CHAPTER-II
FINANCIAL REPORTING: PAST AND PRESENT
PERSPECTIVES

Introduction:

This chapter discusses the historical development of accounting and reporting practices in different countries. A historical perspective of the evolution of accounting and reporting may help us better understand the present situation of disclosure practices. By identifying the objectives that led to the development of accounting practices and by examining how these objectives were recommended at different point of time, it would be fair to evaluate the effectiveness or otherwise of the present disclosure practices.

For the purpose of the present study, the history of accounting since Luca Pacioli era, developments on financial reporting objectives in USA, UK and in India is considered. The emergence of International Accounting Standards is also dealt with briefly. The objective laid down by AICPA is taken because it is the first country, which made an attempt to define the objectives of financial statements and reporting. The British history is considered important because of the large number of similarities between the British and Indian Institutions, which deal with financial reporting regulation. The accounting profession in India is modeled after the British accounting profession. Similarly, the Companies Act 1956 is largely based on the British Companies Act. It is hoped that the experience of these countries in accounting and reporting practices would give us some valuable lesson for disclosure practices.

In the background of the developments of accounting in USA, UK and other countries, the second major part of this chapter discusses the financial disclosure practices in the world. It also throws light on disclosure practices in developed countries and underdeveloped countries and emerging issues in corporate accounting and reporting.
Evolutionary Process of Accounting:

Accounting appears to have been practiced since the beginning of recorded history. Business transactions and land sales were recorded by about 3000 B.C. Introduction of money as a medium of exchange provided the necessary impetus for the development of modern accounting. The Chinese were the originators of this practice. Sophisticated forms of government accounting existed in China as early as 2000 B.C. Banking and other commercial activities led to the maintenance of accounts in ancient Greece. Romans kept their accounts on wax tablet, which perished with the fall of Roman Civilization (700 BC to 400 BC). The economic development of middle ages helped in the development of accounting. It is believed that the banks evolved the idea of double entry during 1300 A.D. The first professional organization of accountants was founded in Venice in 1581.

Luca Pacioli is considered the father of modern accounting because his "Method of Venice" became the model for subsequent textbooks during a period of over 200 years. In 1494 he published his Summa, which contained two chapters describing double entry bookkeeping. Latter, Arthur Cayley, Professor of mathematics at Cambridge University in England wrote a book “The Principles of Double Entry Book keeping”.

The period between 1494 and 1775 is regarded as the age of stagnation of accounting. The world changed very little during this period of about 300 years. There was particularly no economic development. The owner of the business was expected to keep accounts for his own use. We, therefore, do not find the preparation of financial statements and their audit and there was no progress in accounting practice and ideas.

Accounting Knowledge has grown much over the period of about 200 years from 1775-2000. Business firms, being mostly proprietary owners, laid greater emphasis on balance sheet during this period, as the owner was more interested in knowing his capital (Assets-Liabilities). Assets were valued at
current value and balance sheet was prepared in order to measure the changes in the proprietary interest or wealth or net worth.

During 1850-1900, more and more corporations came up and the ownership concept shifted from proprietary ownership to shareholder ownership. A company was regarded as a separate entity resulting in the development of separate entity postulate. The owners of capital were interested in getting return on their investments in a company. This resulted in the development of "accounting concept of income" and the "Periodicity postulate". A company was regarded as going concern, and on this postulate, the fixed assets were valued at original cost less depreciation.

Since the ownership was divested from management, it becomes necessary to get the annual accounts audited by independent outside agencies. This led to the evolution of financial auditing. The basic accounting principles developed during this period.

The revenue principle, the cost principle and matching principle began to be applied in the construction of income statements. In order to be sure of the authenticity of financial accounts, principle of verifiability was applied.

The concept of "Stewardship Accounting" (reporting by management to absentee owners), which came into existence around 1915, did not remain all that significant around 1950. As large-scale businesses became more complex, new techniques of analysis were evolved to face competition. Cost accounting and management accounting developed during this period. Financial statements were no longer regarded as indicators of past business operations and past financial position. Decision usefulness orientation was given to accounting by the end of this period.

Accounting developed into a full-fledged information system during 1950 onwards. It was no longer regarded as a science like other social sciences. Many new theoretical concepts were listed and put to practice. Various accounting
boards and committees were set up to issue statements of concepts standards in many countries. International accounting was developed to harmonize accounting techniques and practices in member countries.

**Concept of Financial Reporting:**

Financial reporting is considered as communication of financial statements and information from a business enterprise to third parties (external users) including shareholders, creditors, customers, Governmental Authorities and the public. Management may communicate information to those outside, an enterprise by means of financial reporting other than formal financial statements either because the information is required to be disclosed by authoritative pronouncement, regulatory rule, or custom, or because management considers it useful to those outside the enterprise and discloses it voluntarily. Information communicated by means of financial reporting other than financial statements may take various forms and relate to various matters. Management forecasts, descriptions of an enterprise’s social or environmental impact, Chairman’s statements are examples of reports giving financial information other than financial statements or giving non-financial information.

**Objectives of Financial Reporting:**

Financial reporting is not an end itself but it is a means to certain objectives. The following are the primary objectives of financial reporting:

(a) **Investment Decision-Making**:

The basic objective of financial reporting is to provide information useful to investors, creditors and other users in making sound investment decisions.

(b) **Management Accountability**:

A second basic objective of financial reporting is to provide information on management accountability to judge management’s effectiveness in utilizing the resources and running the enterprise. Management accountability is of very great interest not only to existing shareholders and other users but also to potential shareholders, creditors and users.
Developments on Financial Reporting Objectives:

Financial reporting objectives have been recognized as very important in the accounting area since a long time. Many accounting bodies and professional institutes all over the world have made attempts to define the objectives of financial statements and financial reporting. This section describes developments in this area at the international level.

