

## **TOPIC FOUR-INTRODUCTION TO FINANCIAL REPORTING FRAMEWORK.**

### **4.1 The Conceptual Framework for Financial Reporting:**

The conceptual framework in accounting serves as a foundation for the development of accounting standards and provides a set of principles, concepts, and objectives that guide the accounting profession.

It is logical system of interrelated objectives and fundamental concepts that underlie the preparation and presentation of financial statements for external users

Its primary purpose is to assist standard setters, preparers, auditors, and users of financial statements in understanding and applying accounting standards consistently as follows:

#### **Purpose of the conceptual framework:**

##### **Provides a framework for standard setting:**

It helps standard setting bodies such as the Financial Accounting Standards Board (FASB), the International Accounting Standards Board (IASB), in developing new standard and also in reviewing the existing ones

**Provides guidance for preparers:** It offers guidance to preparers (Accountants) of financial statements how to apply IFRSs in accounting for various transactions and events to ensure that financial statements are prepared with consistency and reliability.

**Provides assistance for Auditors:** The conceptual framework assists auditors in forming an opinion on whether financial statements comply with IFRSs.

**Provides a foundation for developing National standards.** It assists national standard setting bodies like ICAU in developing national accounting standards

##### **Harmonizing of regulation and standards in financial reporting**

Its assist the IASB in harmonizing regulations, standards & procedures followed in preparation & presentation of financial reports. Harmonization reduces alternative accounting treatments permitted in various countries

It also assists **users** of financial statements in interpreting information contained therein.

Provides **other stakeholders** who may be interested in the work of IASB with information about its approach to formulation of IFRSs

**Enhancing Comparability and Consistency:** One of the goals of the conceptual framework is to enhance the comparability and consistency of financial reporting across different entities and over time. This is crucial for users of financial statements, such as investors, creditors, and analysts.

**Adaptation to Evolving Business Practices:** The conceptual framework is dynamic and evolves over time to adapt to changes in business practices, economic conditions, and financial reporting needs. This adaptability helps maintain the relevance of accounting standards.

## **The status of the conceptual framework**

The status of the conceptual framework varies by jurisdiction and standard setting body. Some countries have their own conceptual frameworks, while others may adopt the framework provided by International standard setting bodies like International Accounting standards Board (IASB) and Financial Accounting Standards Board (FASB)

The frameworks are periodically reviewed and updated to ensure their continued relevance and effectiveness in guiding the development of accounting standards.

Therefore the **authoritative status** of the framework is that;

- ✓ it is not a reporting standard
- ✓ It does not define any standard for any particular measurement or disclosure issue
- ✓ Nothing in the conceptual framework overrides any IFRS and in case of any conflict between the frame work and any IFRS, the requirements of the IFRS prevails over those of the framework

## **The scope of the conceptual framework 2018**

There are 8 issues or topics that are dealt with in the CF 2018 and they include:

- The objective of general purpose financial reporting (statements)
- The qualitative characteristics of useful financial information
- Financial Statements and the reporting entity
- The elements of financial statements
- Recognition and de-recognition of element of financial statements
- Measurement of the elements of financial statements
- Presentation and disclosure
- Concepts of capital and capital maintenance.

### **1- Objective of general Purpose Financial Statements:**

General purpose financial statements are a particular form of financial report, which provides information about the assets, liabilities, equity, income and expenses of the reporting entity.

A complete set (Components) of general purpose financial statements include the following

**a)- Statement of Profit and Loss (Income Statement):** This statement provides information about the company's revenues, expenses, and profits or losses over a specific period.

It helps users understand the profitability of the business.

**b)- Statement of Financial Position (Balance Sheet):** The balance sheet presents a snapshot of a company's financial position as at a specific point in time. It reports on the assets, liabilities, and shareholders' equity.

It helps users to get insights into the company's financial health and its ability to meet its obligations.

**c) Statement of Cash flow:** This statement outlines the cash inflows and outflows during a specific period, categorized into operating activities cash flows, investing activities cash flows, and financing activities cash flows.

