

User  
Orientation  
Needs

## **OBJECTIVES**

Of Financial Reporting

• Is to communicate info that is useful to:

- Investors
- Creditors
- & Other users

For making their resource allocation decisions  
Including *assessing MGMT stewardship*

**First Level:** The “why” - goals and purposes of accounting

# Qualitative Characteristics

Of useful information

- Are what gives financial information **decision usefulness**

Two groups of Qualitative Characteristics:

## 1. FUNDAMENTAL QUALITATIVE CHARACTERISTICS

### RELEVANCE

- Accounting info is relevant if it **Makes a Difference in a Decision**
- If it has a **Predictive Value** - helps users evaluate the financial impact of past present & future events
- Feedback/Confirmatory Value** - helps users confirm or correct expectations

### REPRESENTATIONAL FAITHFULNESS

- Accounting information is representationally faithful if it reflects the underlying **Economic Substance** of an event or transaction
- Transparency** - Clearly presenting economic reality
- For information to be faithful is must be:
  - Complete**- All pertinent information is included
  - Neutral**- Does not favor a stakeholder
  - Free from material bias**- Information is reliable

## 2. ENHANCING QUALITATIVE CHARACTERISTICS

include:

### COMPARABILITY (Consistency)

- Information that has been **Measure and Reported in a Similar Way**
  - From Company to Company
  - From Year to Year

### VERIFIABILITY

- Exists if the financial measurements made by the company can be **Confirmed by Independent Third Parties** (ie. Bank)
  - #'s verified with accuracy = **"HARD"**
  - #'s with a level of uncertainty = **"SOFT"**

### TIMELINESS

- Exists if the information is available to decision-makers before it loses its ability to influence their decisions

### UNDERSTANDABILITY

- Users need to have reasonable knowledge of **Business & Financial Accounting Matters** in order to understand the info in the financial statements

### CONSTRAINTS

- There are obstacles to reporting unlimited information to users

### MATERIALITY

- The information must **change of influence** a **decision**
- 5% or MORE of Income from Continuing Operations (after tax)**

### COST VS. BENEFIT

- The **costs** of providing the information **must be Weighed against the benefits** obtained from using the information

# ELEMENTS

Of Financial Statements

## ASSETS

Involve:

### ECONOMIC RESOURCES

- Things that are scarce and **Capable of Providing Cash Flows** where the **right to access is an enforceable right** (legal title or ownership)
- Present Economic Resource**: Company may sell or use the asset now
- Economic resource is the thing itself (such as building or the right to use it) and not the future cash flows that will be generated by it

## LIABILITIES

### ECONOMIC OBLIGATION

- An **Unconditional Promise** to incur an **Economic Burden** that is enforceable by legal means
- Outflows of economic resources are required to settle the obligation

## EQUITY

- Is the **Residual Interest** in the assets of an entity that remains **After Deducting its Liabilities**
- The ownerships interest

## REVENUES

- Increase in Economic Resources** due to an **inflow** of economic benefits (cash, receivables, or other consideration) arising from an entities **Normal Business Activities**

## EXPENSES

- Decrease in Economic Resources** due to an **outflow** of economic benefits (cash, payables, or other consideration) which result from an entity's normal **Revenue-Generating Activities**

## GAINS

- Increase** in equity from **Peripheral or Incidental Transactions** but **Excluding** transactions between company and owners

## LOSSES

- Decrease** in equity from **Peripheral or Incidental Transactions** but **Excluding** transactions between company and owners

## OTHER COMPREHENSIVE INCOME (OCI)

- Made up by revenues, expenses, gains and losses that are **excluded from net income**
  - Unrealizable holding gains and losses on certain securities
  - Certain gains and losses related for foreign exchange
  - Gains or losses on certain types of hedges

# FOUNDATIONAL PRINCIPLES

- **They Explain:** Which Financial Statement to use, when to use them, how to use them
- **In Order to:** *recognize, measure and disclose financial events* in the accounting system
- They act as **guidelines** when developing an accounting treatment for controversial financial reporting issues

Organized in 3 groups:

1.

