The ExP Group

ACCA FR | ExPress Notes

Financial Reporting

SBL SBR AFM APM ATX AAA

BT MA FA LW PM TX FR AA FM

Valid for September 2020, December 2020, March 2021 and June 2021 exam sittings

Contents

Steve Crossman
CEO The ExP Group

"Hello"

Thank you for downloading a copy of these ExPress notes and I hope you find them useful for your studies.

We provide these ExPress notes free of charge to individual students as part of our CSR initiatives. The notes are designed to help students assimilate and understand the most important areas for the exam as quickly as possible.

A word of warning though in that they have not been designed to cover everything in the syllabus so you should only use these notes for either an overview of the key areas before you start your main studies or as part of your final revision in the run up to your exams.

Importantly though, we want you to be successful in your exams so good luck with your studies and please do let us know how you get on.

All the best

Steve

About The ExP Group

We were born with one passion, with one aim, with one desire. To use technology the way it should be used. To use technology to open up education, and in particular financial education, to whoever needs it regardless of their income, wealth, race, sex, religion or location.

We wanted to use technology to empower individuals to develop themselves through financial expertise, organisations to improve their performance through enhanced human capital and ultimately communities and families to benefit as a result.

We're on target and since our birth we have had the privilege of working with and learning from inspirational individuals and organisations from all 4 corners of the world in countries as varied as the UK in the north, Singapore in the east, South Africa in the south and the Cayman Islands in the west.

We're only part way through our journey but we're doing better than we expected. The best is yet to come though,

Education+Technology=Ethical Empowerment.

Thank you for being part of our story.

01 The Conceptual Framework

The Big Picture

IFRS provides a series of accounting rules that should enhance understandability and consistency of financial statements. However, these rules cannot possibly cover every type of accounting transaction that could ever happen.

To give guidance on what to do with situations that are not covered by a standard, the Framework exists.

The Framework document does not have the status of an IFRS and if there is any conflict between the Framework and a specific provision in an IFRS, the IFRS prevails.

The Framework also provides an underlying logic for the development of new IFRS. This means that each IFRS should define an asset or a gain in the same way for example. This is a marked difference from the historical tendency for accounting standards to be developed in a piecemeal way, sometimes called a "patchwork quilt".

The Framework document starts by discussing what characteristics financial information needs to have and defining some of these key concepts.

Key Definitions

Qualitative characteristics of financial information help make the information included within financial statements useful to others. They are:

(i) Fundamental qualitative characteristics
- Relevance
- Faithful representation

(ii) Enhancing qualitative characteristics
- Comparability
- Verifiability

- Timeliness
- Understandability

Elements of financial statements

There are five elements of financial statements. These definitions are worth knowing well, as their application comes up again and again in understanding IFRS.

Asset	A resource that is both controlled by an entity and is expected to produce future economic benefits that will flow to the entity.
Liability	A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
Equity	The residual interest in the assets of the entity after deducting all its liabilities. **Note: Assets – liabilities = equity = capital + reserves** This mathematical identity comes in very handy when preparing group financial statements.
Income	Increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.
Expenses	Decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

True and fair view

This phrase is not defined by the IASB in any IFRS or the Framework document, although it is a core concept. This is probably to allow a little latitude in its interpretation between companies.

Broadly, it means that if an entity complies with all extant IFRS, then its financial statements will give a true and fair view.

True tends to be more objective (e.g. did the reported transaction actually happen?) and fair tends to mean neutral and unbiased. For example, an allowance for doubtful debts cannot logically be described as true, since it's an estimate and it involves opinion. It can, however, be described as fairly stated.

Valuation of assets and profit

For the FR paper, you need only a brief overview of the limitations of historical cost accounting.

Historical cost accounting has these principal advantages:

- Relatively easy to understand;
- Easy to audit;
- Simple to apply.

In times of low inflation, this means that historical cost accounting works well. However, in periods of higher inflation, or for transactions with a long life (eg plant with a 40 year life) it has some significant limitations, including:

- Matching today's revenues with yesterday's costs, thus overstating profit;
- Giving out of date asset valuations;
- Not recording gains where companies are able to hold net trade payables (assuming the payables don't bear interest);
- Comparatives are misleading, since not expressed in a stable monetary unit;
- Long-term apparent growth can be overstated, due to the compounding effect of inflation.

Capital maintenance concepts

Capital maintenance means preserving the initial value of an investor's investment. This is done using either the financial capital maintenance concept, or the physical capital maintenance concept. Historical cost accounting is the simplest form; being financial capital maintenance with no adjustment for inflation.

Financial capital maintenance means preserving the general purchasing power of an investor's initial investment. Adjustments will be made using the general rate of inflation.

Physical capital maintenance means preserving the ability of the business to continue trading at its current level. Inflation adjustments are specific to the industry in which it operates. Current cost accounting (also known as "replacement cost accounting") uses this method of capital maintenance.

02 Presentation of Financial Statements

The Big Picture

IAS 1 is a cornerstone accounting standard that includes:

- Components of financial statements;
- Core concepts;
- True and fair override.

Components of financial statements

A full set of IFRS financial statements comprises the following primary statements (ie statements that must be shown with equal prominence as each other):

- Statement of financial position (previously called balance sheet);
- Either:
    - A statement of profit or loss and other comprehensive income, or
    - A statement of profit or loss plus a statement showing other comprehensive income.
- Statement of changes in equity;
- Statement of cash flows;
- Accounting policies and explanatory notes.

Core concepts

IAS 1 includes a number of core concepts, with some overlap with the Framework document.

- Fair presentation – fair, neutral description of transactions.
- Going concern – entity assumed to continue trading into the foreseeable future.
- Accruals (matching) basis of accounting – match costs with associated revenues and items to the time period incurred.
- Consistency of presentation – present similar transactions the same way within the current year and year by year.
- Materiality and aggregation – no need to present information about immaterial transactions, but aggregate transactions with similar characteristics instead.
- Offsetting - offset as little as possible.
- Frequency of reporting – normally annually but can be shorter if necessary and certain disclosures made.
- Comparative information – comparative information must be provided and presented in such a way as to make comparison easy (eg use the same accounting policies in both years).

03 Substance and IFRS 15, Revenue Recognition

The Big Picture

Substance over Form

For information to be reliable, it must be reported in accordance with its commercial substance, rather than strictly in adherence to its legal form.

One example of substance over form is in the context of finance leases, where a reporting entity records assets held under a finance lease in the SOFP, although it's not owned by them.

In substance, the degree of control means it's "their" asset although legally it quite possibly never is.

There are a wide range of transactions where identifying the true commercial substance may be difficult. This include:

- Inventory sold on a sale or return basis ("consignment inventory")
- Debt factoring
- Loans secured on assets that will be repurchased.

In order to reach a sensible conclusion in any substance over form scenario, it is necessary to identify:

- What assets are in question?
- What are the intrinsic risks and rewards of holding that asset?
- Which party to the transaction is, on balance, more exposed to the risks and rewards of that asset?

The asset with the greater exposure to risks and rewards recognises the asset on its SOFP. If it involves initial recognition of an asset, this often generates recognition of a gain also.