To develop objectives of financial statements, a Study Group was appointed in 1971 by the American Institute of Certified Accountants (AICPA) under the Chairmanship of Robert M. Trueblood. The report of this group, called the Trueblood Report, was published in October 1973. The main objective is stated as,

"The basic objective of financial statements is to provide information useful for making economic decisions".

The Other objectives of Financial Statements are:

- To serve primarily those users who have limited authority, ability or resources to obtain information and who rely on financial statements as their principal source of information about an enterprise's economic activity.
- To provide information useful to investors and creditors for predicting, comparing and evaluating potential cash flows to them in terms of amount, time and related uncertainty.
- To provide users with information for predicting, comparing and evaluating enterprise earning power.
- To supply information useful in judging management's ability to utilize enterprise resources effectively in achieving the primary enterprise goal.
- To provide factual and interpretive information about transactions and other events, which is useful for predicting, comparing and evaluating enterprise earning power. Basic underlying assumptions with respect to matters subject to interpretation, evaluation, prediction or estimation should be disclosed.
• To provide a statement of financial position useful for predicting, comparing and evaluating enterprise earning power. This statement should provide information concerning enterprise transactions and other events that are part of incomplete earnings cycles. Current values should also be reported when they differ significantly from historical cost. Assets and liabilities should be grouped or segregated by the relative uncertainty of the amount and timing of prospective realization of liquidation.

• To provide a statement of periodic earning useful for predicting and evaluating enterprise earning power. The net result of completed earnings cycles and enterprise activities resulting to recognizable progress toward completion of incomplete cycles should be reported.

• To provide a statement of financial activities useful for predicting, comparing and evaluating enterprise earning power. This statement should report mainly on factual aspects of enterprise transactions, having or significant to have cash consequences.

• To provide information useful for the predictive process. Financial forecasts should be provided when they will enhance the reliability of users' predictions.

• To provide information useful for evaluating the effectiveness of the management of resources in achieving the organization's goals. Performance measures should be qualified in terms of identified goals.

• To report on those activities of the enterprise effecting society, which can be determined and described or measured, and which are important to the role of the enterprise in its social environment.

The Trueblood Report also presented seven qualitative characteristics that the financial statement information should possess in order to satisfy user needs.

- Relevance and materiality.
- Substance rather than form.
- Reliability.
- Freedom from bias.
- Comparability.
- Consistency.
- Understandability.
The FASB laid down the following objectives in November 1978 after considering the Trueblood Committee Report.

- Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions. The information should be comprehensible to those who have reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.
- Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption or maturity of securities or loans.
- Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources and the effects of transactions, events and circumstances that change resources and claims to those resources.
- Financial reporting should provide information about an enterprise's financial performance during a period.
- The primary focus of financial reporting is information about an enterprise's performance provided by measures of earnings and its components.
- Financial reporting should provide information about an enterprise obtains and spends cash, about its capital transactions including cash dividends and other distributions of enterprise resources to owners and about other factors that may affect an enterprise's liquidity or solvency.
- Financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stakeholders) for the use of enterprise resources entrusted to it.
- Financial reporting should provide information that is useful to managers and directors in making decisions in the interest of owners.
The FASB emphasized the use of financial reporting for different classes of users and not for the creditors and the investors only. It considered cash flows important for assessing and evaluating all accounting information.

The Accounting Standards Steering Committee (ASSC) of the Institute of Chartered Accountants in England and Wales (ICAEW) published the corporate report as a discussion paper to review the list of users, purposes and methods of modern financial reporting in the United Kingdom.

The basic philosophy of the report was that financial statement should be appropriate to their expected use by the potential users i.e. they should attempt to satisfy the informational needs of their users. To satisfy the fundamental objectives of annual reports, seven desirable characteristics of a corporate report were cited viz. relevance, understandability, reliability, completeness, objectivity, timeliness and comparability.

It suggested the need for the following additional statements.

- A statement of value added to show how the wealth was produced and it has been distributed among employees, the state, the providers of capital and its investment for maintenance and expansion.
- An employee report dealing with size and composition of work force, efficiency, productivity, industrial relations, benefits earned, personal policies etc.
- A statement of money exchanges with government showing sales tax, corporation tax, rates, royalties and other taxes paid to government i.e. financial relationship between the enterprise and the State.
- A statement of transactions in foreign currency showing overseas borrowings and repayment. Dividend received and paid by the government to other countries.
- A statement of future prospects showing forecasts of profits, employment and investment.
- A statement of corporate objectives showing management policy and strategies.
The report draws attention to the concept of "Social Accounting" and makes an attempt to move in that direction.

A report on "Corporate Reporting, its Future Evolution" written by the Edward Stamp, was published in June 1980 by the Canadian Institute of Chartered Accountants (CICA). The report states the following objectives.

- One of the primary objectives of published corporate financial reports is to provide an accounting by management to both equity and debt investors, not only a management’s exercise of its stewardship function but also of its success or otherwise in achieving the goal of producing a satisfactory economic performance by the enterprise and maintaining it in a strong and healthy financial position.

- It is an objective of good financial reporting to provide such information in such a form as to minimize uncertainty about the validity of the information, and to enable the user to make his assessment of the risks associated with enterprise.

- It is therefore necessary that the standards governing financial reporting should have ample scope for innovation and evolution as improvements become feasible.

- The objective of financial reporting should be taken to be directed toward the needs of users who are capable of comprehending a complete set of financial statements or alternatively to the needs of experts who will be called on by the unsophisticated users to advise them.

The IASC in its framework for the preparation and presentation of financial statements issued in 1989 has stated the objectives of financial statements in the following words.

The objective of financial statements "Is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions."

The Accounting Standards Board (ASB), UK:

The ASB issued a report -Statement of Principles, in July 1991 setting out the objectives of financial statements and qualitative characteristics. The objective stated by ASB in the statement of principles, is as given below;
The objective of financial statements is to provide information about the financial position, performance and financial acceptability of an enterprise that is useful to a wide range of users in making economic decisions.

