FINANCIAL REPORTING

CPA PROGRAM SUBJECT OUTLINE

Financial Reporting is designed to provide you with financial reporting and business skills that are applicable in an international professional environment. The subject is based on the International Financial Reporting Standards (IFRSs), which are issued by the International Accounting Standards Board (IASB). Many international jurisdictions have adopted or are progressively adopting the IFRSs.

In a competitive international environment, financial reporting provides users with information to formulate corporate strategies, business plans and leadership initiatives. There is also a common acceptance of IFRSs for communicating financial information, because they are internationally understood. This reduces the cost of capital for the international reporting entities.

Financial reporting provides information for corporate leadership. Members of the accounting profession with financial reporting skills and knowledge provide business advice to board directors, analysts, shareholders, creditors, colleagues and other stakeholders. Members of the accounting profession who provide assurance services for financial reports also require a good understanding of the IFRSs. Directors are also required to state that the financial statements are fairly stated. These examples reinforce the importance of financial reporting. In addition to the completion of this subject, CPA Australia encourages continuous professional learning in financial reporting, which is constantly evolving.

This subject's technical content includes linkages with the other subjects in the CPA Program. Financial reporting is a significant part of an entity's governance and accountability process, issues that are covered in the subject Ethics and Governance. Compliance with the IFRSs is important because it results in the presentation of fairly stated financial statements. This presentation outcome is also the aim of audit and assurance services. The assurance knowledge and audit skills are taught in the subject Advanced Audit and Assurance. While taxation is covered in the subject Advanced Taxation, and while it is distinct from financial reporting, the accounting for tax is recognised as material information and therefore included in this subject. Financial reporting provides information about the business operations and the financial results. As a result, there is a relevant topical link with the subject Contemporary Business Issues.

SUBJECT AIMS

The aims of the subject are to:

- demonstrate IFRSs requirements for the preparation of a full set of general purpose financial statements
- demonstrate IFRSs requirements for the recognition, measurement and disclosure of specific elements of general purpose financial statements.

EXAM STRUCTURE

The Financial Reporting exam is comprised of a combination of multiple-choice and extended-response questions. It is three hours and 15 minutes in duration.

GENERAL OBJECTIVES

On completion of this subject, you should be able to:

- explain the application and basis of selected IFRSs issued by the IASB
- apply IFRSs in the preparation of general purpose financial statements
- explain details relating to general purpose financial statements
- prepare general purpose financial statements for designated entities, including the exercise of professional judgment.

SUBJECT CONTENT

The subject is divided into seven modules. A brief outline of each module is provided below.

The 'weighting' column in the following table provides an indication of the emphasis placed on each module in the exam, while the 'proportion of study time' column is a guide for you to allocate your study time for each module.

Module	**Recommended proportion of study time %**	**Weighting %**
1. The role and importance of financial reporting	10	10
2. Presentation of financial statements	14	14
3. Revenue received from customers: Provisions, contingent liabilities and contingent assets	10	10
4. Income taxes	18	18
5. Business combinations and group accounting	24	24
6. Financial instruments	14	14
7. Impairment of assets	10	10
	100	100

Module 1: The role and important of financial reporting

This module considers the role and importance of financial reporting, particularly the need for general purpose financial statements (GPFSs), and discusses the application of financial reporting in an international context. It then discusses the role that the IASB Conceptual Framework for Financial Reporting (*Conceptual Framework*) plays in financial reporting, including a discussion on the objective and limitations of GPFSs as identified in the *Conceptual Framework*.

The module discusses the qualitative characteristics of financial information and the definitions, recognition criteria and measurement of financial reporting items as outlined in the *Conceptual Framework*. The concept of materiality and how it is applied to financial reporting is also addressed. This module also examines the application of the measurement principles in International Financial Reporting Standards (IFRSs) in the context of selected issues. IFRSs are developed based on the *Conceptual Framework* as a consistent language for reporting that ensures that financial statements are understandable and can be compared among entities. IFRSs are the global language of accounting standards. Measurement is a complex and controversial aspect of accounting. In this module, alternative measurement bases are studied, and the application of the mixed measurement model (based on cost and fair value) is examined. Measurement issues are considered in the context of leases, employee benefits, share-based payments and investment properties. The module also explores the importance of professional judgment in the reporting process.

