LEVEL 1:
FINANCIAL REPORTING & ANALYSIS

Reading 16 (2nd out of 12): IFRS & U.S. GAAP

Difficulty: **easy**

Benchmark Study Time: **2.5h**

2022

https://soleadea.org/

THIS E-BOOK:

- is a selective summary of the corresponding Reading in your CFA® Program Curriculum,
- provides place for your own notes,
- helps you structure your study and revision time!

How to use this e-book to maximize your knowledge retention:

1. **Print** the e-book in duplex and bind it to keep **all** important info for this Reading **in one place.**
2. **Read** this e-book, best twice, to grasp the idea of what this Reading is about.
3. **Study** the Reading from your curriculum. **Here add** your notes, examples, formulas, definitions, etc.
4. **Review** the Reading using this e-book, e.g. write your summary of key concepts or revise the formulas at the end of this e-book (if applicable).
5. **Done?** Go to your study plan and change the Reading's status to green:
   (it will make your Chance-to-Pass-Score™ grow ☺).
6. **Come back** to this e-book from time to time to **regularly review for knowledge retention!**

NOTE: While studying or reviewing this Reading, you can use the tables at the end of this e-book and mark your study/review sessions to hold yourself accountable.

ROLE OF FINANCIAL REPORTING

The role of financial reporting is to provide reliable, fair, and true information about a company's performance and its financial position.

This information can be then analyzed by different market participants (e.g. analysts, investors, customers, management, etc.) and used to make / help make some economic decisions.

In other words, the purpose of financial reporting is to give information about:

- the company's performance (income, expenses),
- the company's financial situation (assets, equity, liabilities),
- changes in the company's financial situation and performance.

STANDARD-SETTING BODIES & REGULATORY AUTHORITIES

Must-know abbreviations

IASB = International Accounting Standards Board

FASB = Financial Accounting Standards Board

SEC = Securities Exchange Commission

IOSCO = International Organization of Securities Commissions

ESC = European Securities Committee

ESMA = European Securities and Market Authority

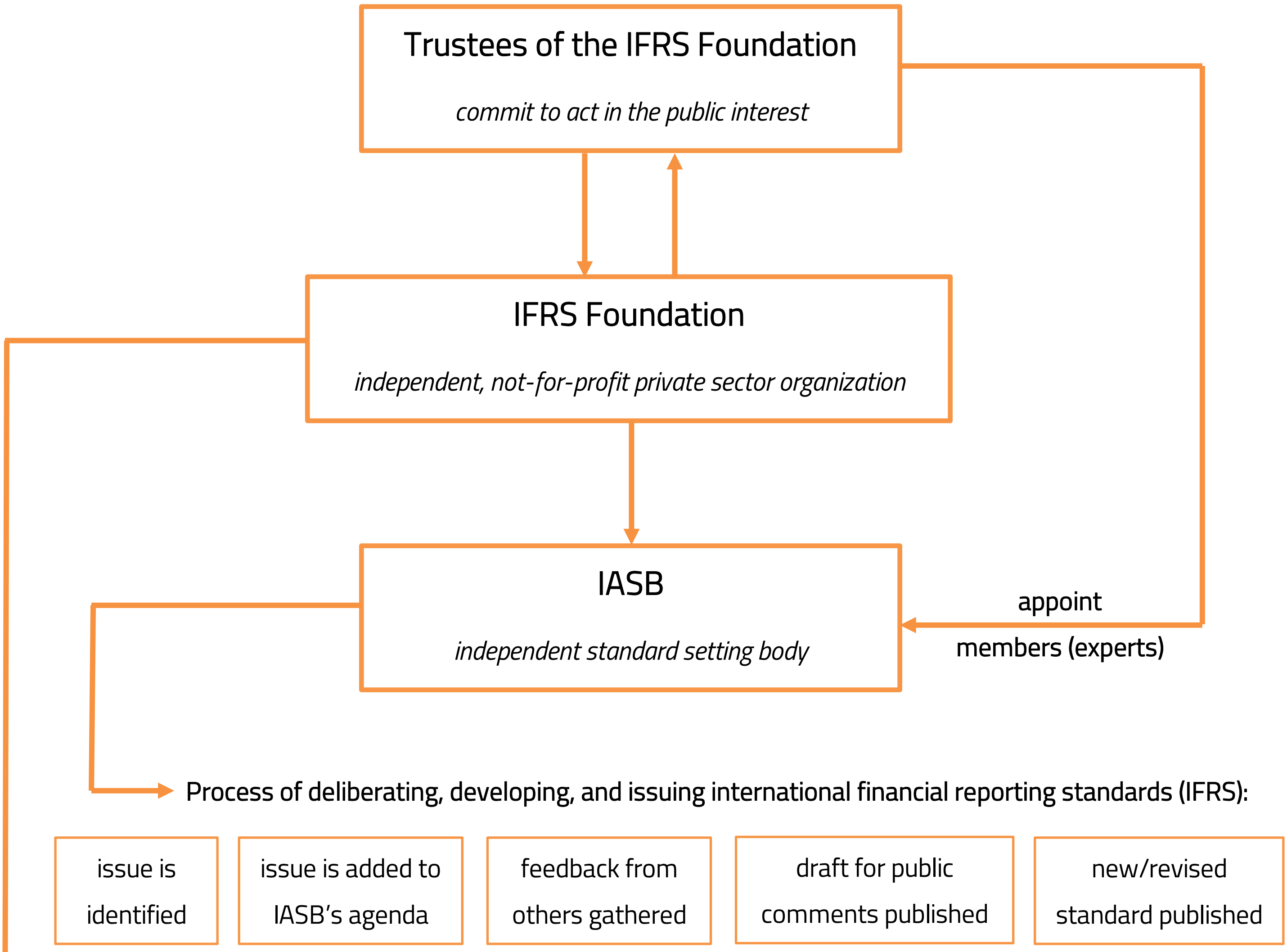
IFRS = International Financial Reporting Standards

