

Financial Reporting (INT)

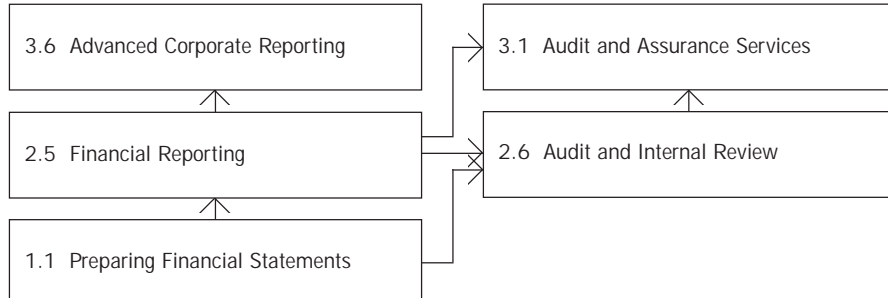
AIM

To build on the basic techniques in Paper 1.1 Preparing Financial Statements and to develop knowledge and understanding of more advanced financial accounting concepts and principles. Candidates will be required to apply this understanding by preparing and interpreting financial reports in a practical context.

OBJECTIVES

On completion of this paper candidates should be able to:

- appraise and apply specified accounting concepts and theories to practical work place situations
- appraise and apply the International regulatory framework of financial reporting
- prepare financial statements for different entities to comply with specified International Accounting Standards, International Financial Reporting Standards and other related pronouncements
- prepare group financial statements (excluding group cash flow statements) to include a single subsidiary. An associate or joint venture may also be included
- analyse, interpret and report on financial statements (including cash flow statements) and related information to a variety of user groups
- discuss and apply the requirements of other specified International Accounting Standards / International Financial Reporting Standards



- demonstrate the skills expected in Part 2.

POSITION OF THE PAPER IN THE OVERALL SYLLABUS

Paper 2.5 builds on the techniques developed at Paper 1.1 Preparing Financial Statements and tests the conceptual and technical financial accounting knowledge that candidates will require in order to progress to the higher level analytical, judgmental and communication skills of Paper 3.6 Advanced Corporate Reporting.

Paper 2.5 also provides essential financial accounting knowledge and principles that need to be fully understood by auditors, thus it forms some of the prerequisite knowledge of Paper 2.6 Audit and Internal Review, and the option Paper 3.1 Audit and Assurance services.

Prerequisite knowledge for Paper 2.5 is largely the basic knowledge and skills demonstrated at Paper 1.1, but many

accounting standards require the use of discounting techniques which candidates will have acquired at Paper 2.4 Financial Management and Control.

SYLLABUS CONTENT

1 Accounting principles, concepts and theory

- (a) The IASB's Framework for the Preparation and Presentation of Financial Statements.
- (b) Agency theory.
- (c) Price level changes, capital maintenance.

2 Regulatory framework

- (a) The structure of the International Accounting Standards Board (IASB).
- (b) The standard setting process.
- (c) The role of the International Financial Reporting Interpretations Committee (IFRIC).
- (d) The IASB's relationship with the

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International Organisation of Security Commission (IOSCO).

3 Preparation and presentation of financial statements for companies limited by liability and other entities

- (a) Accounting for share capital and reserves
 - (i) issue and redemption of shares
 - (ii) the principle of maintenance of capital
 - (iii) the principle of distributable profits.
- (b) Tangible and intangible non-current assets.
- (c) Net current assets.
- (d) Earnings per share.
- (e) Tax in company accounts including:
 - (i) current tax
 - (ii) deferred tax.
- (f) IASs, IFRSs and SIC / IFRIC pronouncements as specified in the examinable documents.

4 Preparation of consolidated financial statements

- (a) Definition of subsidiary companies.
- (b) Exclusions from consolidations.
- (c) Preparation of consolidated income statements and balance sheets including:
 - (i) elimination of intra-group transactions
 - (ii) fair value adjustments.
- (d) Associates and joint ventures.

5 Analysis and interpretation of financial statements and related information

- (a) Analysis of corporate information.
- (b) Preparation of reports on financial performance for various user groups.
- (c) Preparation and analysis of cash flow statements of a single company.
- (d) Related party transactions.
- (e) Segmental information.