The qualitative characteristics that are stated by FASB are as follows,

- **Understandability:** It is the quality of the information that permits reasonably informed users to perceive its significance, i.e. to understand the content and significance of financial statements and reports.

- **Relevance:** The capacity of information to make a difference in a decision by helping users to make predictions about the outcome to past, present and future events or to confirm or correct prior expectations.

- **Predictive Value:** The quality of information that helps users to increase the likelihood of correctly forecasting the outcome of past or present events.

- **Feedback Value:** The quality of information that enables users to confirm or correct prior expectations.

- **Timeliness:** Having information available to decision maker before it loses its capacity to influence decisions.

- **Reliability:** Information is reliable if it is free from errors and bias, and faithfully represents what it purports to represent.

- **Verifiability:** The ability through consensus among measurers to ensure that information represent what it purports to represent or that the chosen method of measurement has been used without error or bias.

- **Neutrality:** It is absence in reported information of bias intended to attain a predetermined result or to induce a particular mode of behavior. The information should not favor one set of interests over others.

- **Comparability:** The quality of information that enables users to identify similarities in and differences between two sets of economic phenomena.

- **Consistency:** Conformity from period to period with unchanging policies and procedures.
The Accounting Standards Board in India issued a framework for the preparation and presentation of financial statements in July 2000. It is practically on similar lines to that of the IASC.

The main purposes of the framework are to assist the ASB in the development of future accounting standards and in its review of the existing accounting standards and in promoting the harmonization of regulations, accounting standards and procedures relating to the number of alternatives accounting treatments permitted by the accounting standards.

The other purposes are to assist the preparers of financial statements in applying accounting standards, to assist auditors in forming an opinion as to whether financial statements conform with accounting standards and to assist users of financial statements in interpreting the information contained in financial statements prepared in conformity with accounting standards. The framework is applicable to all commercial, industrial and business reporting enterprises, whether in the public or the private sector.

In conclusion, according to various Accounting Bodies and Institutions, the main aim of the financial statements is to provide reliable information about economic resources and obligations of business enterprises to various direct and indirect users for the purpose of their analysis and decision-making.

Financial Disclosure Practices:

Disclosure can be defined as a process through which a business enterprise communicates financial affairs to the external parties. It is nothing but the communication of financial information of the activities of the undertaking to the interested parties for facilitating their economic decisions. It is reporting of accounting information of an entity to a user or group of users. It is a system of communication between the management and user groups. The users of accounting information can broadly classified into two groups.
They are:

- Direct Interest Users: This group includes owners, creditors, suppliers, management, taxing authorities, employees and consumers.
- Indirect Interest Users: This group includes financial analysts, stock exchanges, lawyers, regulators and registration authorities, financial press and reporting agencies and trade associations and labor unions. The persons or agencies in this category protect or assist persons/potential persons having a direct interest in them.

The corporate reports are disclosed through company annual reports. This is a periodical statement, which is issued at the end of each accounting period. The periodical statements are prepared on the basis of Generally Accepted Accounting Principles (GAAPs). The annual report usually consists of accounting information and non-accounting information. This can be pictured in the following manner:

![Chart]

Source: Designed in the light of existing literature.
Accounting information are quantitative, formal, structural, numerical, audited, past-oriented materials. On the other hand, non-accounting information is qualitative, narrative, unaudited and future oriented. Both have an impact on the investors' behavior.

In underdeveloped countries, companies only disclose the balance sheet, profit and loss account, auditor’s report, and a few schedules as appendices. In developed countries, besides the above, a statement of changes in financial position, a president’s letter; a five year or ten year summary highlighting, additional financial information, such as turnover, capital investment, profit, dividend, important ratios, and the company’s view about its future plans and prospects are also published.

Further in countries where the social environment dominates besides the economic one, information on value added, employees, customers, government, foreign exchange etc is also given in annual reports. Hence it is very difficult to prescribe the same financial statements to all countries.

However, the following information is commonly provided to users of all categories in all countries.

- Traditional financial statements, namely balance sheet, income statement, the statement of retained earnings, statement of cash flow, chairman speech, directors’ report, auditor’s report, usually included in the published annual reports of all listed companies.
- Disclosure of accounting policies on methods of valuation, methods of changing depreciation, determination of earnings etc.
- Events occurring after the balance sheet date.
- Interim reports of the company to show performance and financial position.
- Accounting for foreign transactions.
- Future prospects of the company.
- Supplementary information on accounting adjustments for changes in prices.
The method of disclosure of information has evolved as a result of the changing environment and consequential improvement in the ways of presentation on the recommendations of professional institutes, and as a result of government measures. Still, there are no hard and fast methods of presentation. They differ from country to country, even from a company to company in the same country.

The balance sheet and income statement and statement of cash flow are the formal financial statements. In many countries, these statements are prepared to meet the requirements of law. The form and content of the balance sheet and income statement are prepared and presented in the traditional manner in strict adherence to law.

- **Balance sheet**: It is meant to reveal the financial position of concern on a particular day. The Balance sheet is prepared and shown in many countries in the following manner.

- **Income Statement**: It is traditionally called as the Trading and Profit and Loss Account. It contains two parts. Part I deals with trading account, which shows gross profit and Part II is the Profit and loss account. For the preparation of Income statements, two methods are commonly used. Many countries in the world following Single-step statement, which shows all items of expense without any classification with all items of revenues.

But, more than half of the companies in USA and few other countries are following multi-step method.

