especially when they have a long-term involvement with, or are dependent on, the entity

Governments and their agencies



- allocation of resources and, therefore, the activities of entities
- information in order to regulate the activities of entities, determine taxation policies and as the basis for national income and similar statistics



Public

- substantial contribution to the local economy
- trends and recent developments in the prosperity of the entity and the range of its activities



Management

- interested in every aspect of accounting as their uses are diverse for different purposes
- interested in the information contained in the financial statements
- has access to additional management and financial information that helps it carry out its planning, decision-making and control responsibilities
- has the ability to determine the form and content of additional information in order to meet its own needs

BOOK-KEEPING AND ACCOUNTANCY



- **Book-keeping is the art of recording business transactions in a set of books of accounts.**
- **Book-keeping and accounting are not synonymous (inter-changeable) terms.**
- **The job of an accountant commences where the work of a book-keeper ends.**



The functions of an accountant

- (i) Examination of entries made in the books of accounts
- (ii) Verification of trial balance
- (iii) Rectification of errors, if any, in accounts
- (iv) Recording the adjustments
- (v) Preparation of trading account
- (vi) Preparation of income statement/P&L
- (vii) Preparation of balance sheet/SFP
- (viii) Analysis of results and
- (ix) Deriving conclusions and communication of the results



Accounting



Financial



Management



Tax



Cost



Environmental
Sustainability ...

A comparison of financial accounting and management accounting

	Characteristics of financial accounting	Characteristics of management accounting
Users of information		
Extent of formal regulation		
Degree of uniformity across different organisations		
Degree of detail		
Likelihood of including non-financial information		
Relevance for managerial decision-making		



Accounting principles

the rules based on assumptions, customs, usages and traditions for recording transactions

Accounting principles may be defined as those rules of action or conduct, which are adopted by the accountants, universally, while recording the transactions.



Need for Regulation



Relevant&reliable
information



Comparability



Fair information



Sources of Regulation



Accounting Standards

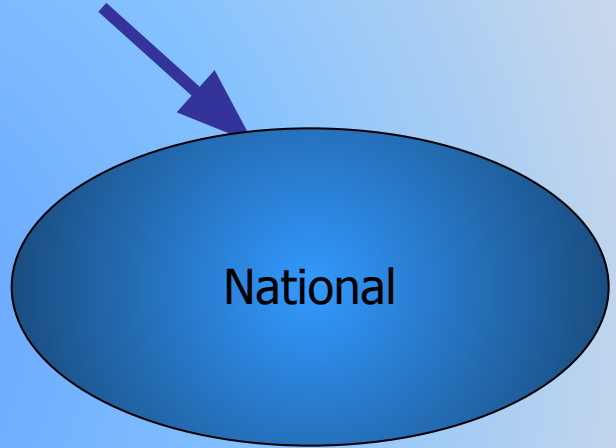
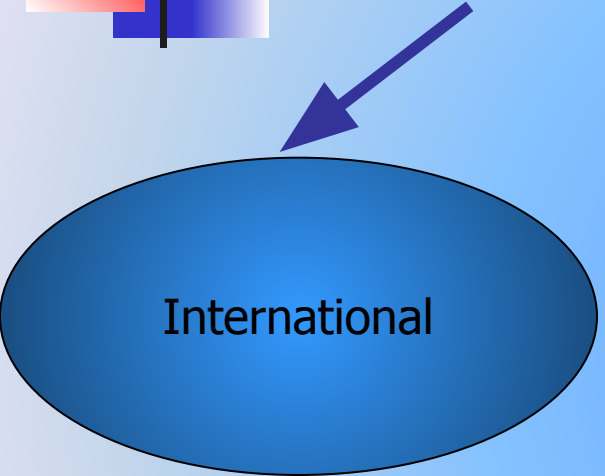
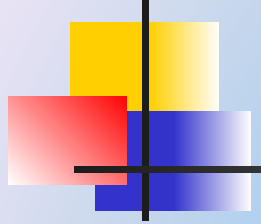


