FA Module 1: Financial Statements (overview)

(The attached PDF file has better formatting.)

[Readings are the same for the third 3rd and fourth 4th editions of the Robinson textbook.]

Readings: chapter 1, §3 major financial statements, *excluding*

- ! Exhibit 9 (Volkswagen)
- ! sub-section 3.1.7 (auditor's reports)
- ! sub-section 3.2 (other sources of information)

[Sections 2 and 4 are not on the syllabus for this course.]

This course focuses on three financial statements (the IFRS names are in parentheses):

- ! Balance sheet (statement of financial position)
- ! Income statement (statement of profit and loss)
- ! Cash flow statement

Total comprehensive income = profit and loss + other comprehensive income. Know which items are included in net income (profit and loss) and which items are in other comprehensive income. Other modules specify certain items as other comprehensive income (such as translation adjustments) and certain items as net income (such as remeasurement gains or losses).

The statement of changes in equity and many financial notes and supplementary schedules are discussed in the illustrations. The final exam tests changes to equity stemming from other comprehensive income.

Readings: chapter 2, Financial reporting mechanics

- ! § 2 the classification of business activities
- ! § 3 accounts and financial statements (especially §3.2 accounting equations)
- ! § 4 the accounting process
- ! § 5 accruals and valuation adjustments
- ! Appendix: debit/credit accounting system

[Sections 6 and 7 are not on the syllabus for this course.]

The mechanics of financial reporting are background. You must understand the financial statements and how they articulate: that is, how the cash flows, balance sheet entries, and income statement entries inter-relate.

The textbook explains the accountant's work as background information. The important items for you are

- ! Accounting equations for the balance sheet and the income statement
- ! Articulation of financial statements
- ! Double-entry book-keeping
- ! Cash vs accrual accounting
- ! Valuation adjustments
- ! Deferred revenue and prepaid expenses

Know well the paragraph beginning "Unearned revenue (or deferred revenue) arises …" following Exhibit 10. Unearned revenue for insurance contracts differs for SFAS 60 (and short duration vs long duration contracts) vs IFRS 17 (and building block approach vs premium allocation approach).

Understand the debit/credit accounting system in the appendix to chapter 2. Double-entry book-keeping helps you follow the accounting entries on the balance sheet and the income statement. Know which entries are debits and which are credits. A practice problem on the discussion forum may say “credit revenue and debit an asset” or “debit expense and credit a liability.”

Some students are confused at first by the terms debit and credit. Keep the following in mind:

! Revenue and income are credits; expenses and losses are debits (income statement entries).
! Revenue and income cause an increase in assets. By double-entry book-keeping, debits equal credits for any transaction. Thus, an increase in assets on the balance sheet is a debit, not a credit.
! Credits and debits are income statement entries or changes in balance sheet entries. Cash (a balance sheet entry) is not itself a credit or debit. An increase in cash is a debit; a decrease in cash is a credit.
! Expenses and losses cause a decrease in assets or an increase in liabilities. By double-entry book-keeping, debits equal credits for any transaction. Thus, an increase in liabilities on the balance sheet is a credit, not a debit.

For many students, financial accounting is a new language. The first two modules of this course use many new terms, but the same terms are used again in all subsequent modules.

Final exam problems do not ask you to create T-accounts or trial balances, but they may ask whether an entry on the income statement or a change on the balance sheet is a credit or a debit.

The textbook often discusses the interpretation of financial statements: is it better or worse to have a higher or lower financial leverage, interest coverage ratio, inventory turnover ratio, etc. These issues depend on the type of firm and the economic environment; they are not asked on the multiple choice final exam for this course.