It helps users assess the company's ability to generate and manage cash

d) **Statement of Changes in Equity:** This statement details the changes in shareholders' equity over a specific period, showing contributions, distributions, and changes in retained earnings.

e) **Accounting policies and explanatory notes to the financial statement**

### **Therefore the objectives of General Purpose Financial Statements is to**

**Provide financial Information about the reporting entity:** This information serves the needs of various stakeholders, thus financial statements being referred to as general purpose financial statement.

Financial information relates to financial performance, financial position and changes in financial position of an entity that helps;

- **Users to make informed economic decisions**
- **Making Comparisons** of performance of the entity over time and against other entities in the same industry or sector.
- **Evaluating/assessing management stewardship:** managing the entity's resources.

### **Benefits of General Purpose Financial Statements:**

- **Transparency:** Financial statements enhance transparency by providing a comprehensive view of the entity's financial performance and position.
- **Credibility:** When prepared in accordance with accounting standards, financial statements increase the credibility of the information presented, fostering trust among users.
- **Decision-making support:** Users can make better-informed decisions, such as investment and lending decisions, based on the information provided in financial statements.
- **Monitoring and accountability:** Financial statements serve as a tool for monitoring management's performance and holding them accountable for the use of resources.

### **Limitations of General Purpose Financial Statements:**

- **Historical Perspective:** Financial statements primarily reflect historical data and may not capture the real-time dynamics of the business.
- **Estimates and judgments:** Financial statements involve various use of estimates and judgments thereby introducing a level of subjectivity **that may affect their reliability.**
- **Limited non-financial information:** Financial statements focus only monetary aspects, and therefore providing limited information about non-financial factors such as the quality of management or the effectiveness of business strategies.
- **Complexity and size:** For large and complex entities, financial statements might be difficult and challenging to interpret for some users. E.g. Financial statements are prepared primarily to serve the interest of shareholders. Other interested parties have to generally make many adjustments before they use them profitably

### **Stakeholders/users of financial information**

- Who are they?
- What economic decisions do they make?
- What type of information do they need?

Users/stakeholder of financial statements are people/entities who have interest in the financial information of entities to help them make various economic decisions based on the information provided.

The users are categorized into two, i.e.

- Internal users (within the entities and take part in the day to day operations)
  - Management
  - Employees
- External users (Outsiders who are associated with the entities in many ways)
  - Investors/ shareholders
  - Lenders
  - Credit suppliers
  - Customers
  - Donors
  - Government and its agencies – URA, NEMA
  - Security exchanges
  - Competitors

### **Key economic decisions made by users of financial statements:**

#### **Investment Decisions:**

a). *Equity Investors (Shareholders)*: Investors decide whether to buy, hold, or sell shares of a company based on assessments of its financial performance, profitability, and growth prospects.

b). *Potential Investors*: Individuals or institutions considering investing in a company analyze financial statements to evaluate the company's financial health, stability, and potential returns.

#### **Credit Decisions:**

a). *Creditors (Lenders)*: Lenders use financial statements to assess a company's creditworthiness before extending loans or credit. They evaluate the ability of the company to meet its debt obligations.

b). *Suppliers*: Suppliers may use financial statements to gauge the financial stability of their customers before entering into significant transactions.

#### **Operational Decisions:**

a). *Management*: Internal decision-makers, such as management, use financial statements to assess the company's operational performance, identify areas for improvement, and make strategic decisions.

b). *Employees*: Employees may be interested in the financial health of their employer, as it can impact job security, compensation, and potential for company growth.

#### **Regulatory Compliance Decisions:**

a). *Regulators*: Regulatory bodies may use financial statements to monitor compliance with accounting standards and regulations, ensuring transparency and fair representation of financial information.

### **Information Needs of Users of Financial Statements:**

#### **Investors:**

a). *Profitability*: Investors are interested in the company's profitability, assessing factors such as net income, earnings per share, and return on investment.

b). *Growth Prospects*: Information about the company's growth potential, market share, and expansion plans is crucial for investors.

c). *Dividend Policy*: Shareholders may want to understand the company's dividend policy and history.

