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FINANCIAL REPORTING | BASIC

Video Transcription: Recording and Reporting Financial Information

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Hello there, my name is Jacqui and today's video is going to focus on understanding the difference between the "recording of" and "reporting of" financial information. Now these terms are often misunderstood and used incorrectly. So what do we actually mean by the terms "recording of financial information" and "reporting of financial information"?

Recording is a systematic way of keeping track of business transactions that have a monetary or financial impact on the business, whereas financial reporting is providing financial information about a business that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

So, why would businesses record financial information? Well, they may use past information to be able to make informed decisions about what's going to happen in the future. They may use this information to be able to make better day-to-day business decisions, they may need to provide this information to authorities like SARS (SARS being the South African tax authorities), or they may use the information to prepare financial reports.

The financial information recorded in the record keeping system: source documents, journals, ledger and trial balances, can be used by internal users. For example, managers in making day-to-day decisions in the business. Now, these decisions could include paying their creditors in time, purchasing the correct type of inventory in the correct quantities and at the correct time.

In this video, however, we are primarily interested in using financial information to report to external users of financial information. Remember, these are the equity and debt providers.
Recording occurs on a day-to-day basis to ensure that all the information about the business is captured. While we are going to see that there is considerable flexibility in how this information is recorded, the business does need to ensure that all transactions are recorded, and are recorded in a systematic way. In other words, similar transactions are recorded in a similar fashion. Reporting, however, occurs at least once during a financial year, at the financial year-end and presents information in a way that is useful to external users in making decisions relating to providing resources to a business.

In order to be useful, information needs to conform to the principles and practices covered in Generally Accepted Accounting Practice, also referred to as GAAP. As explained in International Financial Reporting Standards (IFRS), this provides the guidance for financial reporting in South Africa and much of the rest of the world. And this is what you would be studying if you go on to become a chartered accountant.

Preparers of financial reports need to use the same terms, principles and guidelines as are understood by users. Think about it, it is in this way that the correct financial performance and financial position of a business will be communicated to the users of the financial reports.

It is important to understand that GAAP principles need to be consistently applied when reporting financial information. When recording financial information, it is not necessary to apply GAAP. However, as the financial information that has been recorded is actually used in the preparation of the financial reports, the reporting requirements can influence how we choose to set up our recording system. The recording process is triggered by a transaction that has a monetary or financial impact on the business and this generally has a source document as proof of the transaction. The source document provides information on when the transaction occurs, and what transaction has actually occurred. For example, stationery was purchased by cash, and the amount at which the transaction occurs, for example, R1 000.

So, in this entry what should the bookkeeper record? The credit entry is obvious as bank and asset has decreased. But what should the business debit? Let's think about this, which of the following two options would you say is correct? Should we debit stationery asset by R1 000 or should we debit an equity account stationery expense with R1 000?

Now, remember, when we record the transaction all that we are actually recording is that R1 000 stationery has actually been purchased. Whether we refer to it as a stationery asset or refer to it as an equity account stationery expense, that does not actually change what has happened to the stationery that we have purchased.

What do I mean by this? When the stationery was purchased on the 1st of January, let's assume that the following entry was processed: debit stationery asset R1 000 and credit bank R1 000. Now, does this mean that by the 31st of December, assuming that this is the year end, the business will have R1 000 stationery available to use, in other words, still have an asset in R1 000? No.

What if the following entry was processed: debit stationery expense R1 000, credit bank R1 000. Now, do you think that this means by the 31st of December, remember our financial year end, that the business would have used the R1 000 stationery, in other words, will definitely have an expense of R1 000? No. The recording shows how much stationery was purchased. To determine how much stationery is on-hand, the asset, and how much stationery has been used, the expense, the business will need to do a stock count. It is only when the financial information is reported that the business actually determines what portion of the stationery is recognised as an asset and what is recognised as an expense.

So, which option was correct: debiting stationery "asset" or debiting stationery "expense", the equity account? Well, both are completely acceptable ways to record the information. Regardless of whether we use an account called stationery asset or stationery expense, the record keeping shows that R1 000 stationery was purchased. Now, assume at the reporting date the business does a stock count and stationery of R300 is unused. At this point, the business needs to update the records so that the correct assets and correct expenses can be reported.

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If the purchase of stationery was recorded in an account called stationery asset, the stationery asset account needs to be reduced by R700 and the business needs to recognise an expense of R700. The R300 unused stationery, remember, R1 000 less the R700, is recognised as an asset. The R700 stationery used is recognised as an expense. If the purchase of stationery was recorded in an account called stationery expense, the stationery expense account needs to be reduced by R300. Remember, the R300 is unused and an asset of R300 needs to be recognised. The R300 unused stationery is recognised as an asset, the R700, R1 000 less the R300, stationery that was used is recognised as an expense.

So, the recording process keeps track of the day-to-day transactions that happen in the business whereas the reporting process allows the business to correctly report on the assets, equity and liability accounts at the correct amount that the business should recognise when preparing the financial reports. Now, remember that these videos are not meant to replace your lectures, nor are they meant to replace your own self-study using a textbook. We do encourage you to make sure that you have read the chapter on recording from whichever textbook you happen to be using. We hope you have enjoyed the video and we encourage you to keep finding those that are going to help you understand key concepts that you might be finding difficult.

Thanks for watching.