Financial Accounting 1
ACC 201

Topic 1

IASB Framework for the Preparation and Presentation of Financial Statements





Introduction

The preparation and presentation of financial statements are based on a large number of concepts, principles and detailed rules. Some of these are contained in law, while others are in financial reporting standards and generally accepted accounting principles (GAAP).

Generally Accepted Accounting Principles vary from country to country because their legal and regulatory systems are not the same. However many countries all over the world have now accepted a uniform accounting standards, which is known as International Financial Reporting Standards (IFRS) or International Accounting Standards (IAS). It is this set of standards and use of appropriate local GAAP that are applied when preparing and presenting financial statements.

Accounting Standards

Definition of Accounting Standards

Accounting standards are common sets of principles and procedures that define the basis of financial accounting policies and practices. They apply to the whole spectrum of an entity's financial transactions and other events, including assets, liabilities, revenue, expenses, and equity.

Adoption

Accounting standards do not have the force of law, but they become effective if they are adopted by a country. For instance, Nigeria started adoption of IFRS in the year 2012 with listed companies on the Nigerian Exchange Group

The International Accounting Standards Board (IASB)

The IASB referred to as The Board is responsible for issuing new International Financial Reporting Standards (IFRSs). The board is made up of 14 members that are highly skilled in accounting and each member contributes to the issue and publications of the following documents issued by the Board.

Outputs of the IASB

The IASB issues several types of documents, including:

Exposure draft of standards

Revised International Accounting Standards (IAS) International Financial Reporting Standards (IFRSs)

Final interpretation of the IFRS Interpretation Committee (IFRSIC)

Responsibility of the IASB

The IASB has full responsibility for all technical matters. The Board has the following responsibilities as listed below:

i. Issues the IASB Conceptual Framework, which sets out the concepts that underline the preparation and presentation of financial statements for users.

ii. Issues accounting standards, including IFRSs and Interpretations (IFRICs), which are used globally to promote consistency and transparency in financial reporting.

iii. Sets National accounting standard-setting bodies, such as Nigeria's Financial Reporting Council (FRCON),

iv. Ensures compliance with International Financial Reporting Standards (IFRSs) through the National Accounting Standard Setting Body.

What is Conceptual Framework

The Conceptual Framework is a coherent system of interrelated objectives and fundamental concepts that prescribes the nature, function, and limits of financial accounting and reporting and that is expected to lead to consistent guidance.

It sets out the fundamental concepts for financial reporting that guide the IASB in developing IFRS Standards.

It helps to ensure that the Standards are conceptually consistent and that similar transactions are treated the same way, so as to provide useful information for investors, lenders, and other creditors.

It assists companies in developing accounting policies when no IFRS Standard applies to a particular transaction.

It helps stakeholders to understand and interpret the Standards.

It provides the foundation and guiding principles for developing and interpreting accounting standards

Development of Conceptual Framework

April 1989	*Framework for the Preparation and Presentation of Financial Statements* (the Framework) was approved by the IASC Board
July 1989	Framework was published
April 2001	Framework adopted by the IASB.
September 2010	*Conceptual Framework for Financial Reporting 2010* approved by the IASB
March 2018	*Conceptual Framework for Financial Reporting 2018* (the Framework) published

Purpose of Conceptual Framework

The purpose of the Conceptual Framework is to:

assist the International Accounting Standards Board (IASB) in developing and revising its IFRS Accounting Standards

assist entities in developing consistent accounting policies when no IFRS Accounting Standard applies to a particular transaction or other event, or when a Standard allows a choice of accounting policy, and

assist all stakeholders to understand and interpret the IFRS Accounting Standards

Scope of Conceptual Framework

The 2018 revised *Conceptual Framework* sets out:

The objective of general-purpose financial reporting;

the qualitative characteristics of useful financial information;

- a description of the reporting entity and its boundary;
- Definitions of an asset, a liability, equity, income and expenses, and guidance supporting these definitions;
- criteria for including assets and liabilities in financial statements (recognition) and guidance on when to remove them (derecognition);
- measurement bases and guidance on when to use them;
- concepts and guidance on presentation and disclosure; and
- concepts relating to capital and capital maintenance.

Benefits of Conceptual Framework

-Consistency and Comparability:

By providing a common set of principles, it promotes consistency in accounting practices, making it easier to compare financial statements across different companies and periods.

Guidance for Standard Setters:

It helps the International Accounting Standards Board (IASB) and other standard setters develop consistent and conceptually sound IFRS standards.

Assistance to Preparers:

It provides guidance to companies in developing accounting policies, especially when specific standards are not available or when there is a choice of accounting methods.

Enhanced Understanding:

It helps all stakeholders, including investors, lenders, and analysts, to better understand and interpret financial statements

Objective of a General Purpose Financial Reporting (GPFR)

- GPFRs are financial statements – intended to meet the information needs common to users who are unable to command the preparation of reports tailored specifically to meet all of their information needs.
- GPFRs are financial statements that comply with accounting standards and other generally accepted accounting practices (GAAPs).
- By contrast, special-purpose financial statements are provided to meet the information demands of a particular user or group of users.
- The CF noted that GPFR cannot provide all the information that users may need to make economic decisions. They will need to consider pertinent information from other sources as well.

Users of General Purpose Financial Reporting

The primary users of GPRF are:

- present and potential investors,
- Lenders and other creditors,

who use that information to make decisions about buying, selling, or holding equity or debt instruments, providing or settling loans or other forms of credit, or exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.

