CHAPTER 1

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1.1 Introduction

Accounting being regarded as the language of business is as old as the business itself (Gupta and Mehra, 2002). It is a social phenomenon, the primary object of which is to let the management know the economic activity of the corporate enterprises (Mehrotra and Kulshrestha, 1990). Accounting has two fold phases, first measuring and arraying the economic data and second communicating the results of this process to the interested parties (Gupta, 1977). American Accounting Association (AAA, 1966) describes it as the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of information. Accounting Principles Board (APB) of the American Institute of Certified Public Accountants (AICPA) defined accounting as a service activity. Its function is to provide quantitative information financial in nature and intended to be useful in making economic decisions and making reasoned choices among alternative courses of action. Accounting includes branches i.e. financial accounting, managerial accounting and government accounting (Singh, 2005). In 1975, the American Accounting Association redefined accounting in broader sense as to provide information which is potentially useful for making economic decisions and which if provided will enhance social welfare.

The primary function of accounting is recording the economic data of a business enterprise and to facilitate the administration of its financial activities. It has to measure the economic activity i.e. employment of its assets for profit; and disclose it in the financial statements and reports of the financial aspects of the activities of the enterprise for a particular period (Saeed, 1990). Thus all the activities of a business enterprise have to be disclosed to the shareholders and other users so that they can develop their own attitude towards the firm and know that how efficiently the limited resources of the organization are being utilized through sound decisions.

Financial accounting was formerly concerned with reporting from office managers to principals conveying that all was well with the book-keeping of the business. But times now have changed with an increasing control by the corporate sector over the economic activity; these financial reports have assumed greater importance. They are now considered a corner stone in the trading structure helping to
bridge the gap between the producer and the user, the owner and the manager and commerce and the government. Further, these reports are consulted by a large sector of people, including the government, who have a wide range of interests in them as owners, tax-receivers, workers, employees, administrators, producers, creditors, debenture-holder and the like, besides labour-unions and shareholder’s associations (Gupta, 1977)

1.2 Concept of Corporate Financial Reporting

The concept of corporate financial reporting has gained much significance due to the expansion and growth of company form of organization, increased competition and increase in the information needs of the users (Singh, 2005) The corporate financial reporting is a system of communication between the management and the user-groups of the financial statements; in order to report the results of the business activities of a corporate enterprise and also to demonstrate the credibility, accountability and reliability of its working (Saeed,1990) Kohler’s dictionary for accountants defines it as an explanation or exhibit attached to a financial statement, or embodied in a report containing a fact, opinion or detail required or helpful in the interpretation of the statement or report (Cooper and Ijiri, 1984). As per American Accounting Association the financial reporting is the movement of information from the private domain (i.e. inside information) into the public domain. It is a process through which an entity communicates with the outside world (Chandra, 1974).

The subject of financial reporting has gained significance during the recent years because of various compelling factors, such as the expansion and growth of the company form of organization; shift in the emphasis from the concept of ‘shareholders’ to ‘stakeholders’ and increase in their informational needs; the enactments and amendments in disclosure laws in various countries; professionalism of management; emergence of accounting as a recognized profession; and the pronouncements on disclosure made by various professional accounting bodies in India and abroad (Chander,1992). A series of scandals that have rocked the financial markets and shaken investor confidence have further increased the importance of financial reporting.

There is a general consensus among professionals that a disclosure should be full, fair and adequate. Full disclosure requires that financial statements should be designed and prepared to portray accurately the economic events that affected the firm for the period and to contain information sufficient to make them useful and not
misleading to the average investor (Porwal, 1989). The need for adequate, fair and full disclosure is irrefutable in a free enterprise economy. One can’t over-emphasize the importance of availability of information in investment decisions. It assists the investors in selecting the best portfolio for their investment (Lal, 1985). In the absence of adequate information investors would not be in a position to make wise investment decisions, because it will be difficult to distinguish between potentially successful and unsuccessful business. (Chander, 1992)

Besides investors, disclosure is significant from the point of view of large number of other potential users. Such potential users include, present and prospective investors, lenders, suppliers, creditors, employees, management, customers, financial analysts and advisors, brokers, underwriters, stock exchange authorities, legislators, financial press and reporting agencies, labour unions, trade associations, business researchers, academicians and above all the public at large. Disclosure has behavioral implications for such a wide range of users. There is an obvious need for reliable information which they can use to acquire an essential knowledge of the way in which business enterprises are behaving in relation to the public interest. By perceiving enterprise behavior through communicated information, interested parties can use this knowledge to amend or adopt their own behavior vis-à-vis. the enterprise concerned (Lee, 1976). Thus financial reporting in fact is an effective communication of accounting information.

