

Accounting for Financial and Managerial Decision and Control [AFMDC]

Unit 2

Accounting Standards and Financial Reporting

Structure

- Accounting standards: Concept and disclosures of National and International Accounting and Financial Reporting Standards
- Concept, objectives and importance of Financial Statement: Income Statement, Balance Sheet and Cash Flow Statement

After the completion of this unit, you should be able to:

- Understand the concept and disclosures of accounting standard
- Comprehend national and international accounting standard
- Describe financial reporting standard
- Explain the concept, objectives and importance of financial statement: Income statement, Balance sheet and Cash flow statement

2.1 Accounting Standards

Organization or business firm prepare Financial Statement for internal as well as external users. They use different criteria and measurement for recognition of items in the financial statements. There is a possibility to affect the scope of the financial statements and the disclosures. To standardize the financial statements, the Government of Nepal established Accounting Standards Board (ASB) in March 2003 with an amendment to the Institute of Chartered Accountants of Nepal Act 1997 (<http://www.standards.org.np/asb/>). The primarily responsible of the ASB is setting accounting and financial reporting standards for business enterprises bases on the International Financial Reporting Standards (IFRSs). The ASB believes that financial statements prepared must meet the common needs of majority of the users and they are able to make economic decision based on the financial statement information.

The main objective of Accounting Standard is to improve the quality of financial reporting for the consistency, transparency and comparability. In this respect, Accounting Standard can be taken as a system of measurements and disclosure.

2.2 Nepal Accounting Standards

The International Financial Reporting Standards (IFRS) were developed for the uniformity of the financial reports across the world. Based on the IFRS, Nepal Financial Reporting Standards (NFRS) has been developed by the Accounting Standards Board Nepal. Accounting Standards Board of Nepal has prepared and implemented forty-one Nepal Accounting Standards (NAS) and seventeen Nepal Financial Reporting Standards (NFRS). The lists of Nepal Accounting Standards and Nepal Financial Reporting Standards Are as under:

Table 1: Lists of NAS and NFRS		
S.No.	Standard	Details
1	NAS 1	Presentation of Financial Statements
2	NAS 2	Inventories
3	NAS 7	Statement of Cash Flows
4	NAS 8	Accounting Policies, Changes in Accounting Estimates & Error
5	NAS10	Events after the Reporting Period
6	NAS 11	Construction Contracts
7	NAS 12	Income Taxes
8	NAS 16	Property, Plant & Equipment
9	NAS 17	Leases
10	NAS 18	Revenue
11	NAS 19	Employee Benefits
12	NAS 20	Accounting for Government Grants & Disclosure of Government Assistance
13	NAS 21	The Effects of Changes in Foreign Exchange Rates
14	NAS 23	Borrowing Cost
15	NAS 24	Related Party Disclosures
16	NAS 26	Accounting & Reporting by Retirement Benefit Plans
17	NAS 27	Consolidated and Separate Financial Statements
18	NAS 28	Investments in Associates
19	NAS 29	Financial Reporting in Hyperinflationary Economics
20	NAS 32	Financial Instruments: Presentation
21	NAS 33	Earnings Per Share
22	NAS 34	Interim Financial Reporting
23	NAS 36	Impairment of Assets
24	NAS 37	Provisions, Contingent Liabilities and Contingent Assets
25	NAS 38	Intangible Assets
26	NAS 39	Financial Instruments: Recognition and Measurement
27	NAS 40	Investment Property
28	NAS 41	Agriculture
29	NFRS 1	First-Time Adoption of Nepal Financial Reporting Standards
30	NFRS 2	Share based Payment
31	NFRS 3	Business Combination
32	NFRS 4	Insurance Contracts
33	NFRS 5	Non-Current Assets Held for Sale & Discontinued Operation
34	NFRS 6	Exploration for and Evaluation of Mineral Resources
35	NFRS 7	Financial Instruments: Disclosure
36	NFRS 8	Operating Segments
37	NFRS 9	Financial Instruments
38	NFRS 10	Consolidated Financial Statements
39	NFRS 11	Joint Arrangements
40	NFRS 12	Disclosure of Interests in other Entities
41	NFRS 13	Fair Value Measurements
42	NFRS 14	Regulatory Deferral Accounts
43	NFRS 15	Revenue from Contracts with Customers

44	NFRS 16	Leases
45	NFRS 17	Insurance Contracts

2.3 International Accounting Standards

The International Accounting standards committee (IASC) was established in June, 1973. At present it is known as International Accounting Standards Board. The Board comprises the professional accountancy bodies over 75 countries including Institute of Chartered Accountants of Nepal (ICAN). Wood and Sangster (1996) opined the need for an IASC due to the following reasons:

- (a) The considerable growth in international investment means it is desirable to have similar methods the world over so that investment decisions are more compatible.
- (b) The growth in multinational firms which have to produce accounts covering a large number of countries. Standardization makes the accounting work easier, and reduces costs. As quite a few countries now have their own standard setting bodies, it is desirable that their efforts should be harmonized.
- (c) For poor countries which cannot afford to have standard setting bodies, the IASC can help by letting them use the international standards instead of setting their own standards.