**Creditors:**

a). *Liquidity and Solvency*: Creditors assess the company's liquidity (ability to meet short-term obligations) and solvency (ability to meet long-term obligations) to evaluate credit risk.

b). *Debt Levels*: Information about the company's debt levels, interest coverage ratio, and debt maturity is vital for creditors.

**Management:**

a). *Operational Performance*: Management focuses on operational details, such as revenue growth, cost management, and efficiency.

b). *Cash Flow*: Information about the company's cash flows is crucial for managing working capital and ensuring ongoing operations.

**Regulators:**

a). *Compliance*: Regulators look for compliance with accounting standards and legal requirements, ensuring accurate and fair financial reporting.

b). *Risk Management*: Information related to the identification and management of financial risks is of interest to regulators.

**Analysts and Advisors:**

a). *Market Trends*: Analysts may be interested in market trends, industry comparisons, and economic indicators that could impact the company's financial performance.

b). *Competitor Analysis*: Comparative data on competitors helps analysts assess the relative performance of the company in the industry.

**2- QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION.**

Since accounting information is required by several users, it should possess certain qualities in it in order to be useful.

Therefore qualitative characteristics are attributes that make financial information useful to stakeholders.

For Information to be useful, it must be relevant and faithfully represented and this is enhanced if the information is understandable, comparable, verifiable, and timely

**Therefore the qualitative characteristics are categorized into two;**

- i- Fundamental qualitative characteristic and
- ii- Enhancing qualitative characteristics.

**Fundamental qualitative characteristics**

These are the most important characteristics and an entity cannot do away with them; they include;

- Relevance
- Faithful representation

**Enhancing qualitative characteristics**

These are characteristics which support the fundamental characteristics and they include

- Understand ability
- Comparability
- Verifiability
- Timeliness

### *Fundamental qualitative characteristics*

1. **Relevance** – Relevant financial information is one that is capable of making a difference in decisions. It must have predictive value, confirmatory value or both and must be material
  - Financial information **has predictive value** if it can be used to assess past, present and future events
  - Financial information **has confirmatory value** if it provides feedback about previous evaluations or to confirm a point of view
  - Financial information **is material** if its omission or misstatement can influence decisions that users make on the basis of financial information about a specific reporting entity.  
In other words, materiality is an entity-specific aspect of relevance based on the nature or magnitude, or both, of the items to which the information relates in the context of financial report of an individual entity.
2. **Faithful representation** - financial information must represent the phenomena that it is supposed to represent. To be a perfectly faithful representation, it should be **complete, neutral and free from material error and bias**

### *Enhancing qualitative characteristics*

1. **Comparability** - Information about a reporting entity should be able to be compared with similar information about other entities or with similar information about the same entity for another period.  
This is to enable decision makers to choose between alternatives, for example, selling or holding an investment, or investing in one reporting entity or another.
2. **Verifiability** – **This** means that information must be able to be proved by different knowledgeable and independent observers who could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation.

Verifiability helps assure users that information faithfully represents the economic phenomena it is supposed to represent.

3. **Timeliness** - Timeliness means having information available to decision makers in time to be capable of influencing their decisions.
4. **Understandability** – This means that accounting information should be expressed with clarity in a way that it is understandable to users.  
E.g. Classifying, summarizing and presenting information clearly and concisely make it understandable.

### **The cost constraint on useful financial reporting**

- Cost may limit the information that is provided by financial reporting and it is important that those costs are justified by the benefits of reporting that information.
- Reporting financial information that is relevant and faithfully represents what it purports to represent helps users to make decisions with more confidence.
- This results in more efficient functioning of capital markets and a lower cost of capital for the economy as a whole.
- An individual investor, lender or other creditor also receives benefits by making more informed decisions.

- However, it is not possible for general purpose financial reports to provide all the information that every user finds relevant.