The concept of fair disclosure implies that the accounting and other information should be unbiased and impartial. Its objective is to provide equal treatment to all potential financial statement readers (Chahal, 1990). The task of defining the term ‘adequate disclosure’ is more difficult because the adequacy of disclosure cannot be tested accurately and precisely since no definite test exists in financial reporting to measure it and moreover, it is a subjective term. In very comprehensive terms a disclosure can be an ‘adequate disclosure’ when it entails the answers of “to whom, why, how much, what and when the information to be disclosed” (Chahal, 1990).

1.3. Objectives of Financial Reporting

Corporate financial reporting is not an end in itself but is a means to certain objectives (Devarajan, 2008). The fundamental objective of corporate financial reporting is to communicate economic measurements of information about the resources and performance of the reporting entity useful to those having reasonable rights to such
information and interest in the entity (Oza, 1990). The annual financial statements of a company not only aid its management to regulate the prices of its goods and services but also help its external users in different ways such as existing and potential investors in evaluating their past decisions and making changes in their investment policies, creditors in assessing company’s worthiness, profitability and liquidity, and government in administering the system of taxing the companies (Bhattar, 1995).


### 1.3.1 Accounting Principle Board (APB) 1970

The Accounting Principle Board of America issued its Statement (4), Basic Concepts and Accounting Principles Underlying Financial Statement of Business Enterprises, in 1970. This statement states 1 particular, 5 general and 7 qualitative objectives. The particular objective of financial statements is to present fairly and in conformity with Generally Accepted Accounting Principles (GAAP), the financial position, the results of operations and other changes in the financial position of an enterprise.

The **general objectives of financial statements are:**

1. To provide reliable information about economic resources and obligations of a business enterprise in order to (a) evaluate its strengths and weaknesses, (b) show its financing and investments, (c) evaluate its ability to meet its commitment and (d) show its resource base for growth.

2. To provide reliable information about changes in net resources resulting from a business enterprise’s profit-directed activities in order to (a) show the investors the expected dividend return; (b) show the organization’s ability to pay its creditors and suppliers, provide jobs for employees, pay taxes, and generate funds for expansion;
(c) provide the management with information for planning and control (d) show the long-term profitability of the enterprise.

3. To provide financial information useful for estimating the earning potential of the firm.

4. To provide other needed information about changes in its economic resources and obligations.

5. To disclose other information relevant to the needs of the users.

The qualitative objectives of financial reporting are:

1. Relevance, which means selecting the information most likely to aid the users in their economic decisions.

2. Understandability, which implies not only that the selected information must be intelligible but also that the users can understand it.

3. Verifiability, which implies that the accounting results may be corroborated by independent measurers using the same measurement methods.

4. Neutrality, which implies that the accounting information is directed towards the common needs of the users rather than the particular needs of specific users.

5. Timeliness, which implies an early communication of information to avoid delays in economic decision-making.

6. Comparability, which implies that differences should not be the result of different financial accounting treatments.

7. Completeness, which implies that all the information that is “reasonably” needed to fulfill the requirement of the other qualitative objectives should be reported.

The above general objectives fail to identify the information needs of the owners and the creditors. The main objective was to provide general purpose financial reporting, which provides information for unknown users having multiple decision objectives. Providing information for specific user groups having known decision objectives was not found operational.

1.3.2 The True Blood Report-1973

In view of the criticism of corporate financial reporting, the American Institute of Certified Public Accountants appointed a study group in 1971 under the
chairmanship of Robert M. True-blood. The study group visited various places, interviewed executives, held meetings with institutional and professional groups and submitted its report in 1973. The True-blood committee recommended 12 objectives of financial reporting. The main objective is stated as under:

“The basic objective of financial statements is to provide information useful for making economic decisions.” The other eleven objectives are stated below:

1. 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.

2. To provide information useful to investors and creditors for predicting, comparing, and evaluating potential cash flow to them in terms of amount, timing, and related uncertainty.

3. To provide users with information for predicting, comparing, and evaluating enterprise’s earning power.

4. To supply information useful in judging management’s ability to utilize enterprise’s resources effectively in achieving the enterprise’s primary goal.

5. To provide factual and interpretative information about transactions and other events, which is useful for predicting, comparing, and evaluating enterprise’s earning power. Basic underlying assumption with respect to matters subject to interpretation, evaluation, prediction, or estimation should be disclosed.

6. To provide a statement of financial position useful for predicting, comparing, and evaluating enterprise’s earning power. The statement should provide information concerning enterprise’s transactions and other events that are part of incomplete earning 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 or liquidation.

7. To provide a statement of periodic earnings useful for predicting, and evaluating enterprise-earning power. The net result of completed earning cycles and enterprise activities resulting in recognizable progress towards the completion of incomplete cycles should be reported. Changes in the values reflected in successive statements
of financial position should also be reported, but separately, since they differ in terms of their certainty of realization.

8. To provide a statement of financial activities useful for predicting, comparing, and evaluating enterprise-earning power. This statement should report mainly on the factual aspects of enterprise transactions having or expected to have significant cash consequences. This statement should report data that requires minimal judgment and interpretation by the preparer.

