

MAICSA Syllabus Document – Module 4

Interpreting Financial and Accounting Information

January 2020

Introduction

The content for this module is an expanded version of the content specified in the *International Qualifying Scheme (IQS)* module entitled *Corporate Financial Management and Financial Accounting*. **All** (100%) of the content specified in the IQS syllabus is covered in this module. The name of the module has been changed to *Interpreting Financial and Accounting Information* to more accurately describe the content within the module.

Module 4

Interpreting Financial and Accounting Information

Level: 6

Module type: **Mandatory – Part One (Level 6) Programme**

Total hours study time: **200**

Introduction

The aim of this module is for students to develop their knowledge of finance and accounting and the ability to use that knowledge to interpret financial and accounting information in order to provide advice to the board, or a similar decision-making body, in strategy development and/or decision-making.

Students are not expected to memorise complicated formulae and a formulae sheet will be provided in the exam.

Before studying this module

Students **must** have attained a basic level of understanding of financial accounting and finance.

Learning outcomes

After successful completion of this module you should:

- 1 Be able to critically engage with the need for regulating financial reporting by entities
- 2 Understand how financial statements and reports are prepared and evaluate them in order to provide insightful interpretation
- 3 Be able to identify and critically evaluate sources of finance and their associated risks and returns
- 4 Be able to conceptualise the nature and importance of capital structure and the cost of capital and evaluate these for decision making
- 5 Be able to critically explore fundamental financial decision-making theories and evaluate these for decision making.

Module content

Section A: The need for regulating financial reporting	
<i>10% – 20 Learning hours</i>	
<i>LO.1: Be able to critically engage with the need for regulating financial reporting by entities</i>	
Topic area	Potential content
<p>The regulatory framework (legislation and accounting standards) of financial reporting.</p> <p>IQS topic mapping: The necessity of financial accounting standards (i.e. reasons for regulating)</p>	<p>The need and necessity of regulation in financial reporting, including:</p> <ul style="list-style-type: none"> • Public interest argument - the need to achieve desired social goals: <ul style="list-style-type: none"> - fairness of reporting - information symmetry - protection of investors • regulation in response to the 2007-8 global financial crisis. <p>The role of financial accounting standards such as Malaysian, UK and US Generally Accepted Accounting Practice (GAAP) and International Financial Reporting Standards (IFRS) in regulating financial reporting:</p> <ul style="list-style-type: none"> - providing comparability, transparency and relevance - audiences, e.g. adding value for investors, regulators, taxpayers, the media. <p>Agency theory:</p> <ul style="list-style-type: none"> • factors that have shaped financial reporting to its current and present state. • the principal-agent relationship: <ul style="list-style-type: none"> - definition, roles and responsibilities - conflict of interest - monitoring processes <p>Arguments against accounting regulation Statutory framework and legal requirements:</p> <ul style="list-style-type: none"> - legislation, e.g. Malaysian Companies Act 2016 - auditing standards - ethical standards - integrity, objectivity and independence - the role of corporate governance and the external audit process. <p>Environmental and social reporting, including:</p> <ul style="list-style-type: none"> - Bursa Malaysia Sustainability Reporting Guide - Department of Environment's environmental audit guidance manual - recent developments in corporate social responsibility (CSR) reports

Topic area	Potential content
	<p>- current issues (examples: effects of Industry 4.0), the power of the internet and the importance of complying with ethical standards.</p> <p>Private and public sector regulation of accounting standards:</p> <ul style="list-style-type: none"> - what they entail - benefits and concerns <p>Legitimacy of the standard-setting process:</p> <ul style="list-style-type: none"> • its ability to produce an optimal accounting system <ul style="list-style-type: none"> - the pessimistic prognosis - the optimistic prognosis - accounting standards overload
<p>Role of IFRS in regulating financial reporting</p> <p>IQS topic mapping:</p> <p><i>The conceptual framework of financial reporting</i> <i>International Financial Reporting Standards (IFRS)</i></p>	<p>The international approach:</p> <ul style="list-style-type: none"> • the need for global financial reporting standards - global comparability, consistency and reliability. • the work and objectives of the International Accounting Standards Board (IASB) <ul style="list-style-type: none"> - a principle-based approach to developing a common set of financial reporting standards. <p>The regulatory structure of international financial reporting and the standard-setting process:</p> <ul style="list-style-type: none"> - history - structure of the IASB's financial reporting standards and role of the International Accounting Standards Committee (IASC). <p>IFRS framework and the world:</p> <ul style="list-style-type: none"> • historical reasons for differences in accounting practices - GAAPs versus IFRS • principal differences between IFRS and Malaysia GAAP • the local approach <ul style="list-style-type: none"> - standard setting and the adoption of International Accounting Standards (IAS), - current developments - convergence: <ul style="list-style-type: none"> - factors driving IFRS - progress towards harmonisation of financial reporting standards globally - the work of international standard setters (IASB the European Commission, UK and US GAAPs) towards harmonisation.

