

Financial Reporting and Analysis

Module outline and aims

In professional practice, the Chartered Secretary has to be competent in financial accounting and reporting. In public practice and in some other organisations, the Chartered Secretary can also be called upon to fulfil the role of corporate accountant. There, the emphasis is normally on accounting for purpose rather than on detailed accounting techniques.

Chartered Secretaries need to understand the significance and relevance of accounting information and the process by which it is acquired. Core responsibilities also include compliance with legal and stakeholder requirements, including financial statements. In the boardroom, Chartered Secretaries contribute to the analysis, presentation and interpretation of corporate financial performance and results, including the implications for the organisation, shareholders and stakeholders and for effective corporate governance.

The aim of the module is to develop the knowledge and skills necessary for you to understand and supervise the execution of these professional responsibilities.

Learning outcomes

On successful completion of this module, you will be able to:

- Describe and explain the language, concepts and use of financial accounts and reports.
- Demonstrate a sound understanding of the significance of accounting information systems for both effective financial reporting and good corporate governance and demonstrate a systematic understanding and thorough appreciation of the regulatory framework for the preparation and presentation of financial statements.
- Apply the skills necessary for the preparation and presentation of financial statements for different forms of organisation in compliance with legal and regulatory requirements.
- Interpret and critically analyse corporate financial accounts and reports reflecting on the limitations of both published accounts and standard analytical techniques.
- Describe and explain the relationship between financial reporting and corporate governance.
- Show an understanding of selected current issues in financial reporting and analysis.
- Prepare reports and presentations relating to financial matters for the board and senior officers of organisations.

Syllabus content

The regulatory and conceptual frameworks for the preparation and presentation of financial statements – weighting 15%

The regulatory framework for the preparation and presentation of financial statements

- National differences in financial reporting practices
- Reasons for national differences in financial reporting practices
- Classification of national accounting systems
- Attempts to reduce national differences
- The work of international standard setters
- Arguments for and against accounting standards

The conceptual framework for the preparation and presentation of financial statements

The Framework for the Preparation and Presentation of Financial Statements issued by the International Accounting Standards Board ('IASB') sets out the concepts that underlie the preparation and presentation of financial statements for external users.

The Framework deals with:

- The objective and users of financial statements
- The reporting entity
- The qualitative characteristics that determine the usefulness of information in financial statements
- The definition of the elements of financial statements
- The recognition of the elements from which financial statements are constructed
- The measurement of assets and liabilities reported in financial statements
- Concepts of capital and capital maintenance

The preparation and presentation of financial statements in compliance with legal and regulatory requirements for single companies, groups, not for profit and public sector entities – weighting 40%

The preparation and presentation of financial statements for single companies in compliance with legal and regulatory requirements, including the relevant International Accounting Standards

- Criteria for information appearing in a published income statement and balance sheet
- Income statement
- Balance sheet
- Statement of changes in equity
- Reporting comprehensive income
- Segmental reporting
- Accounting policies
- Fair view treatment
- Chairman's statement and directors' report
- Notes to the accounts
- Cash flow statements
- Preparation of published accounts complying with accounting standards

The preparation and presentation of financial statements for groups in compliance with legal and regulatory requirements, including the relevant International Accounting Standards

- Requirements for preparation of consolidated financial statements
- Consolidated balance sheet
- Consolidated income statement
- Investment in associates
- Interest in joint ventures
- Consolidated cash flow statement

Analysis and interpretation of accounts, the limitations of published accounts, and current issues – weighting 45%

Analysis and interpretation of accounts

- Trend or horizontal analysis
- Common size statements
- Accounting ratios and ratio analysis
- Primary investment, operative and liquidity level ratios
- Subsidiary ratios including investment performance indicators such as price/earnings ratio
- Pyramid of ratios
- Segmental analysis
- Inter-firm comparisons and industrial averages
- Analysing a cash flow statement
- Earnings per share
- Limitations of analytical and interpretative techniques

Limitations of published accounts

- Creative accounting including the treatment of inventories
- Off-balance sheet finance and leasing
- Reporting the substance of transactions
- Corporate governance and the external audit process

Current issues

- Financial reporting on the internet
- Environmental and social reporting
- Ethics for accountants

Commentary on the syllabus

There are seven main areas in the Financial Reporting and Analysis syllabus. What follows is an overview of each of these areas, indicating what students need to achieve in order to prepare effectively for this examination.