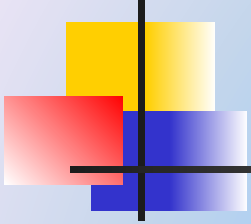
Company Law



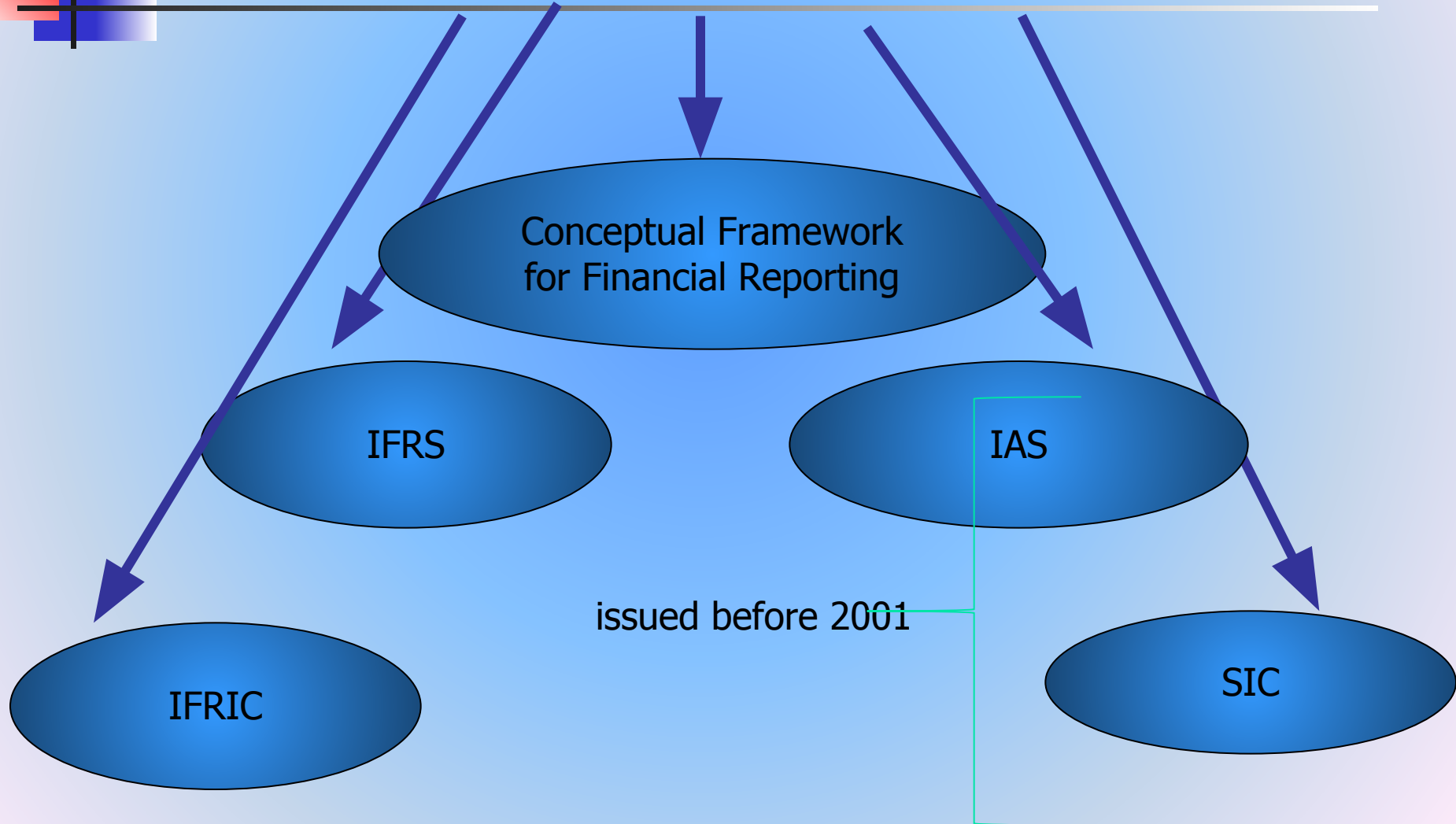
*Listing Rules

GAAP





IASB



IASB

www.ifrs.org

The mission

- To develop IFRS Standards that bring transparency, accountability and efficiency to financial markets around the world.