Topic area	Potential content
	<ul style="list-style-type: none"> • Barriers to complete global harmonisation or reporting standards <ul style="list-style-type: none"> - national differences - culture, national company law and different taxation systems. - Meek and Saudagaran (1990) - identification of five external environmental and institutional factors
<p>The Conceptual Framework for financial reporting</p> <p>IQS topic mapping:</p> <p><i>The conceptual framework of financial reporting</i></p>	<ul style="list-style-type: none"> • Financial accounting concepts and principles and the Conceptual Framework in the preparation and presentation of financial statements. • Purpose of the Conceptual Framework • Basic objectives and users of financial statements • Assumption underlying financial statements: <ul style="list-style-type: none"> - accrual bases of accounting - going concern • Qualitative characteristics of accounting information: <ul style="list-style-type: none"> - fundamental qualitative characteristics: <ul style="list-style-type: none"> - relevance - faithful representation - enhancing qualitative characteristics <ul style="list-style-type: none"> - comparability - verifiability - timeliness - understandability • Elements of financial statements - definition, recognition and measurement of each component as per the MASB Conceptual Framework for financial reporting: <ul style="list-style-type: none"> - elements relating to the statement of financial performance - income and expenses - to include IASB's Exposure Draft on Conceptual Framework to take into account prudence and substance over form. • Use of capital and capital maintenance in accrual basis financial statements • Contribution and inherent limitation of financial statements, including key ethical issues. • The use of the business model concept in financial Reporting, example: Integrated Reporting.

Section B: How financial statements and reports are prepared and how to interpret them

35% – 70 Learning hours

LO.2: Understand how financial statements and reports are prepared and evaluate them in order to provide insightful interpretation.

Topic area	Potential content
<p>Criteria and requirements for information appearing in a published financial statements as per international reporting framework.</p> <p>IQS topic mapping: <i>Financial accounting concepts and principles</i></p>	<p>Objectives of financial statements Structure and content of financial statements Preparation of financial statements and the concepts of:</p> <ul style="list-style-type: none"> • Going concern • Accrual basis • Consistency of presentation • Materiality and aggregation • Offsetting <p>Fair presentation, true and fair and true and fair override</p> <p>Reporting period and comparative information An overview of accounting irregularities and creative accounting.</p>
<p>Key components of financial statements for single entities.</p> <p>IQS topic mapping: <i>Components of financial statements</i></p>	<p>Statement of profit or loss and other comprehensive income:</p> <ul style="list-style-type: none"> • the concepts of profit or loss and comprehensive income • choice of presentation and basic requirements • profit or loss section and the minimum line items • items recognised outside of profit or loss • other comprehensive income section • other requirements of MFRS101. <p>Statement of change in equity:</p> <ul style="list-style-type: none"> • total comprehensive income for the period • retrospective application of accounting policies or restatements • reconciliations between the carrying amounts at the beginning and end of the period • analysis of other comprehensive income by item. <p>Statement of financial position (balance sheet):</p> <ul style="list-style-type: none"> • current and non-current classification • line items to be included on the face of the statement • appropriate format of the statement • share capital and reserves • appropriate methods for valuing assets and liabilities

Topic area	Potential content
	<p>Statement of cash flow - as per requirement of MFRS 107 'Statement of Cash Flows'</p> <p><i>Students will not be required to prepare financial statements as part of their assessment.</i></p>
<p>Other components and disclosures made in published accounts</p> <p>IQS topic mapping: <i>Components of financial statements</i></p>	<p>Purpose and contents of:</p> <ul style="list-style-type: none"> - strategic review - chair statement - directors' report <p>Notes to the accounts - purpose and contents, including:</p> <ul style="list-style-type: none"> • the basis of preparation of the financial statements and the specific accounting policies used. • information required by MFRSs not presented elsewhere in the financial statements • additional information not presented elsewhere in the financial statements but relevant to understanding them, e.g. off-balance sheet finance and related parties • contingent assets and liabilities • other disclosures, including: <ul style="list-style-type: none"> - judgments and key assumptions - dividends - capital commitments - equity instrument • other information, e.g. country of incorporation, principal place of business, principal activities. <p>Reasons for segmental reporting and its importance</p> <p>Reporting the substance of transactions - economic substance versus legal form of a business transaction</p>
<p>Interpretation of accounting policies based on MFRS</p>	<p>Measurement and recognition of revenue</p> <p>Accounting for inventories</p> <p>Accounting for property, plant and equipment, including depreciation, impairment and revaluation</p> <p>Accounting for</p> <ul style="list-style-type: none"> - provision - events after the reporting period