### **3 – Financial statements and the reporting entity**

- Financial statements are a particular form of financial report, which provides information about the assets, liabilities, equity, income and expenses of the reporting entity. **(As discussed above)**
- A reporting entity is described as an entity that is required, or chooses, to prepare financial statements

Those financial statements are prepared from the perspective of the reporting entity and are normally prepared on the assumption that the reporting entity is a **going concern (The underlying accounting assumption)** and will not enter liquidation or cease trading

#### **Going Concern Assumption:**

- The going concern assumption requires financial statements to be prepared on the basis/ assumption that the business will continue in operation in the foreseeable future without significantly reducing its activities or being liquidated.
- It is assumed that the **entity has neither the intention nor the need to liquidate or curtail** materially the scale of its operations.
- It is assumed that the business will **use its assets and settle its obligations** in the normal course of business.
- Following this concept, assets like buildings are classified as long term and depreciated over their expected useful economic life.
- The concept also allows the company to defer some of its prepaid expenses until future accounting periods
  - If a business is not considered a going concern, its management should disclose that fact in its financial statements and thus financial statements should then be prepared on break up or liquidation basis.
  - This means that assets should be recognized at the amount expected to be realized from their sale, less selling costs. Liabilities should be recognized at amounts that are likely to be paid.
  - Possible indicators of going concern problems include big debts, lack of cash and huge trading losses for consecutive years.

#### 4 - ELEMENTS OF FINANCIAL STATEMENT.

These are items that be measured and recognized in the financial statements.

##### (A)- Elements in the statement of financial position/ Balance sheet

The elements directly related to the measurement of financial position are **only (3)** i.e. assets, liabilities and equity. These are defined as follows:

- 1- **Asset – This** is an economic resource controlled by an entity as a result of past events. (Note: An economic resource is a right that has a potential to produce economic benefits)

##### Classification of assets

*Assets can be classified in to two*

- ❖ Current assets
- ❖ Non-Current Assets

**Current Assets** are assets expected to expire or to be used up within a period of one year. They may however be carried forward to the next financial year as balances.

**Examples include e the following among others;**

- Inventory/stock
- Trade receivables/debtors
- Prepaid expenses
- Cash (both at hand & bank).

**Non-current assets**, also known as long-term assets or fixed assets, are assets that a company expects to hold for more than one accounting period, typically for the purpose of generating revenue over an extended period

Examples include

- Property Plant and equipment (E.g. Machinery, Equipment, Motor vehicle, Fixtures, Land, Buildings, etc.)
- Intangible assets (E.g. Goodwill, Patents, copy rights, franchise, softwares, etc)
- Financial assets (Eg, Investments in shares)

**Note:** Non-current assets are not intended for sale or conversion into cash in the short term, and they include items that provide long-term benefits to the company.

**2- Liability -** A liability is a present obligation of the entity to transfer economic resources as a result of past events

**Note:** An obligation is a duty to of responsibility that an entity has no practical ability to avoid

##### Classification of liabilities

*These are categorized into two;*

- ❖ Current/Short-term liabilities
- ❖ Non-Current/Long-term Liabilities

**Current liabilities** - present obligations of the entity that expected to mature or be settled within a period of one year.

*Examples include the following among others:*

- Short term loans
- Bank overdrafts

- Trade creditors/payables
- Outstanding payments/accrued expenses

**Non-Current liabilities** - are obligations of an entity that are expected to be settled any time after a period of one year.

*Examples include the following among others.;*

- Debentures
- Long term loans
- Retirement benefits
- Mortgages
- Bond
- Redeemable preference shares

**3- Equity – This** is the residual interest in the assets of the entity after deducting all its liabilities. It is what the owners of the entity have invested in the enterprise. It represents what the business owes to its owners.

#### **Components of Equity**

- Ordinary share capital or irredeemable preference share capital
- Reserves
- Retained earnings/profits
- Drawings

#### **(B)- Elements in the statement of financial Performance/ statement of profit or loss**

The elements directly related to the measurement of financial performance are (2) i.e. Incomes and expenses. These are defined conceptually as follows:

1. **Income** - Income is an increase in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.
- 2- **Expenses** - Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.  
For example, cost of sales, wages and depreciation. Losses represent other items that meet the definition of expenses and may or may not, arise in the course of the ordinary activities of the entity.