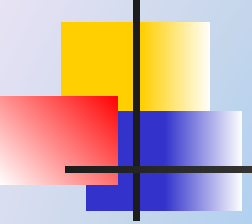
IFRS Standards

Bring transparency

Strengthen accountability

Contribute to economic efficiency

The Need for a Conceptual Framework

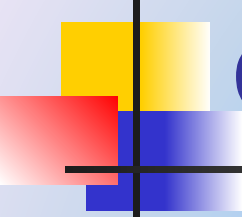
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- To develop a coherent set of standards and rules
 - To solve new and emerging practical problems

Purpose of the Conceptual Framework



- (a) to assist the Board in the development of future IFRSs and in its review of existing IFRSs;
- (b) to assist the Board in promoting harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by IFRSs;
- (c) to assist national standard-setting bodies in developing national standards;
- (d) to assist preparers of financial statements in applying IFRSs and in dealing with topics that have yet to form the subject of an IFRS;
- (e) to assist auditors in forming an opinion on whether financial statements comply with IFRSs;
- (f) to assist users of financial statements in interpreting the information contained in financial statements prepared in compliance with IFRSs;
- (g) to provide those who are interested in the work of the IASB with information about its approach to the formulation of IFRSs.

The Conceptual Framework deals with:



- (a) the objective of financial reporting;
- (b) the qualitative characteristics of useful financial information;
- (c) the definition, recognition and measurement of the elements from which financial statements are constructed;
- (d) concepts of capital and capital maintenance.

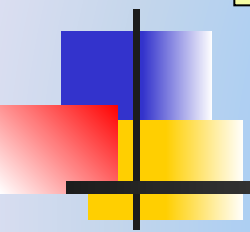
Concepts that underlie the preparation and presentation of financial statement