This group needs information about the resources of the entity to:

- assess an entity's prospects for future net cash inflows; and
- how effectively and efficiently management has discharged its responsibilities to use the entity's existing resources (i.e., stewardship)

Users of General Purpose Financial Reporting

Other users are:

i. Prudential and market regulators,

ii. Managers who guide the company.

iii. Analysts and brokerage firms dealing with the company's stock.

The government, which decides how much tax should be collected from the company.

The CF noted that this group may find GPFR useful, but they are not considered the primary users, and GPFRs are not primarily directed to regulators or other parties

Users and Uses of GPFR

User of Accounting Information	Information Need
Owners of the business/Investors	They will be interested in information that permits appraisal of efficiency of management performance.
Management	They will be interested in the overall performance, growth and survival of the business.
Trade creditors (payables)	They will be interested in the liquidity of the business.
Employees of the business	They will be interested in the liquidity, profitability and survival of the business.
Customers	They will be interested in the quality of the products/services of the business.
Government	They will be interested in the profitability of the business for tax purposes and policy formulation
Financial analysts	They will be interested in information that permits appraisal of the entire business activities.
Lenders	They are interested in the liquidity, profitability, and

Qualitative Characteristics of Useful Financial Information

Financial information is useful when it is **relevant** and represents **faithfully** what it purports to represent.

The usefulness of financial information is enhanced if it is comparable, verifiable, timely, and understandable

Thus, the qualitative characteristics are divided into two:

i. Fundamental qualitative characteristics; and

ii. Enhancing qualitative characteristics

Fundamental qualitative characteristics

Relevance: Accounting information must have the ability to influence decisions. Users should be able to use it for prediction and confirmatory purposes.

- **Materiality** is an entity-specific aspect of relevance based on the nature or magnitude (or both) of the items to which the information relates in the context of an individual entity's financial report.

Faithful Representation: GPFR represents economic phenomena in words and numbers. Therefore, GPFR must represent faithfully the phenomena it purports to represent.

- Faithful representation means representation of the substance of an economic phenomenon instead of representation of its legal form only.
- A faithful representation seeks to maximise the underlying characteristics of **completeness, neutrality**, and **freedom from error**

Illustration 1 - Relevance

A business is a going concern with no intentions to reduce or curtail its operations.

Which would be the most relevant valuation for its machinery – the **net realisable value** of the machinery or its **depreciated cost**?

Solution

As the business is to continue into the future and therefore it can be assumed that the machinery is not going to be sold, the depreciated cost of the machinery would be a more relevant value than the net realisable value. If circumstances changed and the business were not a going concern, the net realisable value would be more relevant to the users of the financial statements.

Enhancing Qualitative Characteristics

Comparability: This quality will enable users to identify changes in the business over time (for example, the trend in sales revenue over the past five years). It will also help them to evaluate the performance of the business in relation to similar businesses

Understandability. Accounting reports should be expressed as clearly as possible and should be understood by those to whom the information is aimed. It assumes that the users have:

a reasonable knowledge of business and economic activities

Review and analyse the provided information diligently

Timeliness: it must be made available early enough for its use and be capable of influencing users' decisions.

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

Reporting Entity

The reporting entity

A reporting entity is an entity that is required, or chooses, to prepare financial statements. It can be a single entity or a portion of an entity or can comprise more than one entity. A reporting entity is not necessarily a legal entity.

Elements of Financial Statements

- Financial statements portray the financial effects of transactions and other events by grouping them into broad classes according to their economic characteristics.
- These broad classes are termed the elements of financial statements.
- The elements are grouped into two:

  a. The elements directly related to statement of financial position (balance sheet) are: Assets, Liabilities, and Equity (Capital)

  b. The elements directly related to performance (income statement) are: Income and Expenses
- The cash flow statement reflects both income statement elements and some changes in statement of financial position elements.

Elements of Financial Statements

Definitions of the elements relating to statement of financial position

Asset - An asset is a resource **controlled** by the entity as a result of **past events** and from which **future economic benefits** are expected to flow to the entity.

Controlled by the entity – control is the ability to obtain the economic benefits and to restrict the access of others (e.g. by an entity being the sole user of its plant and machinery, or by selling surplus plant and machinery).

Past events – the event must be 'past' before an asset can arise. For example, equipment will only become an asset when there is access to the asset's potential. Dependent on the terms of the contract, this may be on acceptance of the order or on delivery.

Elements of Financial Statements

Liability. A liability is 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**.

Obligation – this may be legal or constructive. A constructive obligation is an obligation which is the result of expected practice rather than required by law or a legal contract. An example of a constructive obligation may be an environmental provision created by an entity which has a published policy of environmental responsibility, regardless of whether any legislation exists.

Past events – as with assets, the event causing the liability must be in the past. For example, lease contracts would need to have been signed before the reporting date.

Elements of Financial Statements

Equity – Equity could be the contributions of owners to the business or the **residual interest** in the assets of the entity after deducting all its liabilities.

Asset = Equity + Liability

Equity = Asset - Liability

Elements of Financial Statements

Definitions of the elements relating to performance

Income. Income is an increase 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.

Expense. Expenses are 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.

Elements of Financial Statements

The definition of income encompasses both revenue and gains. Revenue arises in the course of the ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent. Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an entity. Gains represent increases in economic benefits and, as such, are no different in nature from revenue. Hence, they are not regarded as constituting a separate element in the IFRS Framework.

The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity. Expenses that arise in the course of the ordinary activities of the entity include, for example, the cost of sales, wages, and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, property, plant, and equipment. Losses represent other items that meet the definition of expenses and may, or may not, arise in the course of the ordinary activities of the entity. Losses represent decreases in economic benefits, and as such, they are no different in nature from other expenses. Hence, they are not regarded as a separate element in this Framework.

Appreciation

Thank you for listening