## **The Preface to International Financial Reporting Standards (IFRSs)**

The Preface to International Financial Reporting Standards (IFRSs) is a document that serves as an introduction and overview of the framework and objectives of the International Financial Reporting Standards, as established by the International Accounting Standards Board (IASB).

The Preface is an integral part of the IFRS documentation and plays a crucial role in providing context and guidance for users of the standards. Here are key aspects related to the Preface:

### **Purpose of the Preface to IFRSs:**

- a) Introduction to IFRS Framework:** The Preface provides an introduction to the conceptual framework underlying IFRSs. It outlines the fundamental concepts and principles that guide the development and application of the standards. This framework is crucial for understanding the basis on which accounting standards are set.
- b) Objectives of Financial Reporting:** The Preface articulates the objectives of financial reporting that IFRSs aim to achieve. These objectives typically include providing information that is useful for decision making purposes.
- c) Global Applicability:** It emphasizes the international nature of IFRSs and their applicability to entities operating in diverse jurisdictions. IFRSs are designed to be globally accepted, facilitating consistency and comparability in financial reporting across borders.
- d) IASB's Standard-Setting Process:** The Preface outlines the due process followed by the IASB in developing, reviewing, and revising IFRSs. It provides insights into the transparency, inclusiveness, and rigor of the standard-setting process, highlighting the involvement of various stakeholders.
- e) Authority of IFRSs:** It clarifies the authority of IFRSs and the expectation that jurisdictions that adopt IFRSs incorporate them into their local regulatory frameworks. The Preface recognizes that jurisdictions may make modifications or have additional requirements, but core IFRSs should be followed.
- f) Usefulness for Users:** The Preface underscores the usefulness of IFRSs for various stakeholders, including investors, creditors, analysts, regulators, and preparers of financial statements. It emphasizes the importance of financial reporting in supporting economic decision-making.
- g) Role of the IFRS Foundation:** It discusses the role of the IFRS Foundation, the independent organization responsible for the oversight and governance of the IASB. The Preface provides information on the structure, governance, and funding of the IFRS Foundation.
- h) Changes and Amendments:** The Preface acknowledges that accounting standards may evolve over time due to changes in the business environment and financial reporting needs. It explains the procedures for amending existing standards or introducing new ones.

## **The International Accounting Standards Board (IASB)**

The International Accounting Standards Board (IASB) is an independent, private sector body that develops and approves International Financial Reporting Standards (IFRS). The objectives of the IASB, as outlined in its Constitution, are aimed at establishing a set of high quality, globally accepted accounting standards.

## The Objectives of IASB.

- To developing in public interest a single set of high quality, global financial reporting standards: To promote and enforce the use and rigorous application of those across different jurisdictions. This helps enhance transparency, comparability, and relevance of financial information globally.
- To develop in the public interest, a single set of high quality financial reporting standards.
- To work actively with national standard setters to bring about **convergence** of national accounting standards and IFRS to high quality solutions.

## Process of Setting Accounting Standards.

The process of setting accounting standards involves careful consideration, consultation, and deliberation to ensure that the resulting standards are of high quality, globally applicable, and meet the needs of financial statement users.

The International Accounting Standards Board (IASB), an independent standard setting body, follows a structured process, including the following key steps:

- **Identification of Issues:** The process begins with the identification of issues or topics that require accounting standards. These issues may arise from changes in business practices, emerging transactions, or the need to address diversity in existing accounting practices.
- **Conducting research and consultations:** The IASB conducts research and consults with various stakeholders, including preparers, auditors, investors, regulators, and academics. This consultation process helps gather diverse perspectives and understand the potential impact of proposed standards.
- **Issuing of a discussion papers and exposure drafts:** This outlines proposed accounting treatments for the identified issues. These documents are made available for public comment, allowing stakeholders to provide feedback.
- **Public Consultation:** The exposure drafts are subject to a period of public consultation during which interested parties can submit comments and suggestions. The IASB carefully considers the feedback received and may make revisions to the proposed standards based on this input.
- **Standard Development:** The IASB then develops the final reporting standards, taking into account the feedback received, the conceptual framework, and the objective of providing relevant and reliable financial information.
- **Publication and adoption:** Once finalized, the accounting standards are published and may be adopted by jurisdictions for use in their financial reporting. In some cases, jurisdictions may endorse the standards as issued by the IASB, while others may make modifications to suit local requirements.
- **Implementation Guidance:** The IASB may provide implementation guidance to help entities apply the standards consistently. This guidance may come in the form of illustrative examples, educational material, or interpretations from the IFRS Interpretations Committee.