IAS = International Accounting Standards

	Standard-Setting Bodies	Regulatory Authorities
examples	IASB, FASB	SEC in the USA, Accounting and Regulatory Authority in Singapore, etc.
form	private sector, self-regulated organizations	created by authorities in a given country
role	<u>set</u> the standards	<u>enforce</u> the standards
power	their standards can be overruled by specific standards required in a given country	can set the standards that overrule the standards created by private sector organizations like IASB or FASB

HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, formulas, definitions, relations, etc.

International Accounting Standards Board (IASB)



Principle objectives:

- to develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles. These standards should require the information presented in financial statements and other financial reports to be high quality, transparent, and comparable. Aim: to help investors, other participants in the world's capital markets and other users of financial information make economic decisions.
- to promote the use and rigorous application of those standards
- while fulfilling the above objectives, to take account of the needs of various entities in diverse economic settings
- to promote and facilitate the adoption of International Financial Reporting Standards (IFRSs), being the standards and interpretations issued by the IASB, through the convergence of national accounting standards and IFRSs.

source: https://www.iasplus.com/en/resources/ifrsf/governance/ifrsf

HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, formulas, definitions, relations, etc.

Want to learn more about IAS and IFRS?

https://www.iasplus.com/en/standards/ias

https://www.iasplus.com/en/standards/ifrs

Financial Accounting Standards Board (FASB)

Both the structure and process of deliberating, developing, and issuing financial reporting standards are very similar to the IASB's structure and process.

The FASB establishes the so-called U.S. GAAP, which stands for the United States Generally Accepted Accounting Standards.

International Organization of Securities Commissions (IOSCO)

- not a regulatory authority per se
- gathers securities commissions from around the world
- core objectives:
  a. protecting investors,
  b. reducing systematic risk,
  c. ensuring markets are fair, efficient, and transparent.

Securities Exchange Commission (SEC)

In the USA, the regulatory authority, i.e. the SEC, also retains the power to set the financial reporting standards.

It's worth noticing that the SEC rarely overrides standards set by the FASB but often states opinions and guidance about accounting-related disclosures, etc.

The key pieces of legislation in the USA:

- Securities Act of 1933 (specifies required information that investors must receive; prohibits misrepresentation; demands the initial registration of all public issuance of securities),
- Securities Exchange Act of 1934 (creates the SEC and makes it the authority regulating the securities market in the USA),
- Sarbanes-Oxley Act of 2002 (focuses on the independence of auditors; requires the company to report on its internal control over financial reporting; strengthens corporate responsibility for financial reporting).

HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, formulas, definitions, relations, etc.

Source of information:	Prepared by:	Includes:	When:
Securities offerings registration statement	issuers	disclosures about securities being sold and the issuer	always when the company wants to issue new securities
Form 10-K	US registrants	comprehensive overview (business, financial disclosures, 10 years of financial data, MD&A)	annually
Form 40-F	certain Canadian registrants	comprehensive overview (business, financial disclosures, 10 years of financial data, MD&A)	annually
Form 20-F	all other (form 10-K, 40-F) non-US registrants	comprehensive overview (business, financial disclosures, 10 years of financial data, MD&A)	annually
Annual report	most companies, but it's not required by the SEC	overlaps with 10-K, 40-F, 20-F but includes a lot more of marketing content	annually
Proxy Statement in Form DEF-14A	companies	information about proposals that require shareholders voting	usually annually, plus before special shareholder meetings
Form 10-Q	US companies	unaudited financial statement, MD&A, disclosure regarding the adoption of significant accounting policies, significant litigation in a covered period	interim report >> quarterly
Form 6-K	non-US companies	unaudited financial statement, MD&A, disclosure regarding the adoption of significant accounting policies, significant litigation in a covered period	interim report >> semiannually
Form 8-K	companies	events like acquisitions, disposals of important assets, management changes, etc.	current report >> when the described event occurs
Forms 3, 4, 5, and 144	companies	purchases and sales of stocks by affiliates of the issuer	3 – initial; 4– changes; 5 – annual; 144 – notice of the proposed sale
Form 11-K	companies	report of employee stock purchases, savings, and other plans	annual