Topic area	Potential content
	<p>How the choice of accounting policies affects the analysis and interpretation of financial statements.</p> <p>Accounting irregularities and creative accounting.</p> <p>Key differences between MFRS and Malaysia GAAP</p>
<p>Financial reporting by groups of companies</p> <p>IQS topic mapping:</p> <p><i>Financial reporting by groups of companies</i></p>	<p>Concepts and principles surrounding the consolidation of financial statements</p> <p>Requirements and preparation of consolidated financial statements, including:</p> <ul style="list-style-type: none"> - consolidated statement of financial position (balance sheet) - consolidated statement of profit or loss and comprehensive income - consolidated statement of cash flows <p>Circumstances in which entities are required to present consolidated financial statements, including laws and regulations and accounting standards other applicable requirements.</p> <p>Accounting for business combinations, including:</p> <ul style="list-style-type: none"> - control criteria for consolidation - the acquisition method and adjustments for fair value - computation of goodwill and non-controlling interests - distinguishing between pre- and post-acquisition profits. - inter-company balances and unrealised profits on inter-company sales. - uniform accounting policies and reporting dates. <p>Accounting and reporting of:</p> <ul style="list-style-type: none"> - investment in subsidiaries - investment in associates - interest in joint ventures <p>Circumstances in which the obligation to prepare consolidated accounts does not apply.</p> <p>Multinational accounting</p> <p>Application of MFRS to group scenarios.</p>

Topic area	Potential content
<p>Analysis and evaluation of financial statements</p> <p>IQS topic mapping:</p> <p><i>Analysis and evaluation of financial statements</i></p>	<p>Financial analysis methods including:</p> <ul style="list-style-type: none"> • fundamental analysis: <ul style="list-style-type: none"> - economic analysis - industry analysis - company analysis • horizontal analysis between two periods • vertical analysis comparing financial data <p>Use and limitations of ratio analysis to measure financial performance, including:</p> <ul style="list-style-type: none"> - profitability - efficiency - liquidity - gearing - activity - investment performance - cash flow analysis <p>Earnings management - use and limitations of earnings per share (EPS) analysis</p> <p>Purpose and usefulness of value for money and economic value added (EVA) analysis</p> <p>Overtrading, financial distress and insolvency</p>

Section C: Sources of finance and their associated risks and returns

20% – 40 Learning hours

LO.3: Be able to identify and critically evaluate sources of finance and their associated risks and returns.

Topic area	Potential content
<p>Financial markets and market participants (Investor - Borrowers)</p> <p>IQS topic mapping:</p> <p><i>Investor-borrower expectations</i> <i>Private versus public markets</i></p>	<p>Private versus public markets:</p> <ul style="list-style-type: none"> - features, requirements and expectations of private versus public investors - evaluating the advantages and disadvantages of different market types <p>The role of the Stock Exchange (Bursa Malaysia) and its efficiency</p> <p>The role of other sources of finance including:</p> <ul style="list-style-type: none"> - private equity - business angels <p>Investor-borrower expectations:</p> <ul style="list-style-type: none"> - the market process of funds flow from investor to borrower and who the general market participants are - historical returns - historical standard deviations <p>Identification of financing needs, e.g through financial planning and forecast of future cash flows.</p>
<p>Sources of long-term (LT) finance and their associated risks and returns</p> <p>IQS topic mapping:</p> <p><i>Sources of funding</i></p>	<p>Identification and evaluation of the features and use of various sources of long term finance, including:</p> <ul style="list-style-type: none"> - shares - ordinary shares, preference shares, shares warrants - retained earnings - raising equity through profit retention - equity financing - long-term leasing - finance leases (including sale and leaseback) <ul style="list-style-type: none"> - hire purchase - grants/government assistance - securitization of assets <p>Evaluation of the associated risks and returns of various sources of LT Finance - differences in ownership rights and obligations.</p>