EXCLUDED TOPICS

The following topics are specifically excluded from the syllabus:

- partnership and branch financial statements
- preparing group financial statements involving more than one subsidiary
- piecemeal acquisitions, disposal of subsidiaries and group reconstructions
- foreign currency translation/ consolidations, hedging, hyperinflationary economies
- financial statements of banks and similar financial institutions
- group cash flows
- schemes of reorganisation/ reconstruction
- company/share valuation
- derivative financial instruments
- accounting for retirement benefit costs/ plans
- share-based payments
- International Exposure Drafts and Discussion Drafts/Papers.

KEY AREAS OF THE SYLLABUS

The key topic areas are as follows:

Accounting principles and concepts, accounting theory

- Framework for the Preparation and Presentation of Financial Statements.
- Revenue recognition.
- Substance over form.

Preparation of financial statements of companies limited by liability

- Presentation of financial statements.
- Accounting and disclosure requirements of International Accounting Standards/ International Financial Reporting Standards.

Preparation of consolidated financial statements

- Definitions of subsidiaries: exclusions from consolidation.
- Simple groups.

Analysis and interpretation of financial statements

- Preparation of reports for various user groups.
- Preparation and analysis of cash flow statements.

Other topic areas

Note these may be examined as part of a question within the above key areas or as a substantial part of a separate optional question:

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- accounting for leases
- construction contracts
- earnings per share
- impairment of assets, provisions
- non-current assets held for sale and discontinued operations
- goodwill and other intangible assets.

APPROACH TO EXAMINING THE SYLLABUS

The examination is a three hour paper in two sections. It will contain both computational and discursive elements.

Some questions will adopt a scenario/case study approach.

The Section A compulsory question will be the preparation of group financial statements and/or extracts thereof, and may include a small related discussion element. Computations will be designed to test an understanding of principles. At least one of the optional questions in Section B will be a conceptual/discursive question that may include illustrative numerical calculations.

An individual question may often involve elements that relate to different areas of the syllabus. For example a question on the preparation of financial statements for public issue could include elements relating to several accounting standards. In scenario questions candidates may be expected to comment on management's chosen accounting treatment and determine a more appropriate one, based

on circumstances described in the question.

Questions on topic areas that are also included in Paper 1.1 will be examined at an appropriately greater depth in Paper 2.5. Some International Accounting Standards are very detailed and complex. At Paper 2.5 candidates need to be aware of the principles and key elements of these Standards. Candidates will also be expected to have an appreciation of the need for accounting standards and why they have been introduced.

	Number of Marks
Section A: One compulsory question	25
Section B: Choice of 3 from 4 questions (25 marks each)	<u>75</u>
	<u>100</u>

ADDITIONAL INFORMATION

Candidates need to be aware that questions involving knowledge of new examinable regulations will not be set until at least six months after the last day of the month in which the regulation was issued.

The Study Guide provides more detailed guidance on the syllabus. Examinable documents are listed in the 'Exam Notes' section of *student accountant*.

RELEVANT TEXTS

There are a number of sources from which you can obtain a series of materials written for the ACCA examinations. These are listed below:

ACCA's approved publishers:

BPP Professional Education

Contact number: +44(0)20 8740 2222

Website: www.bpp.com

Kaplan Publishing Foulks Lynch

Contact number: +44(0)118 989 0629

Website: www.kaplanfoulkslynch.com

Additional reading:

Accountancy Tuition Centre (ATC)
International

Contact number: +44(0)141 880 6469

Website: www.atc-global.com

International Financial Publishing (IFP)

Contact number: +44(0)148 322 5746

Website: www.ifpbooks.com

Candidates may also find the following text useful:

Abbas Ali Mirza, Graham Holt, Magnus Orrell, Liesel Knorr **International**

Financial Reporting Standards (IFRS)

Workbook: Standard Outlines, Multiple-Choice Questions and Case Studies with Solutions (2005) John Wiley & Sons Inc, UK (ISBN: 0-4716-9742-7)

Wider reading is also desirable, especially regular study of relevant articles in ACCA's *student accountant*.