Underlying assumptions

Qualitative characteristics

Elements of financial statements

Alternative valuation bases

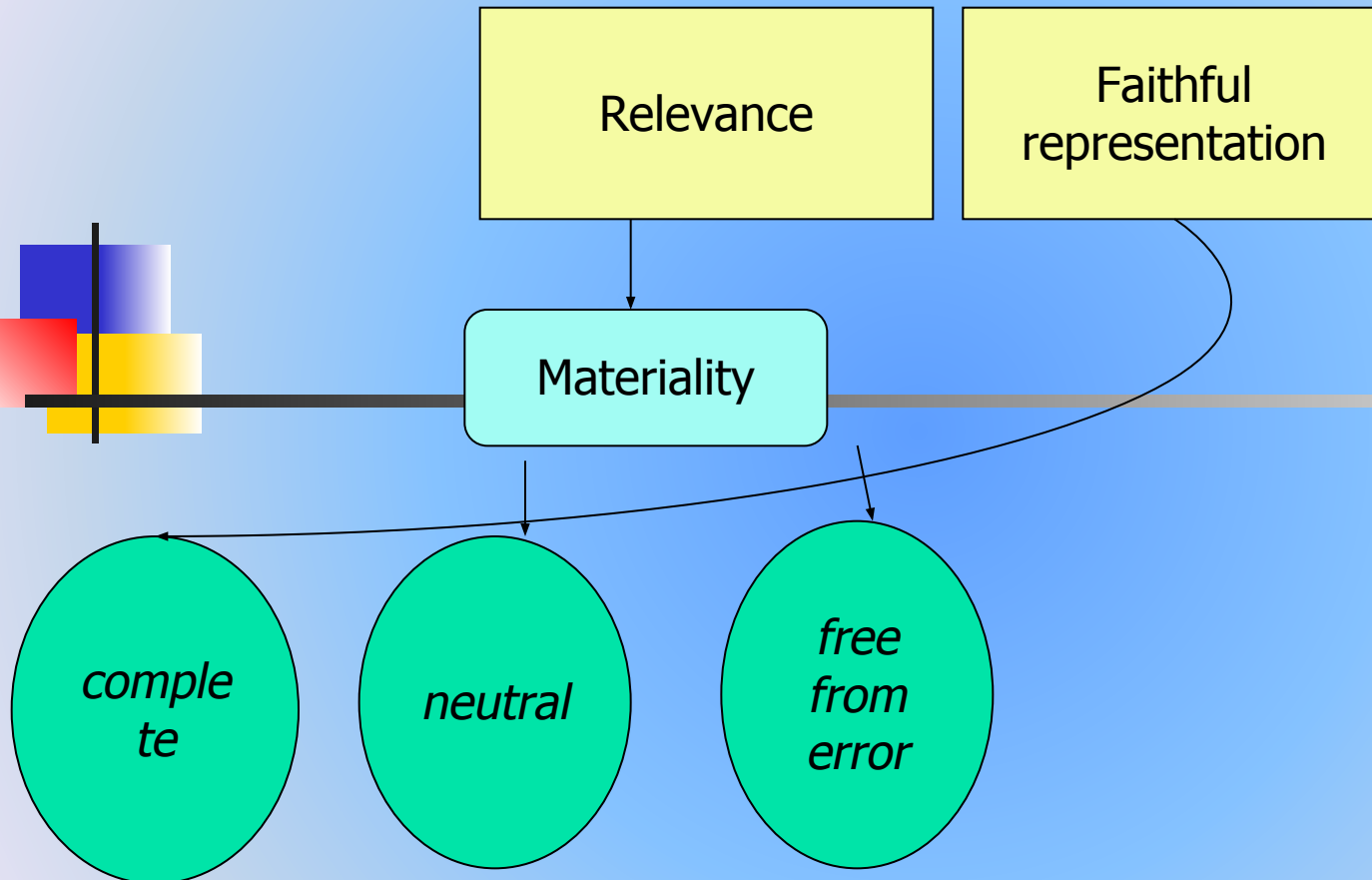




The qualitative characteristics

identify the types of information that are likely to be most useful to the existing and potential investors, lenders and other creditors for making decisions about the reporting entity on the basis of information in its financial report (financial information).

Qualitative characteristics of financial statements





Relevance

Relevant financial information is capable of making a difference in the decisions made by users.

Information may be capable of making a difference in a decision even if some users choose not to take advantage of it or are already aware of it from other sources.

Predictive value



Confirmatory
value



Faithful representation

financial information must faithfully represent the phenomena that it purports to represent



complete

A complete depiction includes all information necessary for a user to understand the phenomenon being depicted, including all necessary descriptions and explanations



neutral

A neutral depiction is without bias in the selection or presentation of financial information

*free
from
error*

there are no errors or omissions in the description of the phenomenon, and the process used to produce the reported information has been selected and applied with no errors in the process



Process for applying the fundamental qualitative characteristics

1. identify an economic phenomenon that has the potential to be useful to users of the reporting entity's financial information.
2. identify the type of information about that phenomenon that would be most relevant if it is available and can be faithfully represented.
3. determine whether that information is available and can be faithfully represented.

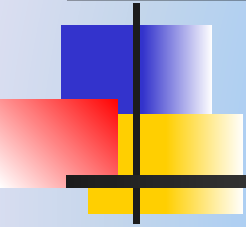
Enhancing qualitative characteristics of financial statements

Comparability

Verifiability

Timeliness

Understandability





Comparability

enables users to identify and understand similarities in, and differences among, items

Consistency



Verifiability

different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation



Timeliness

having information available to decision-makers in time to be capable of influencing their decisions



Understandability

Classifying, characterising and presenting information clearly and concisely makes it *understandable*



The cost constraint on useful financial reporting

- Providers of financial information - collecting, processing, verifying and disseminating financial information
- Users of financial information - analysing and interpreting the information provided



Underlying assumption

The financial statements are normally prepared on the assumption that an entity is a **going concern** and will continue in operation for the foreseeable future.



Accrual basis

Effects of transactions and other events are recognised when they occur (and not as cash is received or paid)

recorded in the accounting records and reported in the financial statements of the periods to which they relate

e.g.:

- Accrued revenue: revenue is recognized before cash is received.
- Accrued expense: expense is recognized before cash is paid out.



Money Measurement

- Recording of all business transactions in terms of money
- Money is the only factor common to all business transactions
- Basic unit of money determined by the country in which business resides
- Exchange rates are used to translate transactions from one currency to another



Money Measure (cont'd)