## Timing of the Application of IFRSs:

The timing of the application of International Financial Reporting Standards (IFRSs) depends on the effective dates specified by the IASB for each standard. The IASB usually provides a reasonable lead time between the publication of a new standard and its effective date to allow entities to prepare for the changes.

The timing aspects include:

- **Publication Date:** The IASB publishes new or amended standards with a specified effective date. The publication includes the full text of the standard, explanatory material, and any necessary implementation guidance.
- **Lead Time for Implementation:** Entities are typically provided with a lead time to implement the new standard. This lead time allows them to understand the requirements, update systems and processes, and make any necessary adjustments to comply with the new standard.
- **Early Adoption:** In some cases, entities may choose to adopt a new standard earlier than the required effective date. Early adoption is allowed if the standard permits it, and if the entity believes it will provide more relevant and reliable financial information.
- **Transition Provisions:** The IASB may provide specific transition provisions for the adoption of a new standard. These provisions may include requirements for the retrospective application of the standard or modified retrospective application, depending on the nature of the changes.
- **First-Time Adoption of IFRS:** Entities transitioning to IFRS for the first time follow specific guidance provided by IFRS 1, "First-time Adoption of International Financial Reporting Standards." This standard includes requirements for reconciling financial statements prepared under previous GAAP to IFRS.

## General Features of Financial Statements.

Financial statements are a key component of corporate reporting, providing a summary of an entity's financial position, performance, and cash flows.

The general features of financial statements, as outlined in the International Accounting Standard 1 (IAS 1) - Presentation of Financial Statements, contribute to the overall quality and usefulness of the financial information presented. These features include:

### Fair Presentation and Compliance with IFRSs:

- *Fair Presentation:* It involves faithful representation, free from material misstatements, and unbiased financial reporting. This implies presenting financial information that reflects the economic substance of transactions.
- *Compliance with IFRSs:* Financial statements should comply with all relevant IFRSs, ensuring that accounting policies and disclosures are in line with the requirements set forth by the IASB.

### Going Concern:

- *Importance:* The going concern assumption is fundamental in financial reporting, as it influences the measurement and presentation of assets and liabilities. It underlines the expectation that the entity will continue its operations for the foreseeable future.

- *Disclosure:* If there are uncertainties about the entity's ability to continue as a going concern, such uncertainties should be disclosed, and the appropriateness of using the going concern assumption is assessed.

#### **Accruals Basis of Accounting:**

- *Recognition of Transactions:* The accruals basis ensures that transactions are recognized when they occur, irrespective of when cash is received or paid. This provides a more accurate reflection of the entity's financial performance and position.
- *Matching Principle:* The accruals basis aligns with the matching principle, where expenses are recognized in the same period as the related revenues, providing a more meaningful depiction of profitability.

#### **Materiality and Aggregation:**

- *Materiality:* Information is material if its omission or misstatement could influence the economic decisions of users. Materiality is assessed based on the nature and size of the item or error.
- *Aggregation:* Financial statements may aggregate or disaggregate items based on materiality considerations, presenting a level of detail that is relevant and not overwhelming to users.

#### **Offsetting:**

- *Non-Offsetting Principle:* Assets and liabilities, or income and expenses, should not be offset unless specifically allowed or required by an IFRS. Offsetting can affect the presentation of the entity's financial position and performance.

#### **Frequency of Reporting:**

- *Annual Reporting:* Financial statements should be presented at least annually, providing a comprehensive overview of the entity's financial position, performance, and cash flows during the reporting period.
- *Interim Reporting:* More frequent reporting, such as interim financial reports, may be necessary to update users on the entity's performance and financial position between annual reporting periods.

