LECTURE 1

FRAMEWORK FOR FINANCIAL REPORTING (STRUCTURE OF PART ONE OF THE SUBJECT)

- Financial reporting exists for things such as investors, stakeholders, financial contracting purposes
- Accounting standards are needed to regulate ways of accounting, as well as to make it easier and more effective to communicate financial information
- Ultimately flows from Corporations Act
- AASB effectively reissues accounting standards issued by international board - Groups of standards:
  → assets
  → liabilities
  → revenues →
  expenses - About identifying:
  → common problems
  → common structures
  → common solutions
- Developing a basis for reading, understanding and applying accounting standards
- There are always choices with how to conduct accounting, such as how often things are paid, when and how transactions are identified, if historic costs are recognised at fair value or not etc. These choices will keep recurring, which is why these common issues with accounting standards are identified and easily understood and applied

INTRODUCTION

- Umbrella standards generally dictate how we think about accounting and what they should look like and what guides their construction
- Conceptual frameworks give a good overview as to how accountants generally consider financial reporting, components of financial reports and how they are constructed

CONCEPTUAL FRAMEWORKS

- Represent an attempt to describe what accounting is and what it should be
- McGregor: they define the nature, subject, purpose and broad content of general purpose financial reports (i.e. why we have accounting)
- Benefits according to McGregor:
  → consistent and logical standards
  → accountability for standard setters (benchmark)
  → understandability
  → economical - history:
  → a tentative statement of accounting principles affecting corporate reporting (AAA 1936) after Great Depression
  → ARS 1, The basic postulates of Accounting (1961), ARS 3, A tentative set of broad accounting principles for business enterprises (1962)
  → APB statement No. 4, Basic concepts and accounting principles underlying financial statements of business enterprises (1970)
- present:
  → FASB 1978>
  → IASC 1989>
  → AARF 1990>
  → AASB: framework for the preparation and presentation of financial statements (06/14), ED264 conceptual framework for financial reporting (hoped to be released in first quarter of 2019)
- Panacea: a solution or remedy for all difficulties or diseases
- Empirical literature- Joyce Libby & Sunder (1982)
- Anecdotes- AASB 9- Impairment of Financial Instruments (inconsistent with conceptual framework) - Think of conceptual frameworks as an educational aid

ED 264

- Exists because:

→ evolutionary and shows conceptual framework with updates
→ follow the submissions/discussion
→ revision ¼ 2019 -
Real implications:
→ challenges surface over special purpose reports
→ Factiva-20180712-0643.pdf

CHAPTER ONE- the objective of general purpose financial reporting
- Prepared for a range of users e.g. employees, government, special interest users
- The regulation would suggest we are much more concerned with equity investors as users of financial reports
- Therefore, we are much for equity investor-centric
- Empirical evidence focuses on equity investors
  → Ball and Brown (1968)
  → Easton & Harris (1991)
  → Easton Harris and Ohlson (1992)

CHAPTER TWO- qualitative characteristics of useful financial information
- Must be relevant and have representative faithfulness
- relevance:
  → materiality
  → measurement of uncertainty
- Faithful representation: →
complete
  → neutral (prudence) i.e. conservatism, but will not be in the framework. However, it will be in a lot of the accounting standards
  → free from error
- Enhancing characteristics:
  → verifiability
  → timeliness
  → understandability
  → comparability

CHAPTER THREE- financial statements and the reporting entity
- Entities can have direct control over assets and where you have indirect control, you have a wider reporting entity, which is synonymous with consolidated financial statements (for groups of businesses)
- Boundaries
- Direct control → unconsolidated
- Indirect control → consolidated

CHAPTER FOUR- elements of financial statements
- Assets: rights, potential to produce economic benefits, control
- Liabilities: obligations, present obligation, past events
- Equity: E = A - L
- Income: can be revenue and gains (because can go into income statement with FV accounting)
- Expenses: can be losses as well

CHAPTER FIVE- recognition and derecognition
- Double entry dimension
- It is probable that any future economic benefit associated with the item will flow to or from the entity; and the item has a cost or value that can be measured with reliability - recognition:
  → relevance
  → existence of uncertainty and separability
  → low probability
  → faithful representation