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STUDY SESSIONS

1 Review of basic concepts and the Framework for the Preparation and Presentation of Financial Statements

- (a) Discuss what is meant by a conceptual framework and GAAP
- (b) Describe the objectives of financial statements and the qualitative characteristics of financial information
- (c) Define the elements of financial statements
- (d) Apply the above definitions to practical situations
- (e) Revision of Paper 1.1 – prepare the final accounts of a company from a trial balance.

2 Accounting concepts and accounting theory

- (a) Outline the concept of 'comprehensive income'
- (b) Explain the principle of fair value
- (c) Discuss and apply accounting policies.
- (d) Describe the deficiencies of historic cost accounts (HCA) during periods of rising prices and explain in principle alternatives to HCA.

3 Revenue recognition

- (a) Outline the principles of the timing of revenue recognition
- (b) Explain the concept of substance over form in relation to recognising sales revenue
- (c) Explain the principle of realised

profits

- (d) Discuss the various points in the production and sales cycle where it may, depending on circumstances, be appropriate to recognise gains and losses – give examples of this
- (e) Describe the IASB's 'balance sheet approach' to revenue recognition within its Framework and compare this to the requirements of relevant accounting standards.

4 The structure of the IASB's regulatory framework

- (a) Describe the constitution of the IASB and its objectives
- (b) Describe the influence of national standard setters and the International Organisation of Security Commissions (IOSCO) on IASs and IFRSs
- (c) Outline the International Accounting Standard setting process and the role of the International Financial Reporting Interpretations Committee (IFRIC).

5 Preparation of financial statements for companies

- (a) State the objectives of accounting standards on Presentation of Financial Statements
- (b) Describe the structure and content of financial statements
- (c) Discuss 'fair presentation' and the accounting concepts/principles in relevant accounting standards

- (d) Prepare the financial statements of companies in accordance with International Accounting Standard / International Financial Reporting Standards
- (e) Describe the main issues involved when a company adopts International Financial Reporting Standards (IFRSs) for the first time
- (f) Apply the requirements of the IASB to the preparation of financial statements for a first time adopter of International Financial Reporting Standards.

6&7 Accounting Policies, Changes in Accounting Estimates and Errors; Non-current Assets Held for Sale and Discontinued Operations

- (a) Explain the need for accounting standards in the above areas
- (b) Discuss the importance of identifying and reporting the results of a discontinued operation; define discontinued operations
- (c) Describe the circumstances where assets meet the criteria of 'held for sale'
- (d) Discuss the accounting treatment of non-current assets held for sale
- (e) Prepare financial statements in accordance with requirements of the relevant accounting standards in the above areas
- (f) Describe the circumstances where a change in accounting policy is permitted

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- (g) Define and account for errors, changes in accounting estimates and changes in accounting policies
- (h) Explain and illustrate the contents and purpose of the statement of changes in equity.

8 Share Capital and Reserves

- (a) Explain the need for an accounting standard on Financial Instruments
- (b) Distinguish between debt and equity capital
- (c) Apply the requirements of relevant accounting standards to the issuing and finance costs of:
 - (i) equity and preference shares
 - (ii) debt instruments with no conversion rights, and
 - (iii) convertible debt (compound financial instruments)
- (d) Explain and apply general principles relating to the purchase or redemption of shares
- (e) Discuss the advantages of companies being able to redeem/purchase their own shares
- (f) Discuss the principles relating to profits available for distribution.

9 Non-current assets – tangible

- (a) Define the initial cost of a non-current asset (including a self-constructed asset) and apply this to various examples of expenditure distinguishing between capital and revenue items
- (b) Describe, and be able to identify,

subsequent expenditure that may be capitalised

- (c) State and appraise the effects of accounting standards on the revaluation of property, plant and equipment
- (d) Account for gains and losses on the disposal of revalued assets
- (e) Calculate depreciation on:
 - (i) revalued assets, and
 - (ii) assets that have two or more major components
- (f) Apply the provisions of accounting standards on Accounting for Government Grants and Disclosure of Government Assistance
- (g) Discuss the way in which the treatment of investment properties differs from other properties
- (h) Apply the requirements of accounting standard on investment properties.