#### **Comparative Information:**

1. *Enhancing Comparability:* Comparative information, including the previous year's financial statements and related notes, enhances the comparability of financial statements. It allows users to analyze changes and trends over time.

#### **Consistency of Presentation:**

- *Consistent Accounting Policies:* Entities should use consistent accounting policies from one period to the next, promoting comparability. Changes in accounting policies are allowed only if they result in more reliable and relevant information, and proper disclosure is required.

#### **The companies Act.**

The Companies Act, which varies by jurisdiction, outlines the legal framework governing the establishment, operation, and dissolution of companies. The specific accounting and reporting requirements within the Companies Act vary, but they typically include provisions related to the preparation, presentation, and audit of financial statements. Below is a general outline of the impact of the Companies Act on financial accounting and reporting:

- **Financial Statement Preparation:** The Companies Act often mandates that companies prepare financial statements in accordance with specified accounting standards. The act may reference a specific set of accounting standards, such as Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS).
- **Timeliness and Filing:** The Companies Act typically sets deadlines for the preparation and filing of financial statements. Companies are required to produce their financial statements within a certain timeframe after the end of the financial year and file them with the relevant regulatory authorities.
- **Audit Requirements:** Many Companies Acts require companies to have their financial statements audited by external auditors. The act may specify the qualifications and responsibilities of auditors, as well as the timing and frequency of audits. The audit requirement is designed to enhance the reliability and credibility of financial statements.
- **Consistency with Accounting Standards:** The Companies Act often emphasizes the importance of consistency with applicable accounting standards. Financial statements should be prepared in accordance with the prescribed accounting framework to ensure comparability and reliability.
- **Directors' Responsibilities:** The act typically outlines the responsibilities of directors in relation to financial reporting. Directors may be required to ensure that the financial statements present a true and fair view of the company's financial position and performance.
- **Disclosure Requirements:** The Companies Act may specify additional disclosure requirements beyond those prescribed by accounting standards. This can include details about related-party transactions, contingent liabilities, and other information that is deemed important for stakeholders.
- **Shareholders' Reports:** Companies Acts often require the inclusion of additional reports, such as directors' reports and shareholders' reports, along with the financial statements. These reports provide additional information on the company's activities, strategies, and performance.
- **Consequences of Non-Compliance:** Non-compliance with the accounting and reporting requirements of the Companies Act can result in legal consequences. This may include fines, penalties, or other regulatory actions. Compliance is crucial not only for legal reasons but also for maintaining the trust and confidence of stakeholders.
- **Changes in Reporting Framework:** If there are changes in the applicable reporting framework, such as a transition from local GAAP to IFRS, the Companies Act may specify the procedures and disclosures required during the transition period.
- **Small Company Exemptions:** Some Companies Acts provide exemptions or simplified reporting requirements for small companies, recognizing that the burden of full compliance may be disproportionately high for smaller entities.
- **Auditor Independence and Rotation:** The Companies Act may include provisions related to auditor independence and rotation. These provisions are designed to ensure that auditors maintain objectivity and independence in their assessments of financial statements.

## Other Regulations.

### Capital Markets Authority (CMA):

The Capital Markets Authority (CMA) is a regulatory body that oversees and regulates capital markets (Capital markets are financial markets where long-term debt or equity securities are bought and sold) activities within a specific jurisdiction. The role of the CMA is to ensure the fairness, transparency, and efficiency of capital markets, protect investors, and foster the development and integrity of the financial system. The functions and responsibilities of a CMA may vary by country, but they generally include the following

#### Role:

- **Market Regulation:** The CMA plays a pivotal role in regulating capital markets, overseeing the conduct of market participants, and ensuring fair and transparent trading practices.
- **Investor Protection:** CMA aims to protect the interests of investors by enforcing regulations that promote transparency, disclosure, and fair treatment of investors in the capital markets.
- **Licensing and Supervision:** The authority is responsible for licensing and supervising market intermediaries, such as brokers and investment advisors, to ensure they adhere to regulatory standards.
- **Listing Rules:** CMA sets and enforces rules for the listing of securities on stock exchanges, including requirements for disclosure and corporate governance.
- **Enforcement:** CMA has the authority to enforce compliance with securities laws and regulations, investigate market misconduct, and take appropriate actions against violators.