## RECOGNITION/DERECOGNITION

**Recognition** is the act of **Including** something on the company's balance sheet or income statement

- Must meet the definition of an element (eg. asset, liability)
- Must be measurable

**Derecognition** is the act of **Removing** something from the balance sheet or income statement

- Under development by standard setters

## ECONOMIC ENTITY

- First step in the preparation of financial statements is to **define the economic entity that is being reported on (The parent, Divisions...)**
- **Consolidated Financial Statements** are then prepared from the perspective of this economic entity
- This allows the company to recognize and group together all the assets, liabilities and other F/S elements that are under the parent's control

## CONTROL

- Things under the entities control are generally included in the economic entity and the consolidated financial statements

*Components of control:*

1. There is power to direct the entities activities
2. Only ONE entity has the power to direct the activities
3. Power need not to be exercised or absolute
4. The reporting entity should have access to the benefits from the entity

## REVENUE RECOGNITION & REALIZATION

*Two approaches:*

1. **The Earnings Approach:** used under CGAAP and IFRS

Revenue is **recognized (recorded)** when the following three conditions are met:

1. Risk and Rewards have passed or the Earnings Process is Substantially Complete
2. Measurability is reasonable certain (price is fixed or determinable)
3. Collectibility is reasonably assured (realized or realizable)

Revenues are **realized** when products (goods or services), merchandise, or other assets are **exchanged** for cash or claims to cash.

Problems:

- Difficult to apply: who has the risk or the reward?
- Subjective
- Does not deal with when receivables should be booked if revenues are not earned yet

2. **Contract-Based Approach:** new proposed approach

STEP 1: The **Sales Contract** is recognized on the balance sheet as follows:

Contractual rights/ obligations (CA)	xxx
Contactual rights/ obligations (CL)	xxx

Can only be done if: The contractual rights are collectible and measurable and the performance is measurable

STEP 2: Revenues are recognized when: control over the good passes, performance obligations are settled

## MATCHING

- Answers the question: When should expenses be recognized?
- Expenses may be recognized (recorded) when the expense helped produce the product for sale
- **Period costs** (officers salary, admin expenses) - expensed immediately
- **Product costs** (material, direct labour, overhead) carried into future periods as inventory (if not sold)

## 2.

## MEASUREMENT

Because accrual accounting is followed many estimated must be used when preparing financial statements.

Therefore we must:

- Determine the level of uncertainty that is acceptable for recognition
- Use appropriate measurement tools
- Disclose sufficient information to indicate/describe the uncertainty

## PERIODICITY

- Economic activity of the corporation is artificially divided into time periods for reporting purposes (monthly, quarterly, yearly)
- To determine estimates of results

## MONETARY UNIT

- Money is the [most common unit of measure](#) of economic transactions

## GOING CONCERN

- Business will continue in the future
- Long enough to meet their objectives and commitments
- Management must look out at least 12 months from balance sheet date
- If the company is going bankrupt then the financial statements are prepared at Net Realizable Value (Sales price - Cost of disposal)

## HISTORICAL COST PRINCIPLE

- Transactions are initially measured at the amount of cash (or cash equivalents) that was paid or received or the fair value that was ascribed to the transactions when took place.

Three basic assumptions:

1. Represents a value at a [Point in Time](#) (generally fair value at transaction date)
2. Results from a [Reciprocal Exchange \(i.e. a two way exchange\)](#)
3. Exchanges includes an [Outside Party](#)

**Initial Recognition:** For non-financial assets, record all costs incurred to get the asset “ready” for sale (transportation and installation)

Sometimes it is not possible to determine cost or fair value: challenges

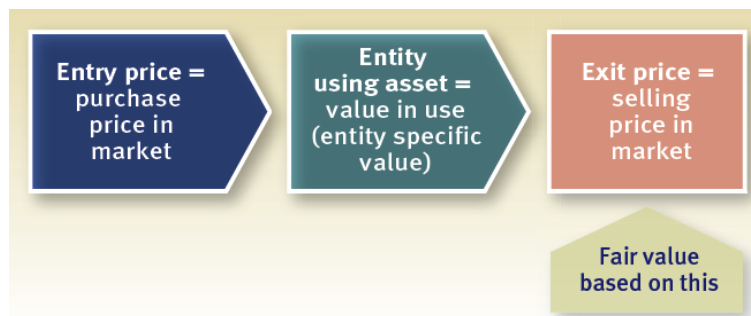
1. Non monetary transactions
2. Non monetary, non-reciprocal (i.e. donations)
3. Related party transactions - not “arms length”

## FAIR VALUE

“the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurable date. Market refers to any mechanism where parties objectively determine price through bargaining, supply & demand” **IFRS allows the use of fair value measurement.**

• **Financial Assets:** companies have the option to use Fair Value for most financial assets (cash, receivables, payable) with gains and losses being booked to income

• **Non financial assets:** IFRS allows the use of Fair Value for assets such as investment properties, and for property, plant and equipment



**3.**

**FULL DISCLOSURE PRINCIPLE**

*Anything that is relevant to users decisions should be included in the financial statement*

**DISCLOSURES**

- Main body of the financial statements
- Notes in the financial Statements
- Discussion in the Management Discussion and Analysis (MD&A)