The multi-step format is as follows:
### Multi-Step Format of Balance Sheet

<table>
<thead>
<tr>
<th>Liabilities:</th>
<th>Amount Rs.</th>
<th>Amount Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Insiders' Equity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equity Share Capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reserves and free Surplus</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retained Earnings</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Preferred Share Capital</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Outsiders' Equity:                  |            |            |
| Bonds (Debentures)                  |            |            |
| Long term loan                      |            |            |
| Total capital employed              |            |            |
| **Total**                           |            |            |

| Assets:                             |            |            |
| Non current assets;                 |            |            |
| Land                                |            |            |
| Property, Plant and equipment       |            |            |
| Others                              |            |            |

| Current Assets:                     |            |            |
| Inventory                           |            |            |
| Receivables                         |            |            |
| Short term securities               |            |            |
| Others                              |            |            |
| Cash and Bank                       |            |            |

| **Total (a)**                       |            |            |

| Less Current Liabilities:           |            |            |
| Bank loan and overdrafts            |            |            |
| Payables                            |            |            |
| Other Current Liabilities           |            |            |
| **Total (b)**                       |            |            |

| Working Capital (a-b)               |            |            |

| **Total**                           |            |            |

## Multi-Step Format of Income Statement

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount Rs.</th>
<th>Amount Rs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales revenue net</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Cost of goods sold;</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beginning inventory</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Add: Purchases, net</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of goods available for sale</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less: Ending inventory</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Gross Profit</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Selling and distribution expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Administration and general expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finance expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from operations</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>± Other income/expenses:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from continuing operations before tax</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less income tax</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income from continuing operations</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>± Discontinued operations:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income loss from operations of segment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gain/loss on disposal of assets of segment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>± Extraordinary items</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Earnings (net income/profit)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>± Cumulative effect of change in Accounting principle</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>± Other non-owner changes in Equity</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Comprehensive Income</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

With the rapid changes in the economic and industrial scenario, the role of accounting has been changed over period of time. Accounting activity is no longer confined to the historical description of financial activities; rather it is now being regarded as a service activity, i.e. providing information to various user groups. In previous years, maximization of profit was regarded as the proper objective of the firm, now it is universally agreed that real objective of financial management is neither the maximization of profits nor the maximization of earnings per share. Rather it is to promote maximum operational efficiency. As such, several types of accounting and methodologies have been devised to cope with the changing needs of the modern times. The important types of accounting and reporting practices are:

- Social Responsibility Accounting
- Value Added Statement
- Human Resource Accounting
- Inflation Accounting
- Environmental Accounting etc.

Social Accounting:

A business enterprise is a social unit. It uses the society resource and produces goods and services for which the society is the ultimate consumer. The society provides the infrastructure and facilities without which a business unit cannot function at all. Thus, a business organization owes its very existence and survival to the society. It is, therefore, necessary that a business unit should operate within the overall parameters determined by society. Business should strive to secure the interest of the society by making available quality and harmless products, keeping the environment free of pollution by recycling waste and making proper arrangements for proper disposal of waste. It also should provide welfare and security to its employees. Business must not only report its shareholders but also to the society as to the steps it has taken in terms of its obligations to the community at large.
Concept of Social Accounting:

The concept of social accounting gained prominence and momentum as a result of high level of industrialization that has necessitated the corporate sector to invest substantial amount in social activities with the sole aim of nullifying the consequences of industrialization like pollution, environmental and ecological imbalances etc.

Ramnathan defines Social accounting, as “The process of selecting the firm level social performance variables, measures and measurement procedures systematically developing information useful for evaluating firms social performance and communicating such information to concerned social group both within and outside the firm”

Ralph Estes defines Social Accounting as “the measurement and reporting, internal or external of information concerning the impact of an entity and its activities on society.”

Thus, social accounting is the reporting of the cost incurred in complying with anti-pollution safety, health and other societal beneficial requirements and more generally, the impact of business entity on its endeavors to protect society, its amenities and the environment.

Objectives of Social Accounting:

The primary objective of accounting is to provide true and fair financial information useful to investors, creditors and public for making economic decisions. It also aims to measure and evaluate the social costs and benefits offered to the employees and to the society.

The important objectives of reporting of social information are as follows:

1. Positive Image Motive:

For the purpose of creating positive image several firms report social information. The management of the enterprise would like the consumers and society to perceive the firm as ‘Responsible Citizen’.
2. To Meet Informational Needs of Consumer and Society:

With increasing social awareness, several public interest groups are closely watching the activities of corporations. Consumers are counteracting about the quality of the products. In these situations it is the primary responsibility of corporations to provide social activity information to the interested parties.

3. To Meet Mandatory Disclosure Requirements:

With the increasing social concern with regard to environmental pollution, quality of products, safety measures at workplace, health care programs and many other social care programs, mandatory disclosure requirements for corporate social activities are being established in several countries. It is the obligation of corporate undertakings to prepare and present the social accounting to the regulatory agencies as per their requirements.

Formats:

Over a period of time various formats have developed for the purpose of social accounting. They are:

1. Narrative Disclosure:

This is given by way of footnotes to financial statements of information concerning environmental problems and efforts. This will include identification of environment problems, abetment, goals of the organization, progress of the organization and disclosure of the material environmental effects on financial position, earnings and business activities of the organization.

2. Integral Welfare Theoretical Approach:

This approach deals with all social activities, which are expected to be undertaken by business enterprises. It involves the preparation of a social report comprising social benefits and social costs. Social costs include labour, material fixed asset and capital costs and social benefits are provided in the form of qualitative products, safety of products, rational prices and regular supply of products.
3. **Social Indicator Approach:**

This approach is very comprehensive one. It involves different areas of social contribution expected to be undertaken by business corporations. This approach includes 5 social indicators such as i) net income contribution ii) human resource contribution iii) public contribution, iv) environmental contribution and v) product or service contribution.

4. **Social Income Statement and Balance Sheet Approach:**

The social income statement provides monetary quantification for the firm's social benefits. These benefits are defined as resources generated by the company operations having positive impact or increasing the society’s resources. The social costs are resources used in the company operation at a “Cost Sacrifice”. The net social income is a social gain or loss to the society’s resources due to the firm’s operations.

The balance sheet part of social accounting contains information on social assets and social liabilities.

5. **Operating Statement Approach:**

In this approach the firm presents both the positive and negative aspects of its social activities. The positive activities are broadly expressed as social benefits and negative activities as social costs and the difference of two aspects is termed as social contribution.