Topic area	Potential content
<p>Sources of short-term (ST) financing and their associated risks and returns</p> <p>IQS topic mapping:</p> <p><i>Sources of funding</i></p> <p><i>Conditions affecting financing</i></p>	<p>Identification and evaluation of the features and uses of various sources of ST finance (both external and internal)</p> <p>External sources of short-term finance, including:</p> <ul style="list-style-type: none"> - bank overdrafts and institutional loans - bills of exchange - debt factoring - invoice discounting <p>- crowd funding and web-innovations</p> <p>- unsecured versus secured financing</p> <p>Internal sources of short-term finance, including:</p> <ul style="list-style-type: none"> - reducing inventories - tighter credit control - delaying payments to payables/suppliers - sale of redundant assets <p>Conditions affecting financing - evaluating covenants and other financing conditions required by lenders with reference to:</p> <ul style="list-style-type: none"> - financial reporting - financial ratios - regulatory reporting - debt covenants

Section D: Capital structure and the cost of capital and how to evaluate these for decision making

10% – 20 Learning hours

LO.4: Be able to conceptualise the nature and importance of capital structure and the cost of capital and evaluate these for decision making.

Topic area	Potential content
<p>Capital structure and cost of capital</p> <p>IQS topic mapping:</p> <p><i>Capital structure and cost of capital</i></p>	<p>Factors that determine capital structure in companies</p> <p>Evaluation of financial models related to the capital structure decision</p> <p>Equity capital including:</p> <ul style="list-style-type: none"> - cost of equity - capital asset pricing model <p>Issuing of shares</p> <p>Loan capital</p> <p>Capital gearing:</p> <ul style="list-style-type: none"> - aspects of company gearing, e.g. reasons why companies borrow - factors influencing the level of gearing (use of debt versus equity) and the impact on risks and returns to shareholders - the capital structure debate - traditional versus Modigliani-Miller arguments and the impact of real world factors <p>The concept of financial risk in relation to gearing.</p> <p>The concept of business risk in relation to areas of operation and to the proportion of fixed overhead in their cost structure.</p> <p>Weighted Average Cost of Capital (WACC), including selection of an appropriate cost of capital for use in valuation.</p> <p>Dividend or internal investment.</p>
<p>Working capital management</p> <p>IQS topic mapping:</p> <p><i>Working capital management</i></p>	<p>The nature and purpose of working capital.</p> <p>The working capital cycle</p> <ul style="list-style-type: none"> - the importance of working capital management, e.g. the financial impact of changes to working capital policies. <p>The interpretation and use of working capital ratios, e.g. inventory turnover ratio and the collection ratio to maintain liquidity and profitability.</p>

Topic area	Potential content
	<p>Management of working capital, including management of:</p> <ul style="list-style-type: none"> - accounts receivable, for example: <ul style="list-style-type: none"> - credit terms, collections, discount policies - assessing creditworthiness - reducing risk of non-payment - inventory, for example: <ul style="list-style-type: none"> - inventory control - use of the economic order quantity (EOQ) model - materials requirement planning - Just-in-Time (JIT) inventory management systems - vendor-managed inventory - cash, including: <ul style="list-style-type: none"> - cash management models - the use of cash flow statements - the cash conversion cycle <p>Accounts payable, including:</p> <ul style="list-style-type: none"> - the trade-off between the benefits and problems of trade credit - adopting policies for the efficient management of trade payables - prompt settlement and the cost of discounts <p>Leasing versus purchase</p> <p>Sale and leaseback</p>

Section E: Financial decision making

25% – 50 Learning hours

LO.5: Be able to critically explore fundamental financial decision-making theories and evaluate these for decision making.

Topic area	Potential content
<p>Financial decisions for investing in equities</p> <p>IQS topic mapping:</p> <p><i>Financial decisions for investing in equities</i></p>	<p>Investment decisions criteria, the need for investment appraisal</p> <p>Investor risk and return and different risk assessment models, including:</p> <ul style="list-style-type: none"> - sensitivity analysis (non-probabilistic approach to project appraisal) - scenario analysis - a most likely view, an optimistic view and a pessimistic view - simulation modelling (uses random numbers) - expected net present value (ENPV) - making use of probabilities - event tree diagrams - risk-adjusted discount rate (RADR) <p>Use of portfolio, including:</p> <ul style="list-style-type: none"> - risk and return - objectives and risk reduction - diversification - correlation of the individual investments in a portfolio efficiency frontier - portfolio theory - its application and limitations. <p>The problem of risk and the risk references of investors, including risk versus risk-free investments</p> <p>Economic outlook and forecasts of interest rates and market return, including:</p> <ul style="list-style-type: none"> - indifference curves - risk-free rate
<p>Company analysis and business valuation methods for making financial decisions</p> <p>IQS topic mapping:</p> <p><i>Financial decisions for investing in equities</i> <i>Financial decisions for investing in projects</i></p>	<p>Financial Statement analysis</p> <p>Relative value measures</p> <p>Discounted cash flow (DCF) models - to estimate the attractiveness of an investment opportunity</p> <p>Efficient market hypothesis and its application to business valuations</p> <p>Earnings Per Share (EPS)</p> <p>Dividend Discount Model (DDM) (also known as Gordon's Growth Model)</p>