→ cost -
derecognition
:
→ control

CHAPTER SIX- measurement

- Process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the balance sheet and income statement, which involves the selection of the particular basis of measurement:
  a) Historic cost
  b) Current value:

  → fair value
  → value in use (realisable value)
- Does not tell you what to use to measure out of the two above options
- Hardest part is deciding which measurement to use to classify a transaction

AASB101 PRESENTATION OF FINANCIAL STATEMENTS

- They generally have general features, as well as structure and content
- General features:
  → fair presentation and compliance with accounting
  → going concern
  → accruals basis
  → materiality
  → offsetting
  → frequency of reporting
  → comparative information
  → consistency -
  Structure and
content:
  → identification of the financial statements
  → ASIC RG230
  → technical details
- Statement of financial position:
  → line items
  → add totals and headings as you choose
  → current/ non-current OR liquidity classification e.g. Bank financial statements (you choose which type)
  → supplement with notes where most of detail is contained
  → equity
- Statement of profit or loss and other comprehensive income:
  → one statement or two
  → line items
  → all inclusive
  → notes
  → nature or function
- Statement of changes in equity:
  → line items
  → equity -
  other:
  → statement of cash flows
  → notes- structure
  → accounting policies

AASB108 ACCOUNTING POLICIES

- Des Quirk changed accounting practices to change a massive loss into a profit, however got caught lol - Selection of accounting policies:
  → comply with accounting standards
  → if no standard, use CF type processes
  → consistency
  → change in accounting policies
  → applying changes
  → disclosure- confession

AASB110 EVENTS AFTER THE REPORTING PERIOD

- Evidence of conditions existing at i.e. (adjusting events)
- Adjust the statements
- Indicative of conditions that arose after i.e. (non-adjusting events)
- Don't adjust
- Disclose

<u>LECTURE 2</u>

WHAT IS EARNINGS?

- Measure of performance
- Economic perspective: the maximum value which he can consume during a week and still expect to be as well off at the end of the week as he was at the beginning (i.e. an increase in wealth/equity/net assets between two periods)
- implications:
  → matching
  → deferred credits

ARE EARNINGS USEFUL?

- Normative theorists:
  → Canning (1929): what is set out as a measure of income can never be supposed to be a fact in any sense at all except that it is a figure that results when the accountant has finished applying the procedures which they adopt - Positive theorists:
  → Ball and Brown (1968): an association between accounting income number surprises and stock returns- therefore information content
  → Dechow (1994): popularized the idea that the role of legitimate accruals is to smooth the impact of transitory shocks to economic working capital on earnings. Focused on the association between earnings, cash flow and stock returns.

CONCEPTUAL FRAMEWORKS

- earnings:
  → income increases (decreases) in assets (liabilities), revenues, gains
  → expenses decreases (increases) in assets (liabilities), expenses, losses - Earnings are an increase in wealth- not a measure of performance

ACCOUNTING CHOICES

1. What is the issue?

Cash	12 000	
Revenue		12 000

- Easy when:
  → only one good being sold
  → immediate payment

→ instantaneous service

2. With more than one good or service being provided e.g. mobile phone plans:

Cash	4 000	
Revenue	4 000	
Cash	8 000	
Unearned Revenue	8 000 -	What?

- Identification of the separate goods or services?

3. Without immediate payment:

AC Receivable	12 000	
Revenue		12 000
Cash		12 000
AC Receivable	12 000 -	How much?

→ collectability i.e. if ultimate payment is uncertain (person will not be able to afford it but purchases anyway)?
→ deferred payments?

4. Without instantaneous service:

Cash	12 000		
Unearned Revenue		12 000	
Unearned Revenue	1 000		
Revenue		1 000	x 12

OR

Unearned Revenue	5 000
Revenue (41.7%)	5 000
Unearned Revenue	4 000
Revenue (33.3%)	4 000
Unearned Revenue	3 000
Revenue (25%)	3 000

erratic depending on the utilisation of the service e.g. electricity bill?

AASB 15 REVENUE

- Applicable for years ending after 1/1/2018 - 5 steps in applying standard:
  1. Identify the contract - Para. 9+ ‘*An agreement between two or more parties that creates enforceable rights and obligations*’
     → contract and commitment- written, oral or custom
     → identify rights regarding goods or services
     → identify payment terms
     → commercial substance
     → collectability