Introduction

The European Commission has ruled that businesses in the European Union (EU) using public funds must present their accounts in accordance with IASB (International Accounting Standards Board) standards. This has a significant impact on most of these companies. Up until 2004, firms listed on European Union stock markets could use their own national accounting standards. In France, for example, consolidated accounts had to be prepared and presented in compliance with CRC regulation 99-02[RS2]. With the introduction of IASB standards, the IFRS (International Financial Reporting Standards) have brought some major changes affecting how financial information is disclosed.

Accounting departments in listed corporations, as well as most users of financial statements, should be able to understand the principles laid out in IFRS. The first part of the book gives an introduction to the language of accounting generally, which has essentially remained unchanged for over 500 years. Secondly, from Chapter 3 onwards, the book makes reference to international accounting standards rather than national standards. For businesses and economic players, this harmonisation of the methods used to measure financial information and present statements makes it much easier to compare and contrast the performance and financial position of companies in different countries. One example is the German group DaimlerChrysler. In 1992, it published its accounts following both German and American standards. According to German standards, it presented a profit of more than 600 million German marks (DEM), while according to American standards it had made a loss of well over 2,000 million marks. Even though the group used exactly the same figures from exactly the same year, the outcome was vastly different depending on which standards had been followed. On what basis should DaimlerChrysler have been compared with its competitors? It's easy to comprehend how useful IFRS can be in analysing the financial statements of groups in (almost) every country around the world: the same rules and the same standards are used, keeping in mind however that there may still be a margin of interpretation.

Before explaining how to draw up and disclose accounting information, it is important to understand how this information will be used and what the objectives of the IASB are.

Users of accounting and financial information

Financial statements meet a need for information from various sources:

- **Current and potential investors** (shareholders). These are the primary users of financial information. They are interested in the risk associated with their investment and how profitable it might be. They look for information that they draw upon to decide if they should buy, hold or sell the stock of a particular company. Shareholders also want to estimate how likely it is that companies will be able to pay dividends.

- **Capital lenders**. The information required by capital lenders helps them find out if their loans and interest will be repaid on time.
- **Suppliers and other creditors**. The information these parties are searching for should give them insight into whether the amounts due to them will be paid on time.
- **Customers**. Customers want information on how healthy the business looks and how healthy it really is, especially when long-standing relationships are involved.
- **Employees** (and their representatives). These parties look for information on how stable the company seems to be, and they are interested in the going concern of the company that employs them. They might also be curious about how profitable the company is, and whether it can remunerate its employees properly, provide retirement benefits and offer employment opportunities.
- **Governments and public organisations**. These parties are particularly interested in how businesses are redistributing the profit they make. They can then determine appropriate tax policies based on national product statistics (and similar). Therefore, some of the information in financial statements is compulsory.
- **General public**. There is public interest in corporate affairs because businesses make substantial contributions to local economies, especially by employing a large workforce or by encouraging their customers to call upon local suppliers. Financial statements keep the public informed about recent trends and developments in how a business operates and if it is successful.

Purpose of accounting and financial information

Many users of financial statements require very specific accounting and financial information. Financial statements have two main purposes, which are not mutually exclusive, and therefore meet the needs of most users:

- **Information**. Many users need to estimate the value of a company. So during their evaluations, potential investors (insurance companies, investment companies, pension funds, etc.), financial analysts and other market players are interested in both the company's past performance and its future prospects. Net income is one of the variables used by investors. Likewise, estimating the cost of a loan depends to a certain extend on how financially healthy a business is. Excessive debt and low net income can have an impact on how many new loans will be granted. Simply by assessing the financial position of a company wishing to obtain bank credit, right through to the complex system used by rating agencies (e.g. Standard & Poor's or Moody's), performance, debt and solvency ratios are among the cornerstones of assessment processes for capital lenders. They are based on the accounting data that the company publishes.

- **Contractual agreements**. Accounting data is also used to ensure that contracts are respected between the firm and its partners. Specific contracts are applied to regulate these relationships (creditors, suppliers, employees, company managers, etc.). Details of a company's contracts, which are based on accounting data, depend on its specific features. For example, in some managers' employment contracts, part of their remuneration is proportional to performance indicators (especially returns on equity or assets, earnings per share), in order to encourage them to maximise the firm's value. Debt contracts contain special clauses to protect creditors' interests. Certain contractual clauses can cap the level of debt (measured using accounting data) and may restrict dividend distribution.

Financial statements cannot meet every single requirement from every single user. However, all users have some common needs. Investors provide the entity with its share capital. And that is why the IASB considers that if financial statements meet the needs of these current and potential shareholders, they will also satisfy most other users.