10 Leases

- (a) Define the essential characteristics of a lease
- (b) Describe and apply the method of determining a lease type (i.e. an operating or finance lease)
- (c) Explain the effect on the financial statements of a finance lease being incorrectly treated as an operating lease
- (d) Account for operating leases in financial statements
- (e) Account for finance leases in the financial statements of lessors and lessees

- (f) Outline the principles of the accounting standard on leasing and its main disclosure requirements
Note: the net cash investment method will not be examined.

11 Intangible assets

- (a) Discuss the nature and possible accounting treatments of both internally generated and purchased goodwill
- (b) Distinguish between goodwill and other intangible assets
- (c) Describe the criteria for the initial recognition and measurement of intangible assets
- (d) Describe the subsequent accounting treatment, including the principle of impairment tests in relation to purchased goodwill
- (e) Describe the circumstances in which the goodwill calculation results in a negative amount, and its subsequent accounting treatment
- (f) Describe and apply the requirements of accounting standards on internally generated assets other than goodwill (e.g. research and development).

12 Impairment of assets

- (a) Define the recoverable amount of an asset; define impairment losses
- (b) Give examples of, and be able to identify circumstances that may indicate that an impairment of an asset has occurred

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- (c) Describe what is meant by a cash-generating unit
- (d) State the basis on which impairment losses should be allocated, and allocate a given impairment loss to the assets of a cash-generating unit.

13 Liabilities – provisions, contingent liabilities and contingent assets

- (a) Explain why an accounting standard on provisions is necessary – give examples of previous abuses in this area
- (b) Define provisions, legal and constructive obligations, past events and the transfer of economic benefits
- (c) State when provisions may and may not be made, and how they should be accounted for
- (d) Explain how provisions should be measured
- (e) Define contingent assets and liabilities – give examples and describe their accounting treatment
- (f) Be able to identify and account for:
 - (i) warranties/guarantees
 - (ii) onerous contracts
 - (iii) environmental and similar provisions
- (g) Discuss the validity of making provisions for future repairs or refurbishments.

14 Inventory and construction contracts

- (a) Review the principles of inventory valuation covered in Paper 1.1
- (b) Define a construction contract and

describe why recognising profit before completion is generally considered to be desirable and the circumstances where it may not be; discuss if this may be profit smoothing

- (c) Describe the ways in which contract revenue and contract cost may be recognised
- (d) Calculate and disclose the amounts to be shown in the financial statements for construction contracts.

15 Earnings per share

- (a) Explain the importance of comparability in relation to the calculation of earnings per share (eps) and its importance as a stock market indicator
- (b) Explain why the trend of eps may be a more accurate indicator of performance than a company's profit trend
- (c) Define earnings and the basic number of shares
- (d) Calculate the eps in accordance with relevant accounting standards in the following circumstances:
 - (i) basic eps
 - (ii) where there has been a bonus issue of shares/stock split during the year, and
 - (iii) where there has been a rights issue of shares during the year
- (e) Explain the relevance to existing shareholders of the diluted eps, and describe the circumstances that will

- give rise to a future dilution of the eps
- (f) Calculate the diluted eps in the following circumstances:
 - (i) where convertible debt or preference shares are in issue; and
 - (ii) where share options and warrants exist.

16 Taxation in financial statements

- (a) Account for current tax liabilities and assets in accordance with relevant accounting standards
- (b) Describe the general principles of government sales taxes (e.g. VAT or GST)
- (c) Explain the effect of taxable temporary differences on accounting and taxable profits
- (d) Outline the principles of accounting for deferred tax
- (e) Outline the requirements of relevant accounting standards relating to deferred tax assets and liabilities
- (f) Calculate and record deferred tax amounts in the financial statements.