Module 2: Presentation of financial statements

This module covers the specific components and overall considerations that should be used when preparing a full set of financial statements as required in IAS 1 *Presentation of Financial Statements.* Part A of this module discusses events after the reporting period and briefly outlines the requirements of IAS 34 Interim Financial Reporting and IFRS 8 Operating Segments. *This module also considers IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors as preparers of financial statements must choose* accounting policies that are both relevant to decision making and reliable. Accounting policy choices have a major influence on the results and financial position reported by an entity, and it is important for comparability reasons that users are able to determine differences in financial performance or position, due to the adoption of alternative accounting policies.

An important principle when preparing financial statements is that they must be prepared on the basis of conditions in existence at the end of the reporting period. In the time between the end of the reporting period and completion of the financial statements, events can occur that either:

- clarify or confirm conditions that existed at the end of the reporting period, or
- give rise to new conditions.

IAS 10 Events after the Reporting Period deals with how to treat these events when preparing the financial statements. In some cases, an event after the reporting period will mean adjustments to the financial statements are required. In other circumstances, an event after the reporting period may lead to separate disclosure in the notes to the financial statements. Such note disclosures are necessary when the information could influence the decisions of financial statement users.

Part B focuses on the reporting requirements of the individual financial statements that must be included in the set of financial statements, beginning with the statement of P/L and OCI.

In relation to the statement of P/L and OCI, this module considers the requirements of IAS 1, which specifies both:

- how an entity determines comprehensive income
- the information to be presented in the statement of P/L and OCI or in the notes to the financial statements.

Part C discusses the statement of changes in equity, which discloses changes in each component of equity and reconciles the opening and closing balances of the components. Changes in equity will include comprehensive income and transactions with owners in their capacity as owners.

Part D deals with the statement of financial position. IAS 1 prescribes:

- how assets and liabilities must be presented
- how assets, liabilities and equity items must be classified
- which disclosures must be made on the face of the statement of financial position and in the notes to the financial statements.

Finally, part E looks at the statement of cash flows, which helps users assess the entity's ability to generate cash flows and the timing and certainty of their generation (IAS 7, 'Objective'). IAS 7 Statement of Cash Flows deals with the preparation and presentation of a statement of cash flows and covers issues such as the definition of cash and cash equivalents, classification of cash inflows and outflows, reconciliations required and disclosure of information about cash flows.

Module 3: Revenue received from customers: Provisions, contingent liabilities and contingent assets

Module 3 considers IFRS 15 Revenue from Contracts with Customers as well as accounting for provisions, contingent liabilities and contingent assets. Part A discusses the five-step model of revenue recognition capable of general application to a variety of transactions and the required disclosures as outlined in IFRS 15.

Part B discusses the requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets. Accounting for provisions raises a number of recognition and measurement issues, particularly in relation to the present obligation and reliable measurement criteria. Further, for provisions extending over more than one reporting period, the issue of discounting future cash flows introduces further measurement issues, including the appropriateness of the discount rate used.

Part C of this module discusses the recognition and measurement requirements in relation to contingent assets and contingent liabilities. Although IAS 37 indicates that neither may be recognised in the statement of financial position (with the exception of some contingent liabilities in a business combination), it clarifies the nature of these potential obligations and benefits, and outlines disclosure requirements.

Overall, the main aim of IFRS 15 and IAS 37 is to ensure that the financial reporting of revenue from contracts with customers, provisions, contingent liabilities and contingent assets is informative for financial statement users. For example, the revenue-related disclosures under IFRS 15 provide users with an understanding of the revenue practices of the entity. This understanding extends to how recognised revenue is earned, at what stage of the activity the revenue is earned and when payment is typically received, as well as to when and how remaining revenue from existing contracts will be recognised in the future. IAS 37 ensures that appropriate recognition criteria and measurement principles are applied to provisions recognised in financial statements. The standard also ensures that disclosures are sufficient to enable users to understand the nature, timing and amount of provisions, contingent liabilities and contingent assets.