In Nepal, most of the provisions of International Accounting Standards are incorporated into existing NASs and NFRSs. Each NAS and NFRS indicates the level of compliance with the relevant of International Accounting Standards.

2.4 International Financial Reporting Standards (IFRS)

Financial reporting refers to the communication of financial information. To communicate financial information, the Financial Statement can be used. Financial statement includes a Balance Sheet, Income Statement and Cash Flow Statement. Financial Reporting also includes all of the company's financial information to users. It involves the disclosure of important financial information and other activities of the company to different stakeholders such as investors, creditors, bankers, public regulatory agencies and government.

According to International Accounting Standard Board, the objective of financial reporting is “to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decision.”

Financial Reporting is very useful and important for an organization. It is required by each and every stakeholder. It also provides information about the economic resources of an organization as to how an organization is procuring and using various resources.

International Financial Reporting Standards Interpretation Committee is the interpretative body of the International Accounting Standards Board. The committee was established in March, 2002. It comprises 14 voting members appointed by the trustees and drawn from variety of countries and professional backgrounds.

International Financial Reporting Standards is issued by International Accounting Standards Board. The main objective of the International Financial Reporting Standards (IFRS) is the consistent,

transparent and comparable financial statements around the world. The IFRS create a common set of accounting language. It includes set of common rules for maintaining different types of transactions, preparing financial statements reporting and disclosure. These common rules help to have a consistent and reliable financial statement.

2.5 Disclosures in Financial Statements Under NFRS and IFRS

Financial statements of the organization contain all the relevant and sufficient financial information. The financial information is needed of further explanation. The further explanation is shown at the end of the financial statements, which is known as disclosures. Disclosures in a financial statement will communicate relevant information which is not captured in the statement itself to the financial information users.

NFRS 7 explained about disclosures of financial instruments. According to NFRS 7, the disclosures should be provided in the financial statements that enable users to evaluate:

- (a) the significance of financial instruments for the entity's financial position and performance; and
- (b) the nature and extent of risks arising from financial instruments to which the entity is exposed during and at the end of the reporting period, and how the entity manages those risks.

Statement of Standard Accounting Practice (SSAP-2) explained about disclosure of accounting policies. SSAP-2 requires disclosure when the generally accepted accounting concepts (i.e., accruals, consistency, going concern, and prudence) are not complied with. Similarly, accounting policies may be guided by management judgements. There should be a note attached to the accounts explaining the policies chosen. The following five examples are given to illustrate where judgements may easily vary:

- (a) methods of depreciating fixed assets;
- (b) the valuation of stocks and work-in-progress;
- (c) capitalization of development expenditure;
- (d) the recognition of profit on long-term contracts;
- (e) hire purchase or instalment transactions

2.6 Financial Statements

The organized summary of detailed information about financial position and performances of a concern is known as the Financial Statement. The financial statement is prepared at the end of accounting period. The purpose for preparing financial statement is for the periodical review of the activities of the organization and results achieved by the organization. It includes profit and loss account or income statement and balance sheet. The income statement also may include manufacturing and trading account. Profit and loss account indicates the results of operation for a particular period and balance sheet indicate the financial position regarding assets, total payable and capital. Thus, financial statements are the condensed form of account.

Financial statement refers to three statements. They are:

- (i) Balance Sheet
- (ii) Income Statement
- (iii) Cash Flow Statement

Nepal Accounting Standard Board officially defined “Financial statements are a structured representation of the financial position and financial performance of an entity (Section 9, NAS 1: Presentation of Financial Statements). The main objective of NAS 1 is to “prescribe the basis for presentation of general-purpose financial statements to ensure comparability both with the entity’s financial statements of previous periods and with the financial statements of their entities. It sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content”. According to Section 10 of NAS 9, the complete set of financial statements comprises as under:

- (a) a statement of financial position as at end of the period (Balance Sheet);
- (b) a statement of profit and loss and other comprehensive income for the period (Income Statement);
- (c) a statement of changes in equity for the period;
- (d) a statement of cash flow for the period (Cash Flow Statement);
- (e) notes, comprising significant accounting policies and other explanatory information.

Objectives of Financial Statement

The objectives of preparing these statements are:

1. To know about business activities whether running at a profit or loss.
2. To ascertain the financial position of the business.
3. To provide meaningful information about the financial activities of a business to different persons or parties.
4. To provide information about the capacity of the business for paying loan and interest thereon.
5. To provide information about economic resources and obligations and their changing pattern.

