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# Financial Accounting, Reporting & Analysis

## *Chapter 1: Financial reporting and accounting*

# Learning objectives

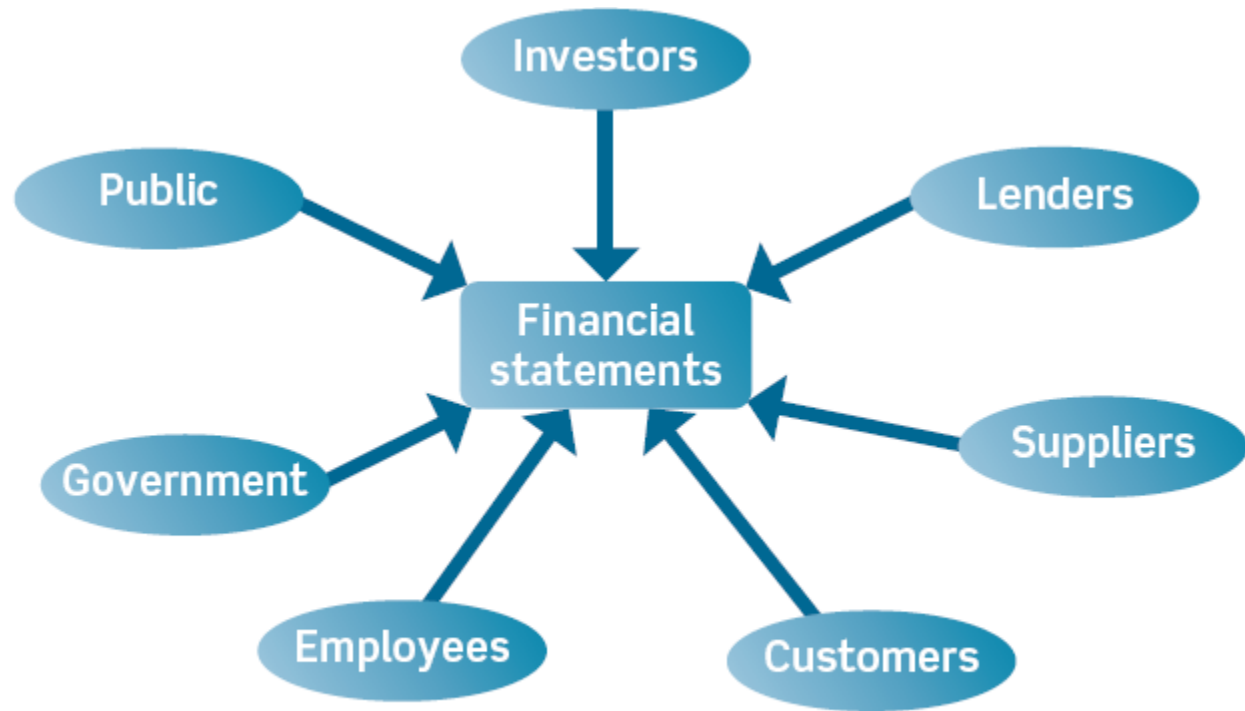
After these lectures you will be able to:

- Understand who the main **users** of financial information are, and the type of information they require to help them make decisions
- Explain the **characteristics** of financial information which makes it useful
- Carry out **double-entry bookkeeping** for simple transactions
- Produce a **trial balance** from the nominal ledger
- Understand the main period-end accounting adjustments required and account for these

# Financial reporting

- The reporting of financial information about an entity to external interested parties
- **Separate business entity** concept underpins reporting
- Key driver – the **decision-usefulness** of financial information:
  - External users or internal users?
  - Who are the external users?
  - For what purposes do users want the information?
  - What is the nature of the financial information required?

# External users of financial statements



**Figure 1.1** The external users of financial statements

# Statement of financial position (balance sheet)

- Shows  $\text{Assets} = \text{Capital} + \text{Liabilities}$
- **Assets** – resources controlled by the entity, as a result of past events, and from which future economic benefits are expected to flow to the entity  
Split between **non-current** and **current**
- **Liabilities** – present obligations of the entity, arising from past events, the settlement of which is expected to result in an outflow of resources embodying economic benefits  
Split between **non-current** and **current**
- **Capital** – the residual interest in the assets of the entity after deducting all its liabilities, representing the owners' investment in the entity

# Income statement (profit and loss account)

- **Income earned – Expenses incurred = Profit / Loss**
- A performance statement to help users understand the return that the business has generated from its resources
- Basis is **accrual accounting**
- **Income** – increases in the economic benefits during the accounting period arising from revenues and other gains
- **Expenses** – decreases in economic benefits during the accounting period encompassing expenses that arise in the normal course of business and other losses