Module 4: Income taxes

Module 4 begins with part A discussing the fundamentals of income tax as prescribed in IAS 12 Income Taxes. The accounting treatment for income taxes is based on the balance sheet method, which focuses on balance sheet items and requires consideration of the difference between the carrying amounts of those items (as recognised in the balance sheet) and their underlying tax bases (as determined according to the tax rates and tax laws enacted in the relevant jurisdiction). This difference gives rise to tax effects deferred for the future, which should be recognised together with the current tax effects.

Part B examines the separate recognition rules (and limited recognition exceptions) for the recognition of deferred tax assets and deferred tax liabilities in the financial statements.

Part C focuses on the special considerations for assets measured at revalued amounts and deals with the recognition and measurement of deferred tax liabilities that arise from asset revaluations.

Part D illustrates the disclosure requirements that enables users of the financial statements to understand and evaluate the impact of current tax and deferred tax on the financial position and performance of the entity.

Part E Comprehensive example contains a comprehensive example illustrating the application of IAS 12.

Module 5: Business combinations and group accounting

The module begins by focusing on the general accounting principles and requirements applicable to IFRS 3 *Business combinations* where an investor acquires one or more businesses or obtains control of other entities (i.e. establishing a parent–subsidiary relationship). IFRS 3 requires that all business combinations within the scope of the standard, no matter the form, be accounted for using the acquisition method, which involves the following four steps:

- identifying the acquirer
- determining the acquisition date
- recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree
- recognising and measuring goodwill or a gain from a bargain purchase.

Part B of this module focuses on additional accounting requirements prescribed in IFRS 10 *Consolidated Financial Statements* for those investments where the investor obtains control of other entities, giving rise to parent–subsidiary relationships. The additional requirements addressed relate to the acquirer's need to prepare consolidated financial statements to show the financial performance, position and cash flows of the acquirer/parent and the subsidiary from the perspective of the reporting entity created. The consolidated financial statements reflect the economic impact of transactions where the economic entity as a whole is involved with external parties, but does not include the effect of transactions within the economic entity — because the users of financial statements need to know how well the entity is doing externally. The accounting requirements from IFRS 3 described in part A are applicable in the preparation of the consolidated financial statements in accordance with IFRS 10.

Part C focuses on investments where the investor obtains significant influence over the investee (associate). It addresses two issues in accordance with IAS 28:

1. determining whether or not that relationship exists specifying the requirements for applying the equity method to account for investments in associates.

Part D of this module provides a brief overview of the general principles and requirements for those investments where the investor has joint control over a joint arrangement, distinguishing between joint operations and joint ventures (IFRS 11).

Module 6: Financial instruments

Module 6 examines the three accounting standards devoted to the accounting for financial instruments, namely:

IFRS 9 *Financial Instruments* — the recognition, derecognition and measurement of financial instruments, including hedge accounting

IAS 32 *Financial Instruments: Presentation* — the appropriate presentation of the financial instruments, once recognised.

IFRS 7 *Financial Instruments: Disclosure* — the appropriate information to disclose for both recognised and unrecognised financial instruments.

It is not necessary to understand every aspect of these three standards. The focus of this module is to highlight the general principles of these standards so users and preparers of financial statements have a common frame of reference when analysing the implications of financial instruments on an entity's financial position, performance and long-term survival.

This module begins by defining 'financial instruments', and then addresses the recognition and measurement of financial instruments. The next section discusses the appropriate presentation of financial instruments. The module concludes with a brief review of disclosure requirements relating to financial information.

Module 7: Impairment of assets

This module discusses the requirements of IAS 36 *Impairment of Assets*, which specifically prescribes that the carrying amount of an asset must not exceed it recoverable amount (the higher of an asset's 'fair value less costs of disposal and it value in use'). IAS 36 requires an 'impairment test' be applied to compare an asset's carrying amount and its recoverable amount at a particular point in time.

Part A provides an overview of IAS 36, including the basic principles relating to the impairment of assets and how to identify assets that may be impaired. Part B addresses the impairment of individual assets, including (where required) the measurement of their recoverable amount. Part C considers the impairment of groups of assets, or cash-generating units (CGUs), including how to identify CGUs and apply the impairment requirements of IAS 36 to CGUs. Finally, in part D, the disclosure requirements of IAS 36 are considered.