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European Union capital markets

Each country in the European Union regulates its own capital market. However, some regulations are adopted at the European level, for example consolidated financial statements of public companies in Europe are to be prepared according to IFRS.

securities regulation in Europe

European Securities Committee (ESC)	+	European Securities and Market Authority (ESMA)
advises the European Commission		*co-ordinate supervision of the EU market*

IASB'S CONCEPTUAL FRAMEWORK

2 Fundamental qualitative characteristics of financial reports

source: https://www.ifrs.org/-/media/project/conceptual-framework/fact-sheet-project-summary-and-feedback-statement/conceptual-framework-project-summary.pdf

"For information to be useful it must both be relevant and provide a faithful representation of what it purports to represent. **Relevance** and **faithful representation** are the fundamental qualitative characteristics of useful financial information, and the guiding concepts that apply throughout the Conceptual Framework."

Relevance

"Information is relevant if it is capable of making a difference to the decisions made by users. Financial information is capable of making a difference in decisions if it has predictive value or confirmatory value."

Faithful representation

"Information must faithfully represent the substance of what it purports to represent. A faithful representation is, to the maximum extent possible, complete, neutral and free from error. A faithful representation is affected by level of measurement uncertainty."

HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, formulas, definitions, relations, etc.

4 Enhancing qualitative characteristics of financial reports

- Comparability
- Verifiability
- Timeliness
- Understandability

Financial reports constraints

We have to balance:

- between the cost of providing and using the information and the benefit of providing the information (the cost should be lower than the benefit), and
- between the 4 enhancing qualitative characteristics of financial reports (for example improving timeliness can have a negative impact on verifiability, so there is a trade-off).

Core elements of financial statements

Financial statements provide information about the company's:

- assets,
- liabilities,
- equity,
- income,
- expenses,
- contributions by and distributions to owners,
- cash flows.

asset = a resource controlled by the company as a result of past events and which is expected to bring future economic benefits to the company

liabilities = a present obligation of the company arising from past events, the settlement of which is expected to result in an outflow from the company of resources embodying economic benefits

equity = assets – liabilities (residual interest in the assets after covering liabilities)

income = increase in assets or decrease in liabilities resulting in an increase in equity not related to contributions from or cash outflows to equity holders

revenues = income received for the supply of goods or services in the ordinary course of business

other income = includes both gains that may or may not occur in the ordinary course of business

expenses = decrease in assets or increase in liabilities resulting in a decrease in equity not related to contributions from or cash outflows to equity holders

HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, formulas, definitions, relations, etc.

Measurement of financial statements elements

historical cost

the amount of cash paid to purchase an asset (including acquisition and preparation costs)

amortized cost

the historical cost adjusted for depreciation and amortization

current cost

assets: the amount of cash that we would have to pay for a given asset today

liabilities: the undiscounted amount of cash that we would have to pay to settle a given obligation today

realizable (settlement) value

assets (realizable value): the amount of cash that we could currently obtain when selling a given asset in an orderly disposal

liabilities (settlement value): the undiscounted amount of cash expected to be paid to settle a given obligation in the normal course of business

present value

the present value of cash inflows (for an asset) or cash outflows (for an obligation) expected to be received (in the case of the asset) or to be paid (in the case of the obligation)

fair value

the price to be paid or received in an orderly transaction between market participants for a given measurement date

HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, formulas, definitions, relations, etc.

PRESENTATION OF FINANCIAL STATEMENTS

source: https://www.iasplus.com/en/standards/ias/ias1

According to IAS No. 1, Presentation of Financial Statements, the required components of financial statements are: "

1. a statement of financial position (balance sheet) at the end of the period,
2. a statement of profit or loss and other comprehensive income for the period (presented as a single statement, or by presenting the profit or loss section in a separate statement of profit or loss, immediately followed by a statement presenting comprehensive income beginning with profit or loss),
3. a statement of changes in equity for the period,
4. a statement of cash flows for the period,
5. notes, comprising a summary of significant accounting policies and other explanatory notes,
6. comparative information prescribed by the standard."