# Statement of cash flows

- **Cash inflows – Cash outflows = Net cash flows**
- A performance statement measured solely in terms of cash receipts and payments
- Helps users assess the ability of the entity to generate future net cash inflows, and evaluate its liquidity or solvency
- Net cash flows are grouped according to business activity:
  - Operating activities
  - Investing activities
  - Financing activities

# Statement of changes in equity

- Shows all changes in the different equity balances over the accounting period
- Equity = capital for a company
- Equity = share capital + reserves
- Reserves – e.g. share premium, revaluation reserve, general reserve



# Fundamental qualitative characteristics

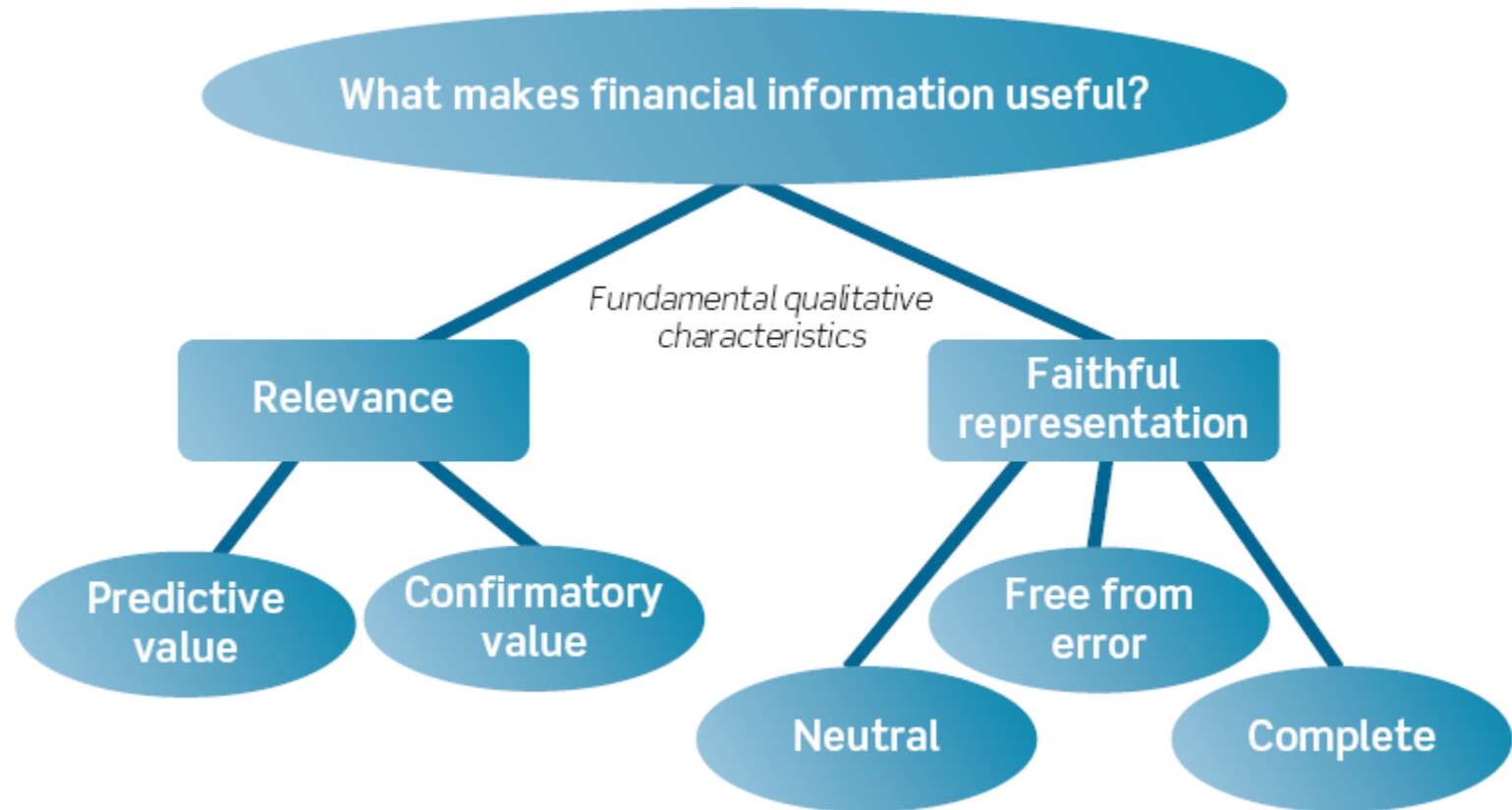