The IASB and the IFRS

IFRS (International Financial Reporting Standards) are developed by the IASB (International Accounting Standards Board), an organisation headquartered in London. This committee is made up of 14 members who are selected according to where they based and what professional experience they have. Its objective is to ensure that its members represent as wide a scope as possible, which helps to facilitate the acceptance of the standards all over the world and from all stakeholders (preparers, users, regulators, etc.).

The first standards were called IAS (International Accounting Standards). Forty-one IAS have been published over the years, but just under 30 of them are still in force. An overhaul of the institution began in the early 2000s, and IFRS are now replacing IAS. Some of them now mainly cover general information rather than specific points of accounting. In spring 2018, 17 IFRS were published. Both IAS and IFRS still apply, but as an ensemble they are known as "IFRS", including official interpretations for some aspects not specifically addressed by these standards.

IFRS are developed according to a fairly participatory process. The IASB strives to involve all stakeholders as much as possible when it develops its standards. Each published document (working document, exposure draft, etc.) is published online for subscribers, or a paper copy is sent out. Subscribers have several weeks, sometimes several months, to express their views, either by answering questions asked by the IASB about some of the points included in its project, or by sharing their comments in another manner. The IASB takes the time to analyse the various reactions and incorporates the suggestions it deems relevant as it updates the document. This obviously means that the process can be lengthy. On average, a new standard takes around three years to develop, but some may take as long as ten or more years.

IASB objectives

With the aim of meeting the accounting and financial information requirements of shareholders and investors, the IASB presents its three standardisation objectives in its preface to the IFRS:

- Develop a single set of high-quality global standards that are understandable and applicable, providing complete, transparent information in the public interest. The financial statements drawn up based on these standards must be comparable to other accounting data. This helps users of the information, including those in global capital markets, to make economic decisions.
- Promote the rigorous use and application of these standards.
- Coordinate with standard setters in different countries to regulate accounting standards in different countries with IFRS in order to obtain high quality solutions.

The structure behind the IASB – the Framework for the Preparation and Presentation of Financial Statements – sets out the concepts that underlie the preparation and presentation of financial statements. In theory, when harmonisation decisions are made, the IASB must ensure that the Framework is respected: "The objective of financial statements is to provide information about the financial position, performance, and changes in financial position of an entity that is useful to a wide range of users in making economic decisions."

For users of financial statements to make economic decisions, they need to evaluate a company's ability to produce cash and cash equivalents as and when they are needed. A company's financial position is impacted by the economic resources it controls, its financial structure, its liquidity and its solvency, as well as its ability to adapt to any changes in its environment.

How this book works

Financial statements are therefore very important for decision-making and must genuinely reflect the resources that the company controls. All the elements required in financial statements are explained in terms of assets and debts. The balance sheet shows a company's assets and debts, and the residual difference gives the benefit for the shareholder.

Chapter 1 ("Financial statements and accounting mechanisms") presents how financial statements are structured and drawn up.

Chapter 2 ("Operating income") covers business performance and explains how it is measured by comparing the difference between the revenue and expenses of the business for a given period, and including its main tax concerns. Revenue and expenses are presented in form of a financial statement known as the income statement. Revenues are generated when there is an increase in assets or a decrease in debts. Expenses result from a drop in assets or a rise in debts. Anyone designing accounting regulations must choose between two options: (1) start with the income statement and make measurements by observing commercial transactions, and then consider the balance sheet as further information (2) start with the balance sheet, wondering what wealth the company has garnered and what debts it has incurred, which implies changes in the balance sheet items, which are expressed in the income statement.

Chapters 3 ("Current assets") and 5 ("Non-current assets") cover the assets which are used when a company does its business. They generate a number of obligations: on the one hand, towards suppliers when goods or raw materials are purchased on credit; on the other hand, towards employees in terms of remuneration and retirement contributions. And that issue is dealt with in Chapter 4 ("Non-financial obligations").

Chapter 6 ("Financial resources") describes the main financial obligations, for example with regards to credit institutions.

Presenting financial statements for a group of companies requires specific accounting treatments, and these are examined in Chapters 7 ("Business combinations") and 8 ("Consolidation").

Chapter 9 ("Financial and non-financial analysis") provides an introduction to the concepts of financial analysis based on financial statements. As such, the principles of establishing the cash flow statement are discussed. Finally, this chapter presents an introduction to the analysis of non-financial performance.

Chapter 10 ("Analysing financial statements") covers all the information provided up to this point, both from a credit risk and profitability perspective for shareholders.

This fifth edition takes into account the recent requirements stipulated in IFRS 9, 13, 15 and 16. It also presents a recent IASB exposure draft (December 2019), which aims to improve information on performance by proposing a new structure for the income statement (Appendix to Chapter 9). To finish, this edition also addresses aspects of non-financial communication, including the presentation and illustration of the obligations in the "Declaration of extra-financial performance", or non-financial reporting in Chapter 9.