6. **Goal Oriented Social Reporting Approach:**

It is based on the recognition of the fact that companies usually have elaborate goals and purposes describing the economic and social objective, which they have set for themselves. It involves two aspects;

1. The selection of social goals
2. The reporting and assessment of company’s performance according to those goals.
The countries like USA, Germany, Britain, France, Netherlands are strictly following the social accounting concept as mandatory requirements. But in our country, there is no legal obligations on companies to provide information on social costs and social benefits in their annual reports.

Social Accounting in India:

The Companies Act, 1956 deals with the preparation of Balance sheet and profit and loss account. Although this act has been amended from time to time, no specific provision has been made requiring companies to provide social responsibility disclosures in their annual report.

The Sachar Committee Report recommended that the companies should disclose the steps taken by them in various spheres with a view to discharging the social responsibilities towards different segments of the society, quantifying wherever possible and in monetary terms in their Director’s Report. It was made effective from 1.4.1989 by Companies’ Amendment Act. 1988. The directors are required to report regarding conservation of energy, technology absorption, foreign exchange earnings and outgo. For conservation of energy Form A is prescribed for some industries. Accordingly they are required to give details regarding electricity purchased and generated. The consumption of coal and furnace oil is also required to be given in addition to this. And with reference to the technology absorption the companies are supposed to supply the details regarding Research and Development activities and efforts put up for technology absorption.

Human Resource Accounting:

Organization is a group of people working together to achieve some common goals, under a structured system of hierarchy and procedures. Human resources are the most vital resources of any organization. The conventional system of accounting takes care of any changes taking place in the areas of assets and liabilities. However, it is not equipped with methods and orientation to the
changes in human resources. HRA develops useful management information systems in which costs and benefits on investments on human resources are given special attention.

The American Accounting Associations Committee (AAAC) on HRA defined HRA, as “HRA is the process of identifying and measuring data about human resources and communicating this information to interested parties”. 4

And Eric Flamholtz explained HRA, as accounting for people as organizational resources it is the measurement of the cost and value of people for the organization.

**Objectives of HRA:**

The objective of HRA is not just the recognition of the value of all resources used or controlled by a firm but it also includes the improvement of the management of human resources so that the quantity and quality of goods and services are increased. The basic objective underlying human resource accounting is to facilitate the effective and efficient management of human resources.

**Measurement of Human Resources:**

Human Resource Accounting has focused on two basic issues:

1. How human resource assets should be valued i.e. should historical cost or replacement value or present value methods be used?

2. The implications of capitalized human resources once they are recorded, i.e. how should human resources be amortized? What are the tax implications of human resource amortization? What are the implications of human resource accounting on internal and external auditing.

Once it is accepted that human resources are an asset the question of measuring the cost of this asset arises. The monetary approaches to measurement of human assets are broadly based either upon cost or economic value.
Approaches:

Over a period of time the following approaches have been developed in the field of HRA.

- **The Historical Cost Approach:**

  In this approach the actual cost of recruiting, selecting, hiring, training, placing and developing the employees of an organization are capitalized and amortized, over the expected useful life of the asset concerned. If the asset is liquidated permanently, losses are recorded and if an asset has a longer life than estimated, revisions are made in the amortization schedule.

- **The Replacement Cost Approach:**

  Value to an Organization of an individual's services is reflected by the amount that the organization would have to pay to replace these services. This method consists of estimating the cost of replacing a firm's existing human resources.

  These costs will include the costs of recruiting, selecting, hiring training placing and development new employees to reach the level of compliance of the existing employees.

  This approach incorporates the current value of the company's human resources. It takes into account the fluctuations of the job market and the general rise in price level.

- **The Opportunity Cost Approach:**

  This approach values human resources on the basis of the economic concept of opportunity cost. Hekimian and Jones proposed this method to overcome the limitations of the replacement cost method. The human resources values are measured through a competitive bidding process within the firm, based on the concept of opportunity cost.
Under this method, "the investment centre managers will bid for the scarce employees they need to recruit. These 'scarce' employees come from within the firm and include only those who are the subject of recruitment request made by an investment centre manager. In other words, employees are not considered 'scarce' are not included in the human asset base of the organization.

- **Lev and Schwartz Present Value of Future Earning Model:**

  This model is also known as the compensation model. Lev and Schwartz suggested the use of an individual employee's future compensation as a surrogate of his value.

  According to them, "the value of human capital embodied in a person of age x is the present value of his remaining earnings from employment.

  The formula used

  \[ V_x = \sum_{t=x}^{T} \frac{I(t)}{(1+r)^{t-x}} \]

  - \( V_x \) = the human capital value of a person x yrs old
  - \( I(t) \) = the person's annual earnings upto retirement.
  - \( r \) = a discount rate specific to the person
  - \( T \) = retirement age

- **Hermanson's Adjusted Discount Future Wages Model:**

  This model is based on the assumption that a relationship exists between a person's salary and his value to the organization. This is another model using compensation as a surrogate measure of a person's value to the firm.

  Compensation means the present value of the future stream of wages or salaries to persons employed is adjusted by an efficiency ratio, which is the weighted average of the ratio of the return on investment of the given firm to all the firms in the economy for a specified period, usually the current year and the preceding four years. The weights are assigned in a reverse order highest to the current year i.e. 5 and 1 to preceding fourth year.
The formula used is:

\[
\text{Efficiency Ratio} = \frac{5 \cdot RF(0)}{RE(0)} + \frac{4 \cdot RF(1)}{RE(1)} + \frac{3 \cdot RF(2)}{RE(2)} + \frac{2 \cdot RF(3)}{RE(3)} + \frac{RF(4)}{RE(4)}
\]

Where:

\(RF(0)\) = The rate of accounting income on owned assets for the firm for the current year.

\(RE(0)\) = The rate of accounting income on owned assets for all the firms in the economy for the current year.