The regulatory framework

Candidates need to be able to show an understanding of international differences in financial reporting practices that accounting standards are designed to address, and the economic consequences of such differences. They must be familiar with the history and potential of the convergence project and be able to explain and evaluate the case for international accounting standards.

The candidate will be expected to be able to:

- Explain how national characteristics may produce differences in financial reporting practices
- Identify and discuss the specific reasons for variation in financial reporting practices
- Show an awareness of the existence of different ways of classifying national accounting systems
- Demonstrate familiarity with initiatives designed to reduce international differences in financial reporting systems
- Identify and discuss the contribution of major international bodies to the harmonisation and standardisation of financial reporting
- Outline the current state of the convergence project and be aware of planned future developments
- Demonstrate an understanding of the economic consequences of different accounting practices
- Identify and evaluate the main arguments for and against the imposition of standard accounting practice

The conceptual framework

Candidates need to be fully familiar with the content and significance of the Framework for the Preparation and Presentation of Financial Statements issued by the International Accounting Standards Board.

The candidate will be expected to be able to:

- Explain the objective of financial statements
- Identify and distinguish between the users of financial statements
- Explain when an entity should report its affairs and how it decides which activities to include
- List and explain the significance of each of the qualitative characteristics of financial information
- Identify and distinguish between the elements of financial statements
- Show an understanding of the conditions that must be met to justify the recognition of assets and liabilities
- Be aware of the significance of the concepts of sufficient evidence and sufficient reliability for the recognition of assets and liabilities

- Describe how entity managers decide which measurement basis to adopt for financial reporting purposes.
- Demonstrate an understanding of the concept of value to the business and of how the concept is given operational effect
- Reveal an understanding of the existence of different concepts of capital and capital maintenance.

The preparation and presentation of financial statements

Candidates are expected to be able to prepare and present financial statements for single companies in compliance with legal and regulatory requirements, including the relevant international accounting standards.

The candidate will be expected to be able to:

- Identify the criteria which must be met for information to appear in the published income statement and balance sheet
- Construct the income statement in accordance with prescribed format 1
- Understand the effect of adopting different accounting policies on the content of the income statement and balance sheet
- Report in the income statement the impact of discontinued operations
- Account appropriately for 'non-recurring' items requiring separate disclosure in the income statement
- Construct the balance sheet in accordance with prescribed formats
- Show an understanding of the appropriate methods for valuing assets and liabilities
- Demonstrate familiarity with the notes that accompany financial statements
- Prepare the statement of changes in equity and explain why it must be published
- Show an awareness of developments concerning the publication of a statement of comprehensive income
- Explain the importance of segmental reporting and be able to prepare accounts on that basis
- Demonstrate familiarity with the nature of accounting policies and the significance of differences between them
- Reveal an understanding of the concepts of fair presentation, true and fair and the true and fair override
- Explain the purpose of the directors' report and chairman's statement and give examples of the type of information each contains
- Show an understanding of the reasons why entities are today required to publish a cash flow statement
- Prepare a cash flow statement in accordance with standard accounting practice

Group accounting

Candidates need to be able to prepare and present consolidated financial statements in compliance with legal and regulatory requirements, including the relevant international accounting standards.

The candidate will be expected to be able to:

- Define a reporting group in accordance with standard accounting practice
- Explain why parent companies are required to publish consolidated accounts and the circumstance in which this obligation does not apply

- Outline the circumstances in which a subsidiary company may be excluded from the consolidated accounts and the further disclosures required in such circumstances
- Explain how the idea of control is applied to decide whether another entity must be included in the consolidated accounts
- Prepare a consolidated balance sheet in accordance with the purchase method, making appropriate adjustments for fair value.
- Compute goodwill and minority interest for inclusion in the consolidated balance sheet
- Distinguish between pre- and post-acquisition profits when preparing consolidated accounts
- Make appropriate adjustments for inter-company balances and unrealised profits on inter-company sales
- Show an appreciation of the need for uniform accounting policies and reporting dates
- Explain how an investment in subsidiaries should be reported in the parent's own balance sheet
- Prepare a consolidated income statement in accordance with standard accounting practice
- Demonstrate knowledge of the definitions of an associate and of significance influence
- Make calculations to enable an associate to be reported in accordance with the equity method
- Identify the circumstances in which a joint venture exists
- Describe the approved methods of accounting for a joint venture
- Show familiarity with the content of a consolidated cash flow statement.