### Financial Institutions Act:

#### Role:

- **Regulation of Financial Institutions:** The Financial Institutions Act (FIA) typically regulates banks and other financial institutions, ensuring their soundness, stability, and compliance with prudential standards.
- **Licensing and Supervision:** FIA provides a framework for the licensing and supervision of financial institutions, specifying the conditions they must meet to operate in the jurisdiction.
- **Risk Management:** The act often includes provisions related to risk management, capital adequacy, and liquidity requirements to mitigate the risks associated with financial activities.
- **Consumer Protection:** FIA may include provisions to protect consumers of financial services, ensuring fair treatment, disclosure of terms, and handling of customer complaints.
- **Resolution Mechanisms:** The act may outline mechanisms for resolving financial institutions in distress, aiming to maintain financial stability and protect depositors and creditors.

## **Insurance Act:**

### **Role:**

- **Regulation of Insurance Companies:** The Insurance Act regulates insurance companies, ensuring their financial stability, solvency, and compliance with industry standards.
- **Licensing and Supervision:** Similar to the Financial Institutions Act, the Insurance Act provides a framework for the licensing and supervision of insurance companies.
- **Policyholder Protection:** The act often includes provisions to protect policyholders, ensuring fair treatment, disclosure of policy terms, and appropriate handling of claims.
- **Capital Adequacy:** The act may stipulate capital requirements for insurance companies to ensure they have sufficient financial resources to meet their obligations to policyholders.
- **Market Conduct:** Insurance regulations typically cover market conduct, prohibiting unfair practices and ensuring transparency in the sale and servicing of insurance products.

## **MEASUREMENT OF ELEMENTS OF FINANCIAL STATEMENTS:**

### **MEASUREMENT BASES.**

Measurement is the *process of determining the monetary amounts* at which the elements of the financial statements are to be recognised and carried in the statement of financial position and statement of comprehensive income.

#### **HISTORICAL COST.**

This requires transactions to be recorded at the *price ruling at the transaction date*. Assets are recorded at the amount of *cash or cash equivalents* paid or *the fair value of the consideration* given to acquire them at the time of their acquisition.

Liabilities are recorded at the amount of *proceeds received* in exchange for the obligation, or in some circumstances at the amounts of *cash or cash equivalents* expected to be paid to satisfy the liability in the normal course of business.

#### **CURRENT COST.**

This is a method of accounting in which assets are valued on the basis of their *current replacement cost*.

Assets are carried at the *amount of cash or cash equivalents* that would have to be paid if the same or an equivalent asset was acquired currently.

Liabilities are carried at the *undiscounted amount of cash or cash equivalents* that would be required to settle the obligation currently.

#### **MODIFIED HISTORICAL COST.**

This is a modification of the historical-cost convention in which certain assets are included at *revalued amounts* rather than their *original cost*.

#### **REALIZABLE (SETTLEMENT) VALUE.**

**Realizable value.** The amount of cash or cash equivalents that could currently be obtained by *selling an asset in an orderly disposal*.

❑ **SETTLEMENT VALUE.**

The *undiscounted amounts* of cash or cash equivalents expected to be paid to *satisfy the liabilities* in the normal course of business.

❑ **PRESENT VALUE.**

This is the *current worth* of a *future sum of money* or stream of cash flows given a specified rate of return. Future cash flows are discounted at the discount rate, and the higher discount rate, the lower the present value of future cash flows.

**CONCEPTS OF CAPITAL MAINTENANCE.**

❑ **FINANCIAL CAPITAL MAINTENANCE.**

Under this concept a *profit* is earned only if the *financial (or money)* amount of the net assets at the end of the period *exceeds the financial (or money)* amount of net assets at the *beginning of the period*, after excluding any distributions to, and contributions from, owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.

❑ **PHYSICAL CAPITAL MAINTENANCE**

Under this concept a *profit* is earned only if the *physical productive capacity (or operating capability)* of the entity (or the resources or funds needed to achieve that capacity) at the end of the period *exceeds* the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.