\(RF(4)\) = The rate of accounting income on owned assets for the firm for the fourth previous year, and

\(RE(4)\) = The rate of accounting income on owned assets for all the firms in the economy for the fourth previous year.

The efficiency ratio measures the rate of effectiveness of the human resources operating in the given entity over a five-year period. A ratio greater than one implies that the rate of return of the rate is above the average rate of return for all firms in the economy.

- **Stochastic Rewards Valuation Model:**

  The Flamholtz’ Stochastic rewards valuation model identifies the major variables which determine the value of an individual to the organization. The model advocates that a person generates value for an organization as he occupies and plays different roles and renders services to the organization. The movement of people from one organizational role to another is stochastic process. As people move and occupy different organizational roles they render services to the organization. Based on the above concept, a person’s expected realizable value to the organization can be measured as the discounted
mathematical expectation of the monetary worth of the future rewards a person is expected to render to the organization in future roles he is expected to occupy, taking into consideration the probability of his remaining in the organization. The model suggested by Flamholtz is most scientific model as it provides a future oriented economic value of human assets. However, its practical use is very difficult as the collection of reliable data regarding the value of a service state, a person's expected tenure, and the probabilities of occupying various service states at specific times is not an easy job.

- **Jaggi and Lau Model**:

  The model suggested by Jaggi and Lau is based on valuation of groups rather than individuals. A group implies homogeneous employees who may or may not belong to the same department or division. It might be difficult to predict an individual's expected service tenure in the organization or at a particular level or position, but on a group basis it is easier to ascertain the percentage of people in a particular group likely either to leave the firm during each of the forthcoming period, or to be promoted to higher levels.

  In order to consider the role movements of employee's within the organization a Marker Chain representation can be used. The model requires the determination of Rank Transitional Matrix and the expected quantities of services for each rank of service. The matrix can be prepared from the historical personal records of the employees available in the organization. For the purpose of measurement of quantities of services, certain service or performance criterion is used. The value of the services an organizations' current employee render in a future period is computed by multiplying the estimated number of current employees that will be in each service state in that period, by the value of the services an employee in each state renders to the organization.
The equation for computation of value of human resources of an organization is as follows.

\[ T_v = (N) r^n (T)^n (V) \]

- **Tv** = The current value of all current employees in each rank.
- **N** = Number of employees in each rank
- **r** = Discount rate
- **n** = Time period
- **T** = Probability that an employee will be in each rank within organization.
- **V** = Economic value of an employee of rank during each period.

The usefulness of HRA model in the process of HRD would depend upon how best it meets certain basic requirements. These requirements are,

1. The model should identify the factors, which determine the value of human resources.
2. The model should identify the factors, which can improve the value of human resources.
3. It should be capable of measuring the value of human resources operationally. A model can be made operational only if the data, which it requires, can be made available.
4. The information generated by the model should help users to make decisions relating to the process of human resource development.

Thus, various models, have been suggested by many experts, but there is not even a single model which fulfills all the requirements of a model which could help in the process of HRD.

**Human Resource Accounting in India:**

Though the ASB of ICAI has brought out accounting standards on most of the important areas in accounting and has ensured their implementation by making accounting standards mandatory, it has not made any effort to bring any definite accounting standard on measurement and reporting of human resources cost and value.
**Inflation Accounting:**

Inflation is condition of overall rising prices. Inflation may be defined as a decline in the purchasing power of money due to an increase in money supply and rise in price level. Inflation Accounting attempts to reflect and mitigate the impact of rising price level on the operating results and financial position of a firm through various adjustments or reforms in the accounting process. Inflation accounting is the system of accounting, which regularly records all items in financial statements at their current values. The system recognizes the fact that the purchasing power of money is decreasing day-by-day during inflation and finds out profit or loss or states the financial position of the business on the basis of the current price prevailing in the economy.

**Objectives of Inflation Accounting:**

1. To portray the real profit or loss for the period under consideration as against the profit or loss on the basis of historical cost.
2. To set out the real financial position in present day terms, rather than the conventional position on historical costs basis and to indicate the real capital employed.
3. To ensure that sufficient funds will be available to replace the various assets where the replacement becomes due and.
4. To indicate profits in constant rupees, i.e. having regard to the general movement in prices for the guidance of shareholders as well as management.

**Techniques of Inflation Accounting:**

The following are the generally accepted methods of accounting for price level changes.

1. **General Price Level Accounting (G.P.L.A) or Constant Purchasing Power Accounting (C.P.P.A)**
   
   G.P.P.A or C.P.P.A attempts to measure changes in the value of the currency. A restatement process is used to convert all items in the financial
statements to a stable measurement scale. A general price level index is used to convert all items in terms of money units of end of accounting period.

C.P.P.A based financial statements are generally prepared by a series of adjustments applied to the information collected by conventional accounting system. Appropriate assumptions should be made about the timing of production and trading activities during the year. Restatement adjustments should be computed on an average basis. Additional information is required about the timing of transactions and the age of non-monetary assets.

In the income statement items such as sales, purchases and expenses are restated in terms of period and purchasing power by applying average price index for the year. Opening and closing inventories are restated by applying the price index of the actual or average data of acquisition both in the income statement and Balance sheet. Depreciation is calculated on the amount at which assets are shown in the balances sheet. No adjustment is made for money assets and liabilities in the balance sheet. The equity shone capital is, however, restated in terms of period and purchasing power by applying the index number on the date of issue or the average index for the year. Alternatively, the increase in share capital may be treated as capital reserve on an inflation allowance. Purchasing power gain or loss arises on account of holding monetary assets or liabilities. Since the rupee value of monetary items is fixed, a rising price level will result in purchasing power losses on positive monetary items and purchasing power gains on negative monetary items.

