# CORPORATE FINANCIAL REPORTING

## INTRODUCTION

An understanding of the conceptual bases of the corporate financing reporting system and of the preparation of financial statement is essential prerequisites to be a good accountant or a financial analyst. Financial reporting is the communication of financial information of an enterprise to the external world. Measurement and disclosure are two dimensions of reporting process and these two aspects are interrelated. Publication of unaudited financial results, news releases, management forecasts and description of future plans are examples of reports that are provided outside the general purpose financial statements.

## USERS

According to 'ICAI Conceptual Framework' the users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. The ICAI Conceptual Framework states that the provision of financial statements, which meet the investors' needs, will also meet most of the needs of other users. Also in practice, top priority is given to the information needs of the investors while deciding what items of information should be disclosed in general purpose financial statements.

## OBJECTIVES

The objective of financial statements is to provide information about financial position, performance and cash flows of an enterprise that is useful to a wide range of users in making economic decisions. The competition among the companies to obtain external financing at a relatively cheaper rate has impact on corporate disclosure. Voluntary reporting of employee information, environmental information and other corporate social responsibility reports (e.g. social balance sheet) are example of disclosure arising from non-financial influences.

Apart from investment decision making another objective of financial reporting is to provide information on management accountability. The accountability relationship may be created by a constitution, a law, a contract an organization make, a custom or even by informal moral obligation.

Modern concept of accountability of management extends beyond the element of stewardship and covers performance based issues. Apart from accountability to shareholders, there is a growing worldwide trend of holding companies accountable to the public at large.

## QUALITATIVE CHARACTERISTICS

ICAI Conceptual Framework earmarks four principal qualitative characteristics viz., understandability relevance, reliability and comparability. Materiality is considered as a threshold limit, which needs to be judged before referring to any other qualities of any information provided in financial statements.

**Understandability**

Information in annual reports should be presented in such a way that it is readily understandable by users. ICAI Conceptual Framework states that the criterion of understandability requires that the users have a reasonable knowledge of business and economic activities, accounting, and a willingness to study the information with reasonable diligence.

**Relevance**

All those items of information, which may aid the users in making predictions or decisions, should be reported. Information, which does not assist users in decision making, is irrelevant, and hence, should be omitted. *Timeliness* is an important aspect of relevance. As time passes and the future becomes the present, past information became increasingly irrelevant.

**Reliability**

Reliability encompasses *representational faithfulness*, *verifiability* and *neutrality*. Unfortunately, relevance and reliability are likely to be opposing qualities. For example, the audit process increases the reliability of financial data, but timeliness and consequently, relevance is worsened. Some forecast data, like expected growth in sales during the next three years is less reliable than historical figures of sales. In such a case, the management should maintain a balance between these two qualitative characteristics.

**Comparability**

The primary objective of comparability should be to facilitate the making of predictions and financial decisions by creditors, investors and others. The important implication of comparability is that users should be informed of the accounting policies employed in the preparation of financial statements, any changes of those policies and the effects of such changes. For achieving comparability, paragraph 40 of the Framework suggests compliance with relevant accounting standards including the disclosure of accounting policies used by the enterprise.

**Disclosure**

Disclosure in financial reporting is the presentation of information necessary for optimum operation of efficient capital markets. In a broader sense, disclosure is the communication of both financial and non-financial information for making decisions by external users. Competition for capital is the major motivating force to disclose decision oriented information to different user groups. Corporations not only compete among each other in the capital markets but also attempt to obtain capital at a lower cost. Apart from stock market considerations some important considerations are viz. political costs consideration, users' needs consideration, and ideological goal consideration.

**Political costs consideration:** Fines, penalties, potential public hostility toward the company are the examples of political costs.

**Users' needs consideration:** Companies may disclose social information to meet the stakeholders' demand for such information depends on the users' needs.

**Ideological goal consideration:** Such disclosure would be guided by companies' agenda, ideologies and goals which are likely to be different for different companies even within the same industry.

In disclosing information, business enterprises, particularly corporate entities, are confronted with certain basic problems, the solutions of which requires identification, purposes and deciding about the mode and timing of disclosure. From regulator's standpoints, leaving the decision about disclosure in the hand corporate management or market forces, has not been viewed favourably.

Thus, the scope of negative sanctions of regulatory controls over corporate disclosure increases when users groups perceive that there are deficiencies on the part of companies in providing adequate disclosure.

## ROLE OF AUDITORS

Management is responsible for the preparation of financial statement including the notes. The auditor is responsible for seeing that the financial statements issued conform with generally accepted accounting principles. Thus, the auditor must agree that accounting policies adopted by the management is appropriate and all estimates are reasonable. Because of boilerplate nature of these reports, there is tendency to skip over them while analyzing financial statements. However, such failure to give attention to the auditor's report may cause the user to miss significant information.

## QUALITY

Regulations on financial reporting generally provides for penalties and other measures to deter accounting frauds. Manipulations mainly relate to management of bottom-line (profit or loss) and commonly referred to an earnings management.

## MODE

Annual report, interim report, employee report, environmental report, communications with analysts, letters to shareholders and debt holders, question and answer sessions held at annual general meeting, telephone conversations, speeches made by company officials at stock exchanges and so on. The annual report is regarded as the most important source of information about a company's affairs. Many companies in India now include Management Discussion and Analysis (MD & A) report, corporate governance report, chairman's statement, historical summary, operating positions, highlights of important data etc.

## INDIAN FINANCIAL REPORTING SYSTEM

Apart from professional regulation, corporate financial reporting in India is governed primarily by one central Act i.e., the Companies Act, 1956. SEBI requirements are to be followed by the companies listed in the Indian stock exchanges.