17 Accounting for the substance of transactions

- (a) Explain the importance of recording the substance rather than the legal form of transactions – give examples of previous abuses in this area
- (b) Describe the features which may indicate that the substance of transactions may differ from their legal form
- (c) Explain and apply the principles of

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recognition and derecognition of assets and liabilities

- (d) Be able to recognise the substance of transactions in general, and specifically account for the following types of transaction:
- (i) goods sold on sale or return/consignment goods
 - (ii) sale and repurchase/leaseback agreements
 - (iii) factoring of accounts receivable.

18 & 19

Business combinations – introduction

- (a) Describe the concept of a group and the objective and usefulness of consolidated financial statements
- (b) Explain the different methods which could be used to prepare consolidated financial statements
- (c) Explain and apply the definition of subsidiary companies
- (d) Describe the circumstances and reasoning for subsidiaries to be excluded from consolidated financial statements in accordance with relevant accounting standards
- (e) Prepare a consolidated balance sheet for a simple group dealing with pre and post acquisition profits, minority interests and consolidated goodwill
- (f) Explain the need for using coterminous year ends and uniform accounting policies when preparing consolidated financial statements
- (g) Describe how the above is achieved

in practice

- (h) Prepare a consolidated Income Statement for a simple group, including an example where an acquisition occurs during the year and there is a minority interest.

20 Business combinations – intra-group adjustments

- (a) Explain why intra-group transactions should be eliminated on consolidation
- (b) Explain the nature of a dividend paid out of pre-acquisition profits
- (c) Account for the effects (in the income statement and balance sheet) of intra-group trading and other transactions including:
 - (i) unrealised profits in inventory and non-current assets
 - (ii) intra-group loans and interest and other intra-group charges, and
 - (iii) intra-group dividends including those paid out of pre-acquisition profits.

21 Business combinations – fair value adjustments

- (a) Explain why it is necessary for both the consideration paid for a subsidiary and the subsidiary's identifiable assets and liabilities to be accounted for at their fair values when preparing consolidated financial statements
- (b) Prepare consolidated financial statements dealing with fair value adjustments (including their effect on

consolidated goodwill) in respect of:

- (i) depreciating and non-depreciating non-current assets
- (ii) inventory
- (iii) monetary liabilities (basic discounting techniques may be required)
- (iv) assets and liabilities (including contingencies), not included in the subsidiary's own balance sheet.

22 & 23

Business combinations - associates and joint ventures

- (a) Define associates and joint ventures (i.e. jointly controlled operations, assets and entities)
- (b) Distinguish between equity accounting and proportional consolidation
- (c) Describe the two formats of proportional consolidation
- (d) Prepare consolidated financial statements to include a single subsidiary and an associate or a joint venture.

24 Analysis and interpretation of financial statements

- (a) Calculate useful financial ratios for a single company or for group financial statements
- (b) Analyse and interpret ratios to give an assessment of a company's performance in comparison with:
 - (i) a company's previous period's financial statements
 - (ii) another similar company for the

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same period

(iii) industry average ratios

- (c) Discuss the effect that changes in accounting policies or the use of different accounting policies between companies can have on the ability to interpret performance
- (d) Discuss how the interpretation of current value information would differ from that of historical cost information
- (e) Discuss the limitations in the use of ratio analysis for assessing corporate performance, outlining other information that may be of relevance.

Note: the content of reports should draw upon knowledge acquired in other sessions.

These sessions concentrate on the preparation of reports and report writing skills.

25 & 26 Cash flow statements

- (a) Prepare a cash flow statement, including relevant notes, for an individual company in accordance with relevant accounting standards
- Note: questions may specify the use of the direct or the indirect method
- (b) Appraise the usefulness of, and interpret the information in, a cash flow statement.

27 Related party disclosures

- (a) Define and apply the definition of related parties in accordance with

relevant accounting standards

- (b) Describe the potential to mislead users when related party transactions are included in a company's financial statements
- (c) Adjust financial statements (for comparative purposes) for the effects of non-commercial related party transactions
- (d) Describe the disclosure requirements for related party transactions.

28 Segment reporting

- (a) Discuss the usefulness and problems associated with the provision of segment information
- (b) Define a reportable segment and the information that is to be reported (primary and secondary formats)
- (c) Prepare segment reports in accordance with relevant accounting standards
- (d) Assess the performance of a company based on the information contained in its segment report.