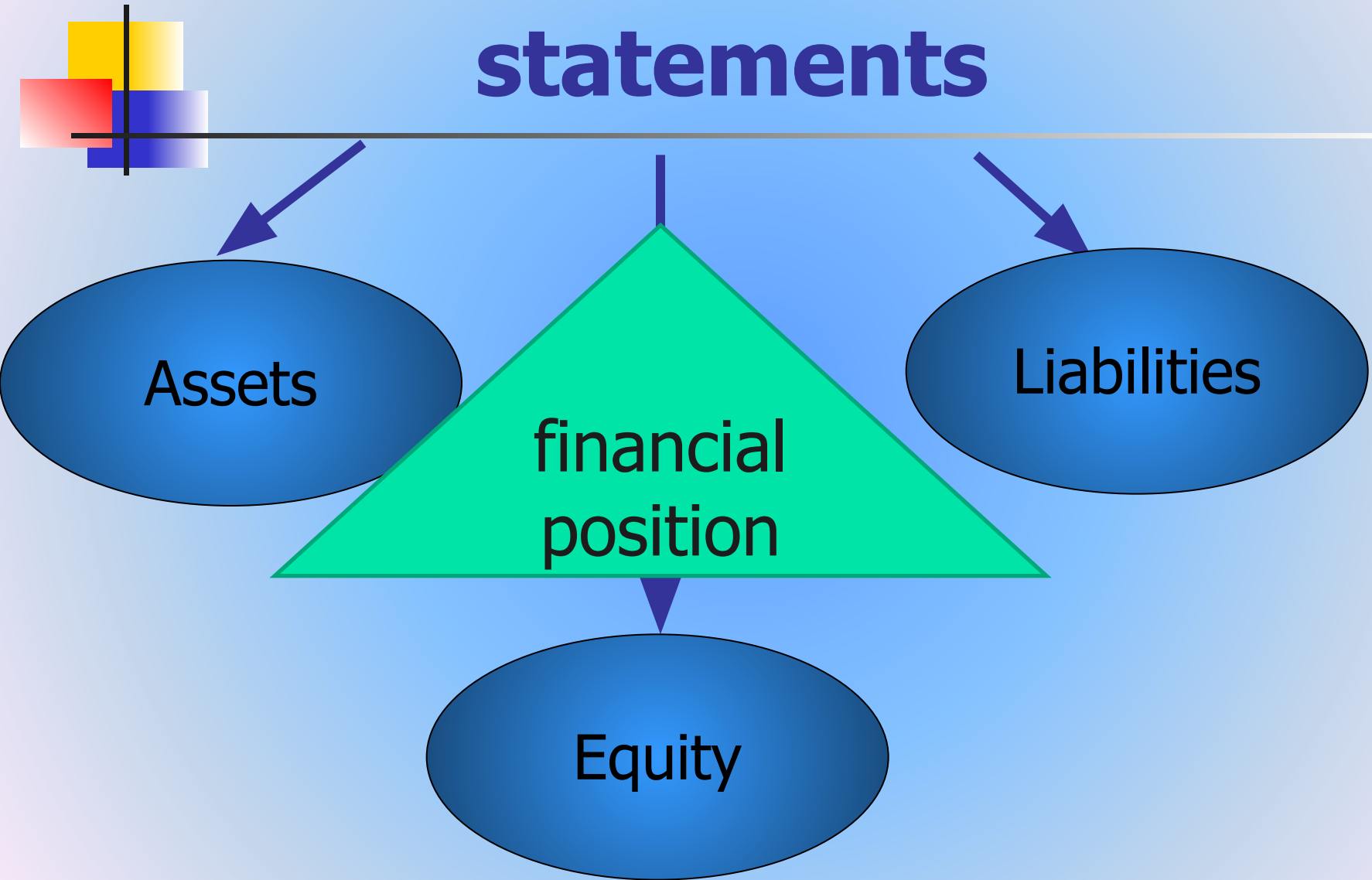
- Exchange Rate
 - The value of one currency in terms of another
 - Changes daily
- Example:
 - Assume the price of one British pound is 1.61 U.S. dollars. How many British pounds would one U.S. dollar buy?
 - $1 \text{ British pound} \div 1.61 \text{ U.S. dollars}$
 - $= 0.62 \text{ British pounds per U.S. dollar}$



Separate Entity

- A business is distinct from its
 - Owner(s)
 - Creditors
 - Customers
- Its financial records and reports should refer only to its own financial affairs

The elements of financial statements





Profit



Income

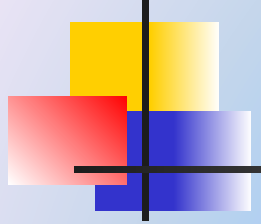


Performance



Expenses

Recognition of the elements of financial statements



The probability of future economic benefit

Reliability of measurement

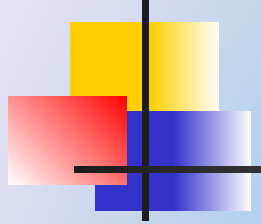
Recognition of assets

Recognition of liabilities

Recognition of income

Recognition of expenses

Measurement of the elements of financial statements



Historical cost


Current cost

Realisable (settlement) value

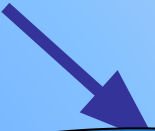
Present value



Concepts of capital



financial
concept



physical
concept

Concepts of capital maintenance and the determination of profit



*Financial
capital
maintenance*



*Physical
capital
maintenance*