Monetary assets include cash, bank deposits, investments, prepaid expenses, Bills receivable, debtors, advance corporation-tax, advance to employees, suppliers etc. Monetary liabilities include creditors, refundable deposits, accrued expenses, dividends and interest payable, bank overdrafts, convertible debentures, loans and preference shares. During a period of inflation, a business should as far as possible, be in a position of net monetary liabilities (i.e. monetary liabilities are more than monetary assets) so as to gain
from reductions in the purchasing power of its monetary liabilities to a greater extent than the loss incurred from the fall in the purchasing power of its monetary assets.

In this way under this approach, income normally reflects the effects of general price level changes on depreciation, cost of sales and net monetary items and it reported after the general purchasing power of shareholders equity in the enterprise has been maintained.

2. Current Value or Current Cost or Replacement Cost Accounting (C.V.A/C.CA or RCA)

Current values are prices of specific goods and services and these may change as a result of shifts in relative prices even if the general price level is unchanged. Current value Accounting refers to those accounting methods in which asset values are determined with reference to the present time dimension of value. Income for a period may be defined as the amount by which capital value at the end of the period exceeds capital value at the commencement of the period. Income comprises two elements.

a. The measurement of capital value (Asset valuation)

b. The measurement at the end of the period, of the amount required maintaining intact the capital value at the start of the period measurement of capital and value involves the valuation of assets and liabilities.

As regards the preparation of financial statement under current cost accounting, fixed assets, stock and other non-monetary items are shown in the balance sheet at their “Value to the Business” which is generally the replacement cost of a specific asset or the current acquisition cost of a similar asset, new or used or of an asset with equivalent productive capacity or service potential. If the current replacement cost is higher than both net realizable value and net present value, the higher of this value is used for measurement. Monetary assets and liabilities are included at face value.
The current cost profit is arrived at after making adjustments for depreciation and cost methods include an adjustment reflecting the effect of inflation on all monetary items including long term liabilities, leading to a loss from holding net monetary assets or gain from holding net monetary liabilities. Current cost methods recognize income after the operating capability of the enterprise has been maintained. However, some methods recognize income after the portion of the firm's operating capacity financed by its shareholders has been maintained (gearing adjustment). This is done by reducing the total adjustment for depreciation cost of sales and monetary working capital adjustment in the proportion that finance by borrowing bears to finance by the total of borrowing and equity capital.

Another item included in the current cost balance sheet is the current cost reserve. The total reserve includes the unrealized revaluation surpluses and realized amounts equal to the cumulative net total current cost adjustment i.e. depreciation adjustment, the two working capital adjustments and gearing adjustment. Notes to the balance sheet should be supported by summaries of the fixed assets accounts and the movements on reserves.

Thus CCA is one of the techniques, which allows the users to know the financial performance in terms of current values.

3. Hybrid Models:

Some have proposed specific and general price level accounting to find a compromise solution to the problems caused by drawbacks of CPPA and CCA. The items in the financial statements are first converted in terms of units of C.P.P as in G.P.L.A. The assets are then revalued and stated in terms of net replacement cost. It involves a change in measurement and a change in the method of valuation. It is viewed as an extension of C.V.A. this approach presents both monetary and non-monetary items at their real worth.
Inflation Accounting in India:

In India, corporate accounts presented to the revenue authorities and the shareholders are prepared on historical cost basis. But the ICAI issued a guidance note accounting for changing prices in December 1982. It considered three proposals,

1. Period’s revaluation of fixed assets along with the adoption of life formula for inventory valuation.
2. The current purchasing power accounting method.
3. The current cost accounting method.

The main recommendations were;

a. CCA method appears to be appropriate in the context of the economic environment in our country until the introduction of a full fledged CCA method, the impact of inflation on trading and manufacturing concerns could be depicted through periodic revaluation of fixed assets on the life method of inventory valuation.

b. Although selection of price indices depends upon the circumstances in each case, price indices published by the government in its monthly bulletin would be applicable to a majority of cases.

But it was recommendatory in nature. The government has not taken any action to bring about amendments in the companies Act to incorporate the effects of changing prices in the accounts.

Environmental Accounting and Reporting:

Environmental accounting is a very new concept of the accounting system. It is an attempt to identify and bring to the light the resources exhausted and cost rendered to the environment by the business units. It can be defined as a process of economically recognizing the exhaustion of natural or free goods and services in the process of making economic goods and services, analyzing and balancing the benefits rendered by the environment to a corporate citizen and the costs and benefits tendered to the environment by a corporate citizen.
Simply, environmental accounting is the process of recording and summarizing the value of environmental goods and services in monetary terms. It is a part of corporate social accounting and attempts to evaluate the impact of organizational activities on environmental resources.

Conventional accounting has a place for non-living things, a partial place for human power and no place for the environment. But the environment is very much responsible for the establishment, survival and growth of an entity hence; there is a justification of environmental accounting.

Environmental reporting means incorporation of environmental issues into the corporate annual reports of corporate entities. It denotes voluntary and involuntary disclosures by corporate entity on the impacts of its activities on environment. It covers the preparation and provision of information by management for the use of multiple stakeholder groups (internal and external) on the environmental status and performance of their company or organization. It is also called as green accounting or eco-accounting.

**Users of Environment Accounting and their Information Needs:**

The used of environmental accounting and reporting include resource providers, constitutions, Government and oversight bodies and the management. They use environmental information.

- Resource providers include owners/investors, lenders suppliers and other trade creditors. They are interested in information that enables them to determine whether their resources are protected and the expected returns are regularly given.

- Government and oversight bodies are interested in the allocation of resources and, therefore, the activities of enterprises. They are also interested about the compliance aspect of rules and regulation as set up by various governmental bodies.
Constituents include employees, customers and general public. Employees and their representatives groups are interested in information about the stability and profitability of their employers. Customers have an interest in information about the continuation of an enterprise. In addition to this, the general public interested about company’s compliance with international quality standard and production of environmentally friendly product.

Management is concerned about establishing the image of their company as an enlightened one. They are also interested about the production efficiency, cost effectiveness and effect on profitability of the company for being an environmentally friendly company.