Topic area	Potential content
	<p>Capital Asset Pricing Model (CAPM), systematic risk, β factor, α values</p> <p>Price/earnings (P/E) ratio</p>
<p>Shareholder value analysis (SVA)</p> <p>IQS topic mapping:</p> <p><i>Financial decisions for investing in projects</i></p>	<p>Value creation</p> <p>Value drivers including:</p> <ul style="list-style-type: none"> - free cash flow - growth in sales - profit margins <ul style="list-style-type: none"> - investments in fixed assets, and depreciation - investment in working capital - the cost of capital <ul style="list-style-type: none"> - the tax rate <p>Strengths and weaknesses of SVA</p> <p>Economic value added (EVA) as an alternative to SVA</p> <ul style="list-style-type: none"> - Measuring value creation: <ul style="list-style-type: none"> - total shareholder return (TSR) - market value added (MVA) - the effects of dividend payments on shareholder wealth <ul style="list-style-type: none"> - stock market influences
<p>Financial decisions for investing in projects</p> <p>IQS topic mapping:</p> <p><i>Financial decisions for investing in equities</i></p> <p><i>Financial decisions for investing in projects</i></p>	<p>Identification and analysis of a project's:</p> <ul style="list-style-type: none"> - costs, benefits and risks - requirements and product/service design <p>Factors in project appraisal:</p> <ul style="list-style-type: none"> - relevant factors, e.g. cash flow, financing costs, timing of returns, incremental costs, working capital, taxation and inflation. - non-relevant factors, e.g. sunk cost, non-relevant, overhead costs, depreciation. <p>Project appraisal techniques, including:</p> <ul style="list-style-type: none"> - non-discounting methods: <ul style="list-style-type: none"> - payback period - accounting rate of return (ARR) - discounted cash flow (DCF) methods (based on time value of money (TVM)): <ul style="list-style-type: none"> - net present value (NPV) - internal rate of return (IRR) - discounted payback

Topic area	Potential content
	<ul style="list-style-type: none"> - factors affecting project appraisal: <ul style="list-style-type: none"> - taxation factors, including foreign, direct and withholding taxes. - economic factors - inflation, interest and exchange rates - advantages, disadvantages and appropriateness of investment appraisal methods in different circumstances. Evaluating projects with unequal costs and service lives Profitability index (benefit-cost ratio) and its use in capital rationing situations, including: <ul style="list-style-type: none"> - mutually exclusive investments - multi-period capital rationing - soft and hard capital rationing
<p>Monitoring and controlling of investment projects</p> <p>IQS topic mapping:</p> <p><i>Budgeting and budgetary control</i></p>	<p>Use and purpose of budgeting and budgetary control:</p> <ul style="list-style-type: none"> - theory - types of budgets - master versus flexible budgets

Reading List for Interpreting Financial and Accounting Information

Accounting:

Thomas, A. & A. M. Ward (2015). *Introduction to Financial Accounting*. (7th ed.). London: McGraw-Hill Education

Elliot, B. & Elliot, J. (2013). *Financial Accounting and Reporting*, 16th Ed, Harlow, England: Financial Times Prentice Hall.

Lazar, J. and Huang, C.C. (2014). *Malaysian Financial Reporting Standards for Malaysia*. 4th Ed, Kuala Lumpur: McGraw Hill.

Tan Liong Tong (2017). *Financial Accounting and Reporting in Malaysia*, Volume 1, 6th Ed.

Tan Liong Tong (2015). *Financial Accounting and Reporting in Malaysia*, Volume 2, 5th Ed.

Malaysian Financial Reporting Standards and Extant Accounting Standards adopted by Malaysian Accounting Standards Board.

Finance:

Subramanyam, K. R. & J.J. Wild, (2013). *Financial Statement Analysis*, 11th Ed, McGraw-Hill.

Titman S. J., A. J., Keown, & J. D. Martin, (2014). *Financial management: Principles and applications* (12th ed.). Upper Saddle River, New Jersey: Pearson Prentice Hall.

Gitman, L. J., & C. J. Zutter, (2015). *Principles of Managerial Finance* (14th Ed.). Boston: Pearson Addison Wesley.

Pike, R., B.Neale, & P.Linsley, (2015). *Corporate Finance and Investment: Decision and strategies*. 8th Ed, London: Prentice Hall.

Alexander, D., & A Britton, (2017). *Financial Reporting*, 7th Ed, Thomson Business Press.