Analysis and interpretation of accounts

Candidates need to know how to calculate the percentages and ratios used to analyse entity performance. They must also be able to display expertise in interpreting the significance of such calculations.

The candidate will be expected to be able to:

- Undertake horizontal analysis of accounts between two periods based on percentage changes
- Take account of the effect of exceptional items on comparability
- Apply trend analysis to the results of a series of accounting periods
- Undertake vertical analysis based on common size statements
- Understand the nature of accounting ratios and the use that can be made of them
- Calculate and interpret the significance of primary investment, primary operative and primary liquidity level ratios
- Calculate and interpret subsidiary ratios: gearing, liquidity, asset utilisation, investment and profitability
- Construct and understand the pyramid of ratios
- Explain the reasons for and importance of segmental accounting
- Undertake statement analysis based on segmental accounts
- Outline sources of data available for inter-firm comparisons
- Analyse and interpret the information contained in the cash flow statement
- Display an understanding of the importance of earnings per share (EPS) and its relationship with the price/earnings ratio
- Explain the calculation of the basic and diluted EPS
- Compare and contrast the uses and limitations of EPS

- Make calculations of EPS that require adjustments to the number of shares used in the basic EPS calculation
- Calculate the EPS where there has been a rights issue
- Compute and explain the significance of the fully diluted EPS
- Show familiarity with the disclosure requirements applying to the EPS
- Explain the limitations of accounting ratios computed on the basis of the information financial statements contain.

Limitations of published accounts

Candidates are required to demonstrate a thorough awareness of the limitations of published accounts as reliable indicators of entity progress and position. They are required to display such expertise in the context of creative accounting, off balance sheet finance, the issue of substance versus form, and the effectiveness of the external audit process.

The candidate will be expected to be able to:

- Demonstrate an awareness of the steps entities might take to improve their accounts so as, for example, to reduce the reported gearing ratio, increase the published EPS, and strengthen the balance sheet
- Reveal a full understanding of the opportunities for subjectivity and creative accounting when measuring inventory for inclusion in published financial reports.
- Show familiarity with the role of the audit in countering creative accounting practices
- Explain what is meant by off balance sheet finance and understand its significance
- Demonstrate the way in which leasing arrangements may be exploited to access the advantages of off balance sheet finance
- Outline and evaluate proposals designed to counter opportunistic behaviour by management when accounting for leases
- Distinguish between the economic substance and the legal form of a business transaction
- Examine the concept of substance over form in the context of consignment stocks, sale and repurchase agreements and debt factoring
- Explain the principal qualities required of external auditors if they are to contribute to effective corporate governance
- Evaluate the corporate governance implications of auditors providing consultancy services

Current issues

Among the issues with which entity managers need to be fully familiar are the power of the internet, environmental and social reporting and the importance of complying with ethical standards.

The candidate will be expected to be able to:

- Reveal an awareness of the existence of online subscription databases that reformat company accounts in standardised form for comparative purposes.
- Explain what XBRL is and how it can be used
- Describe the accountant's role in capitalist society
- Trace the main steps in the evolution of stand-alone environmental reports and be aware of the economic consequences of environmental reporting

- List the main elements of the Eco-Management and Audit Scheme for environmental disclosure in Europe
- Reveal familiarity with the activities involved in an environmental audit
- Outline the main features of social accounting
- Demonstrate awareness of the history of social accounting in Britain – the Corporate Report
- Outline recent developments in corporate social responsibility (CSR) reports and triple bottom line reporting
- Discuss the nature of business ethics
- Explain and evaluate the positivist and normative approaches in addressing ethical issues
- Examine the role of ethics in modern business
- Demonstrate familiarity with guidelines and regulations developed to help accountants in practice and in business to address ethical issues

Overview

Financial accounting and reporting is central to modern entity management 'by the numbers'. The Chartered Secretary is regularly required to fulfil the following 'accounting' functions during his/her career:

- Analyse and interpret the outputs from an entity's accounting system
- Initiate and participate in decision-making based on accounting information
- Initiate and suggest improvements in the entity's accounting system and its outputs
- Provide advice on the significance for the entity of contemporary accounting developments including regulatory changes
- Counsel senior management on the significance of (proposed) published information for external user groups