Objectives of Environmental Accounting:

The objectives of environmental accounting are:

1. To estimate total stock of assets realized to environmental issues and changes therein and to estimate total expenditure on protection of environment.
2. To identify the cost necessary to compensate for the negative impact of economic growth.
3. To assess environmental costs and benefits;
   a) The decrease in natural resources due to their use in production and final demand and
   b) The changes in environmental quality resulting from pollution and other impact of production and consumption and other natural events on one hand and the expenditure for environmental protection and enhancement of the environment on the other.

Procedure for Environmental Accounting

Profit and loss Account:

All revenue expenditure incurred for the protection of environment should be debited to this account.
• Balance Sheet:

All natural resources consumed by the business should be regarded as environmental asset and it should be the liability of organization towards the society to utilize such assets at maximum capacity at minimum cost without adversely affecting the interest of society. All capital expenditure incurred by the organization should be shown in the balance sheet.

Environmental Reporting in India:

Both government and non-government organizations became active about environment protection after Bhopal gas leakage disaster. Various statutory provisions enforced for the Pollution control and the preservation of the environment.

The Companies' Act 1956 was also amended so as to make the details about the environmental protection reported in a systematic manner. According to it every company shall in the Report of its Board of Directors disclose briefly the particulars of compliance with environmental laws, steps taken or proposed to be taken towards adoption of clean technologies for prevention of pollution, waste minimization, waste recycling and utilization, Pollution control measures, investment on waste reduction, water other resources conservation.

In addition to the above notification, the companies are required to prepare the directors' report according to Director's Report Rules 1988. The statutory provisions also required periodical reports to the State Pollution Control Boards. The companies are also required to prepare and filed with regulatory authorities an "Environmental Impact Assessment Statement."

Value Added Reporting Statement:

A business organization is an independent separately identified entity doing business, to earn profit and serve society with quality goods at reasonable profits. Since it is an independent entity created by law and it is an artificial body created by law, the results of business activities is communicated to
various agents or parties such as shareholders, leaders, government, customers, suppliers, creditors, debenture holders, financial institutions, banks, tax collecting authorities, employees and so on. The primary role of accounting is to provide an effective reporting system. The conventional accounting system reveals only profit or loss made by a business unit and does not provide any information showing the extent to which the wealth is created by a business unit in a given period. Contribution of a business enterprise to the society and community cannot be assessed through the profit and loss account or Income statement, which aims at exhibiting the “return to share holders”. Hence, ‘Value Added’ concept has been introduced for measuring the “wealth created” by an enterprise. Value Added is the kind of wealth generated by the efforts and ingenuity of mankind. It differs from the conventional profit depicted by profit and loss account. Conventional profit calculation is made by deducting all costs from sales income where as value added is obtained by deducting the cost of bought in materials and services from the sales revenue. It is the excess of sales revenue plus income from other sources over the cost of bought in goods and services purchased from outsiders. This may be represented through the following equation.

\[
\text{Value Added} = (\text{Value of Output} + \text{Income from other source}) - (\text{Cost of materials and Services purchased from outside}).
\]

**Application of Value Added**

1. Employees (Wages, Salaries and Pensions)
2. Government (Tax on profit)
3. Bankers (Interest on overdrafts)
4. Share holders (Dividend)
5. Replace Assets (Depreciation)
6. Finance Inflation (Maintenance of working capital)
7. Finance Expansion (Profit Retained)

Thus, Value Added is more useful to shareholders; bondholders, loan holders, employees, government and others are it proves more transparent in its presentation. But preparation and presentation of VAS is not mandatory in nature it is an external document open to circulation. But it should be prepared in accordance with the generally accepted accounting principles to satisfy other parties as a matter of transparency in accounting. In India, also, the Companies Act, 1956 has not made any provisions for preparation and presentation of VAS.

Format of Value Added Statement

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sources of Income</td>
<td>Rs</td>
</tr>
<tr>
<td>Domestic sales</td>
<td>XXX</td>
</tr>
<tr>
<td>Foreign sales</td>
<td>XXX</td>
</tr>
<tr>
<td>Total sales</td>
<td>XXX</td>
</tr>
<tr>
<td>Less: Cost of materials and purchased services</td>
<td>XXX</td>
</tr>
<tr>
<td>Value Added</td>
<td>XXX</td>
</tr>
<tr>
<td>Disposal of Value Added</td>
<td></td>
</tr>
<tr>
<td>To Employees:</td>
<td></td>
</tr>
<tr>
<td>Wages and salaries</td>
<td>XXX</td>
</tr>
<tr>
<td>Pension find contributions</td>
<td>XXX</td>
</tr>
<tr>
<td>Profit sharing bonus</td>
<td>XXX</td>
</tr>
<tr>
<td>Total a)</td>
<td>XXX</td>
</tr>
<tr>
<td>To Government:</td>
<td></td>
</tr>
<tr>
<td>Corporation tax</td>
<td>XXX</td>
</tr>
<tr>
<td>Tax on dividends</td>
<td>XXX</td>
</tr>
<tr>
<td>Less: Grants</td>
<td>(XXX)</td>
</tr>
<tr>
<td>Total b)</td>
<td>XXX</td>
</tr>
<tr>
<td>To Providers of Capital:</td>
<td></td>
</tr>
<tr>
<td>Interest to loan holders</td>
<td>XXX</td>
</tr>
<tr>
<td>Dividends to shareholders</td>
<td>XXX</td>
</tr>
<tr>
<td>Minority shareholders in subsidiaries</td>
<td>XXX</td>
</tr>
<tr>
<td>Total c)</td>
<td>XXX</td>
</tr>
<tr>
<td>Reinvested in the business</td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>XXX</td>
</tr>
<tr>
<td>Profit retained</td>
<td>XXX</td>
</tr>
<tr>
<td>Total d)</td>
<td>XXX</td>
</tr>
<tr>
<td>Value Added (a+b+c+d)</td>
<td>XXX</td>
</tr>
</tbody>
</table>

References:


