

## Busi 293 Notes

### Chapter Six

### Communicating and Interpreting Accounting Information

Integrity in communication with investors and other users of financial statements is the key to maintaining relationships with suppliers of capital. Always keep this in the back of your mind when preparing financial information.

In Chapter 1 we touched on the importance of standard setting. Faced with accounting scandals, governments were forced to increase the regulatory environment. Corporate governance, the procedures designed to ensure that companies are managed in the best interests of shareholders, became of interest to lawmakers and regulatory bodies.

The US Congress passed the Public Accounting Reform and Investor Protection Act - the Sarbanes-Oxley Act. The overall aim is to ensure the public is protected and receives sound financial information.

Please refer to textbook Reference A which identifies the participants involved in ensuring the integrity of financial information.

Remember that **management is responsible for the financial statements and related disclosure**. The Board of Directors is responsible for ensuring that processes are in place for maintaining the integrity of the company's accounting system and the financial statement preparation and reporting.

The auditors are hired by the shareholders to provide an opinion on the fairness of the financial statements. Auditors do not look at every transaction and do not prepare the financial statements. As noted in Chapter 1, all publicly traded entities must have an unqualified Auditor's Report.

Public companies have an obligation to make timely disclosure of all material events affecting a company. Such disclosure is made through:

Press releases

Annual Reports which include audited financial statements and Management Discussion and Analysis (MDA) of financial condition and results of operations

Quarterly Reports

Annual Information Returns

To ensure this information is widely distributed to users websites have been established:

**Canada** – [www.sedar.com](http://www.sedar.com) – System for Electronic Document Analysis and Retrieval

**US** – [www.edgar.com](http://www.edgar.com) – Electronic Data Gathering and Retrieval

In Chapter 2 we introduced the qualitative characteristics of accounting information. Please refer to textbook Reference B for identification of these qualitative characteristics. Remember this topic is discussed in Section 1000 of the CICA Handbook (ASPE) and IASB The Conceptual Framework (IFRS).

Please refer to and carefully review textbook Reference C. **I cannot overemphasize the importance of the Conceptual Framework.**

Next time you are reviewing financial information ask yourself whether the information is **understandable**. This test should be applied by a reasonable knowledgeable investor.

Information should be **relevant**. To be relevant it must have predictive and/or confirmatory value. Predictive is forward looking while confirmatory analyzes past events. **Timely** information enhances both its predictive and confirmatory values.

Information must be a **faithful representation** of the economic phenomena it is supposed to represent. It must be complete, neutral, and free from material error. If users believe that information is not then they will no longer rely on the source of that information.

Financial statements are presented with **comparative** results of previous periods. Users are better able to identify similarities and discrepancies between time periods.

The information is **verifiable** if independent accountants can agree on the nature and amount of the transaction.

As previously discussed, there are many acceptable methods of accounting allowed under GAAP. Users expect that a company will prepare financial information using consistent application of accounting principles. Should a change be required, the user must be advised of the change and the effect or magnitude of the change on the financial statements. Further discussion will occur in Intermediate Accounting courses.

In a perfect world companies would produce perfect information. We know this is not the case. Accounting is not exact; there are many uncertainties in the preparation of financial information. An important concept in Accounting is materiality. An item is material if it is likely to influence the decision of a user. Financial statements often ignore

trivial or immaterial amounts as they do not affect the decisions made by users.

Preparing information is time-consuming and expensive. If the cost of securing or preparing this information is greater than the benefit of providing the information, clearly it is uneconomical to prepare the information. The costs and benefits are often difficult to quantify. **Again professional judgment is required.**

Accountants are usually regarded as conservative by nature. Accounting information should be as accurate as possible – not overly conservative or optimistic. However when uncertainty arises, prudence suggests that care should be taken to avoid overstating Assets/Revenues and understating Liabilities/Expenses. When you read newspaper articles or business magazines on financial scandals note how often the cause of the problem is aggressive accounting treatment of important financial statement elements.

This chapter focuses another company's financial statements. Again look at the presentation of the information. Note the clear format, presentation style and the comparative figures. This is one example of financial statements - as you become more comfortable doing your own research you will see the wide array of presentation styles.

Please refer to and review textbook Reference D - **You only get good at accounting when you are exposed to lots of examples.**

At this stage **I think you should be able to identify significant deficiencies in financial statements** - failure to produce complete financial statements or include proper notes. Have assets and liabilities been properly classified into current and non-current categories?

As you proceed to intermediate and advanced courses you will study topics which require complicated note disclosure - e.g. pensions, leases, income tax etc. It is a real art to present such information in an understandable and informative manner. Often a more difficult decision facing management is the disclosure required for items for which there are no specific published Handbook recommendations.

There is a trend for management to include voluntary disclosures in the financial statements. In the textbook they highlight the area of sustainability as an example.