Figure 1.2 Fundamental qualitative characteristics

# Enhancing qualitative characteristics

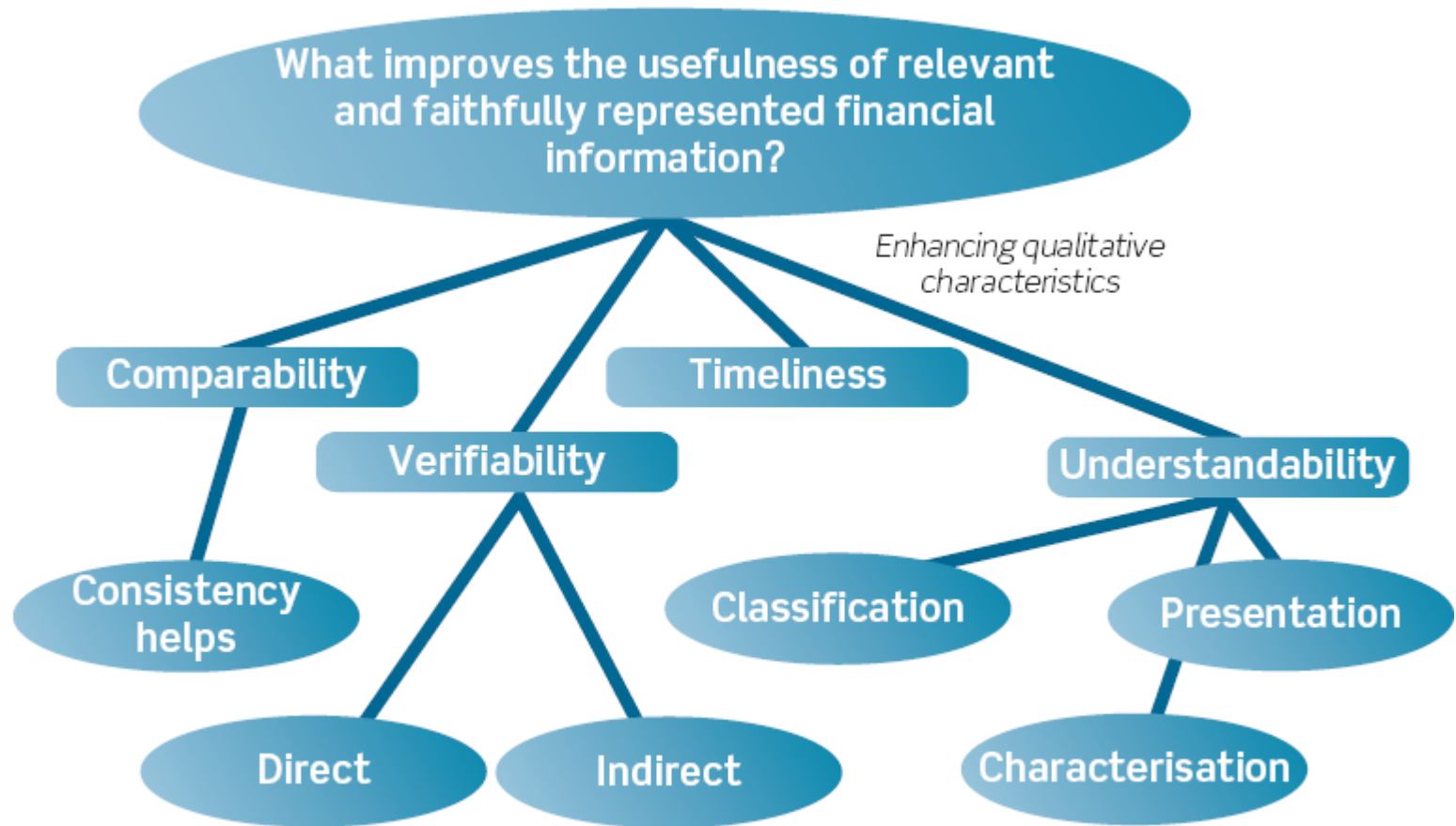


Figure 1.3 Enhancing qualitative characteristics

# The financial accounting system

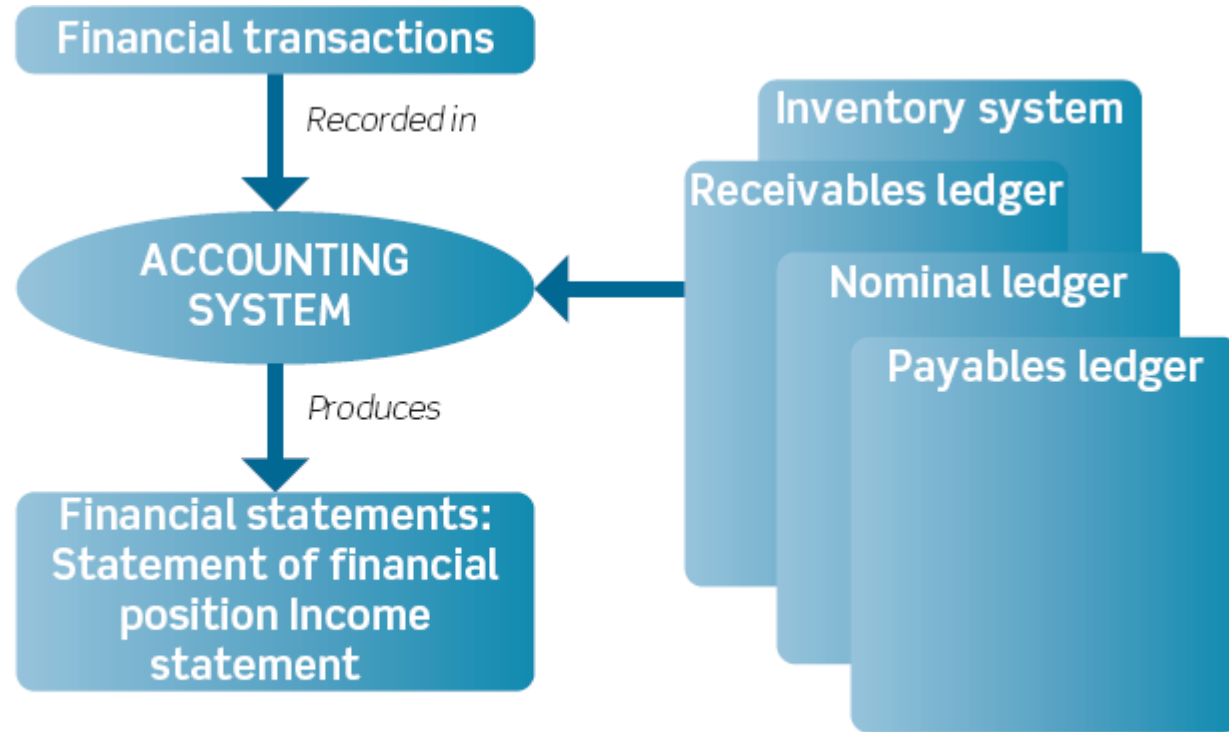


Figure 1.4 The financial accounting system

# The nominal ledger

- The heart of the financial accounting system – records every financial transaction and item via **double entry** in the different accounts
- 5 account types:

**Asset** – e.g.  
property, plant and equipment, motor vehicles, inventory, receivables, bank

**Liability** – e.g.  
bank overdraft, payables, loans

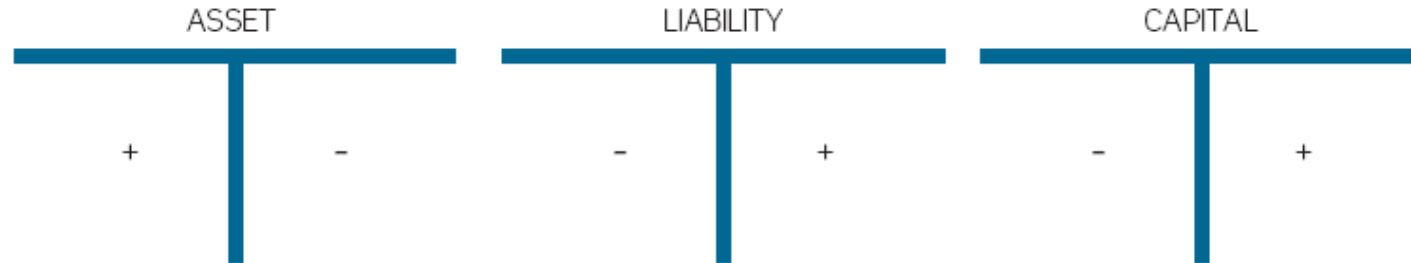
**Capital** – e.g.  
Share capital, share premium, retained profits and losses, dividends paid

**Income** – e.g.  
Sales, rent receivable, interest receivable

**Expense** – e.g.  
Salaries, heat & light, telephone, insurance, motor expenses, interest payable

# Double entry bookkeeping

*Statement of financial position accounts*



*Income statement accounts*



## Figure 1.5 The rules of double-entry bookkeeping

A '+' indicates an account *increases* as a result of the transaction. This will mean a debit or credit entry, dependent upon whether the '+' is on the debit or credit side of the account.

A '-' indicates an account *decreases* as a result of the transaction. This will mean a debit or credit entry, dependent upon whether the '-' is on the debit or credit side of the account.