General features underlying the preparation of financial statements

source: https://www.iasplus.com/en/standards/ias/ias1

fair presentation

"The financial statements must "present fairly" the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events, and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation."

going concern

"The Conceptual Framework notes that financial statements are normally prepared assuming the entity is a going concern and will continue in operation for the foreseeable future."

accrual basis

"IAS 1 requires that an entity prepare its financial statements, except for cash flow information, using the accrual basis of accounting."

Accrual basis means that we recognize a transaction when it actually occurs and not when cash changes hands.

HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, formulas, definitions, relations, etc.

<u>materiality and aggregation</u>

“Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.

Each material class of similar items must be presented separately in the financial statements. Dissimilar items may be aggregated only if they are individually immaterial.

However, information should not be obscured by aggregating or by providing immaterial information, materiality considerations apply to the all parts of the financial statements, and even when a standard requires a specific disclosure, materiality considerations do apply.”

<u>no offsetting</u>

“Assets and liabilities, and income and expenses, may not be offset unless required or permitted by an IFRS.”

<u>frequency of reporting</u>

“There is a presumption that financial statements will be prepared at least annually. If the annual reporting period changes and financial statements are prepared for a different period, the entity must disclose the reason for the change and state that amounts are not entirely comparable.”

<u>comparative information</u>

“IAS 1 requires that comparative information be disclosed in respect of the previous period for all amounts reported in the financial statements, both on the face of the financial statements and in the notes, unless another Standard requires otherwise. Comparative information is provided for narrative and descriptive where it is relevant to understanding the financial statements of the current period.”

<u>consistency of presentation</u>

“The presentation and classification of items in the financial statements shall be retained from one period to the next unless a change is justified either by a change in circumstances or a requirement of a new IFRS.”

HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, formulas, definitions, relations, etc.

Structure and content of financial statements

source: https://www.iasplus.com/en/standards/ias/ias1

classified statement of financial position

"An entity must normally present a **classified statement of financial position**, separating current and non-current assets and liabilities, unless presentation based on liquidity provides information that is reliable. In either case, if an asset (liability) category combines amounts that will be received (settled) after 12 months with assets (liabilities) that will be received (settled) within 12 months, note disclosure is required that separates the longer-term amounts from the 12-month amounts. "

line items

"The line items to be included on the face of the statement of financial position are:

- property, plant and equipment
- investment property
- intangible assets
- financial assets
- investments accounted for using the equity method
- biological assets
- inventories
- trade and other receivables
- cash and cash equivalents
- assets held for sale
- trade and other payables
- provisions
- financial liabilities
- current tax liabilities and current tax assets, as defined in IAS 12
- deferred tax liabilities and deferred tax assets, as defined in IAS 12
- liabilities included in disposal groups
- non-controlling interests, presented within equity
- issued capital and reserves attributable to owners of the parent."

HERE KNOWLEDGE RETENTION HAPPENS | WRITE: notes, examples, formulas, definitions, relations, etc.

Summarizing key concepts:

☐ Roles of financial reporting

My summary:

☐ IASB

My summary:

☐ FASB

My summary:

☐ IOSCO

My summary:

☐ SEC

My summary:

☐ ESC & ESMA

My summary:

☐ 2 Fundamental qualitative characteristics of financial reports

My summary:

☐ 4 Enhancing qualitative characteristics of financial reports

My summary:

☐ Financial reports constraints

My summary:

☐ Core elements of financial statements

My summary:

☐ Measurement of financial statements elements

My summary:

☐ Presentation of financial statements

My summary:

☐ General features underlying the preparation of financial statements

My summary:

☐ Structure and content of financial statements

My summary:

Keeping myself accountable:

TABLE 1 | STUDY

When you sit down to study, you may want to **try the Pomodoro Technique** to handle your study sessions: study for 25 minutes, then take a 5-minute break. Repeat this 25+5 study-break sequence all throughout your daily study session.

✔ Tick off as you proceed.

POMODORO TIMETABLE: study-break sequences (25′ + 5′)													
date		date		date		date		date		date		date	
25′		25′		25′		25′		25′		25′		25′	
5′		5′		5′		5′		5′		5′		5′	
25′		25′		25′		25′		25′		25′		25′	
5′		5′		5′		5′		5′		5′		5′	
25′		25′		25′		25′		25′		25′		25′	
5′		5′		5′		5′		5′		5′		5′	
25′		25′		25′		25′		25′		25′		25′	
5′		5′		5′		5′		5′		5′		5′	

TABLE 2 | REVIEW

Never ever neglect revision! Though it's not the most popular thing among CFA candidates, regular revision is what makes the difference. If you want to pass your exam, **schedule & do your review sessions.**

REVIEW TIMETABLE: When did I review this Reading?													
date		date		date		date		date		date		date	
date		date		date		date		date		date		date	