Importance of Financial Statement

The financial statements are very important. The major consequence of financial statements is mentioned below:

1. The management can get a lot of information from the financial statement which is very important for different decision making.
2. The information related to profitability and operation cost are also provided by the financial statement.
3. The financial position of a business is shown by its financial statement.
4. With the help of financial statement, a financial institution can get important information at the time of taking decisions regarding sanctioning of loans.

(i) Balance Sheet

A summary of the financial position of an organization at a particular point of time is known as balance sheet. It is a quantitative summary of a company's financial condition at a specific point in time, which includes assets, liabilities, and net worth. Liabilities refer to the financial obligation of an enterprise and assets refer to tangible objects or intangible rights owned by an enterprise and carrying probable future benefits. Assets are also termed as economic resources owned by an enterprise. The sum total of contributed and earned capital is known as the Owner's Equity. It can be expressed as total assets over total liabilities and it is called Net Worth. It includes capital, reserve and credit balance of profit and loss account.

Objectives of Balance Sheet

The objectives of the balance sheet are as follows:

- (a) to provide information about financial health at a particular date including the financial position and performance;
- (b) to show amount of financial assets including property, plant and equipment, investment, intangible assets;
- (c) to provide information about inventories, receivables, cash and cash equivalents;
- (d) to show payables, provisions, financial liabilities, issued capital and reserves attributable to owners.

Importance of Balance Sheet

The balance sheet is widely recognized as one of the best indicators of the financial position of an organization. The importance of the balance sheet is as under:

- (a) lenders able to know about the capacity of organization to pay back the borrowed money;
- (b) government interested to calculation of tax due;
- (c) customers assess the capability of the organization to take up the order;
- (d) allows comparison of the financial status of the organization over different periods; and
- (e) especially with respect to financial health, it allows comparison between multiple companies.

(ii) Income Statement

An income statement shows the net result of the business operations during an accounting period. It may include manufacturing and trading account, profit and loss account and profit and loss appropriation account. An income statement presents the summary of revenues, expenses and net income or net loss of a firm. It serves as a measure of the firm's profitability.

The amount received in the ordinary course of a business is known as Revenue Income. It is the income earned from selling merchandise or in the form of discount, commission, interest, transfer fees etc.

Expenditure is incurred for the running productivity or earning capacity of a business. Such expenditure yields benefit in current accounting period. And expenditures are recognized as revenue where they are incurred for the following purposes:

- (a) Expenditure to acquire raw materials or stock of finished goods.
- (b) Expenditure whose benefit will expire within the year.
- (c) Expenditure to maintain assets in working order.

Objectives of Income Statement

Income statement of an organization shows the amount of profit or loss made on its business activities after deduction of appropriate expenses. The objectives of the income statement are as:

- (a) to provide information about profit or loss in the particular time period;
- (b) to show revenues and total other comprehensive income;
- (c) to provide information about revenue expenditures (administration, distribution and other expenses), financial cost, raw materials and consumable used, employee benefits expenses, depreciation and amortization expenses.
- (d) To show information about the profit distributions.

Importance of Income Statement

The income statement is widely used indicator of the financial situation of an organization. The importance of the income statement is as under:

- (a) Customers and lenders able to know about the financial situation of organization
- (b) government interested to calculation of tax amount for a particular period of time;
- (c) allows comparison of the financial situation of the organization over different periods; and
- (d) especially with respect to financial situation, it allows comparison between multiple companies.

(iii) Cash Flow Statement

Cash flow statement of an organization provides users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilities those cash flows (Section 111, NAS 1). It indicates that cash flow information provides amount of cash inflows and outflow in an organization in a particular period of time.

Objectives of Cash Flow Statement

The objectives of the cash flow statement are as follows:

- (a) to provide information about cash inflows and outflows in a particular time period;
- (b) to show amount of cash receipts from customers and paid to employees and suppliers;
- (c) to provide information about tax and interest paid;
- (d) to show amount generated from extraordinary activities;
- (e) to provide information about cash generated (used) from (to) investing activities; and
- (f) to show cash used (generated) to (from) financing activities.

Importance of Cash Flow Statement

The cash flow statement is widely used as one of the best indicators of the financial situation of an organization. The importance's of the cash flow statement are under:

- (a) lenders able to know about the capacity of an organization to cash pay back the borrowed money;
- (b) suppliers evaluate about credit pay back capacity of the organization;
- (c) investors able to assess about the dividend payment capacity and business expansion capacity;
- (d) civil society determines the organization's expenses capacity for social cause;
- (e) allows comparison of the financial status of the organization over different periods; and
- (f) especially with respect to financial health, it allows comparison between multiple companies.

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