9. To provide information useful for the predictive process. Financial forecasts should be provided when they will enhance the reliability or user’s predictions.

10. For government and not-for-profit organizations, an objective of financial statements is to provide information useful for evaluating the effectiveness of the management of resources in achieving the organization’s goals.

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

The True Blood Report also presented 7 qualitative characteristics which financial statement information should possess in order to satisfy needs of the users. These are:

1. Relevance and Materiality
2. Substance rather than Form
3. Reliability
4. Freedom from Bias
5. Comparability
6. Consistency
7. Understandability

This study group considered the needs of the investors and the creditors but there are other users of financial statements whose needs were not given proper weight.

1.3.3 The Corporate Report, London 1975

The Accounting Standards Steering Committee of the Institute of Chartered Accountants in England and Wales 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 statements should be appropriate to their expected use by the potential users. The report emphasized seven characteristics viz, relevance, understandability, reliability, completeness, objectivity, consistency and timeliness in addition to the other fundamental objectives of annual reports. The Corporate Report suggested the need for the following additional statements:

1. A statement of Value Added to show how the wealth was produced, and how it has been distributed among the employees, the state, the providers of capital and its reinvestment for maintenance and expansion.

2. An employee report dealing with the size and composition of the work force, efficiency, productivity, industrial relations, the benefits earned, personnel policies, etc.

3. A statement of money exchanges with the government showing sales tax, corporation tax, rates, royalties and other taxes paid to the government, i.e., financial relationship between the enterprise and the state.

4. A statement of transactions in foreign currency showing overseas borrowings and repayment, dividends received and paid by the government to other countries.

5. A statement of future prospects showing forecasts of profits, employment and investment.

6. A statement of corporate objectives showing management policy and strategies.

1.3.4 Financial Accounting Standard Board (FASB)-1978

The financial Accounting Standard Board laid down the following objectives in November 1978 after considering the True blood Committee Report.

(i) Financial reporting should provide information that is useful to the 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 a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.

(ii) Financial reporting should provide information to help the 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. Since ‘investors’ and ‘creditors’ cash flows are related to enterprise’s cash flows, financial reporting should provide information to help investors, creditors, and others, assess the amounts, timing and uncertainty of prospective net cash inflows to the related enterprises.

(iii) Financial reporting should provide information about the economic resources of an enterprise, the claim to those resources (obligations of the enterprise to transfer resources to other entities and owner’s equity), and the effects of transactions, events and circumstances that change its resources and claim to those resources.

(iv) Financial reporting should provide information about an enterprise’s financial performance during a period. Investors and creditors often use information about the past in assessing the prospects of an enterprise. Thus, although investment and credit decision reflect investors’ and creditors’ expectations about future enterprise performance, these expectations are commonly based at least partly on the evaluation of past performance.

(v) Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowings, about its capital transactions, including cash dividend and other distributions of enterprises resources to the owners, and about other factors that may affect an enterprise’s liquidity or solvency.

(vi) Financial reporting should provide information about how the management of an enterprise has discharged its stewardship responsibilities to the owners (shareholders) for the use of enterprise resources entrusted to it.

(vii) Financial reporting should provide information that is useful to the management and the directors in making decisions in the interests of the owners.

The FASB emphasized the use of financial reporting for different classes of users and not for the creditors and the investors only. Predictability was also included as an element of the objectives of accounting information. The intention was to provide useful information for making business and economic decisions by the parties having an interest in the organization.
1.3.5 The Stamp Report-1980

The Canadian Institute of Chartered Accountants published report in June 1980 on “Corporate Reporting-Its Future Evolution,” written by Edward Stamp and popularly known as Stamp Report. It states the following as the objectives of financial accounting:

1. One of the primary objectives of published corporate financial reports is to provide an accounting by the management to both equity and debt investors, not only for the management’s exercise of its stewardship function but also for 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.

In short important objective of financial reporting is the provision of useful information to all of the potential users of such information in a form and in a time frame that is relevant to their various needs.

2. 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 its own assessment of the risks associated with the enterprise.

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

4. The objectives of financial reporting should be taken to be directed towards the needs of the users who are capable of comprehending a complete (and necessarily sophisticated) set of financial statements or alternatively, to the needs of experts who will be called on by the unsophisticated users to advise them.

The Stamp Report stressed the accountability of the management to equity and debt investors. It also emphasized that information should be given in such a manner as to minimize uncertainty about the validity of the information. The report should also include information on innovations and evolution of the enterprise. It should be useful for both sophisticated and unsophisticated users.

1.3.6 The International Accounting Standards Committee (IASC)-1989

The IASC issued a framework for the preparation and presentation of financial statements in the year 1989. According to this framework the objectives of the 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 (Porwal, 2007).

1.3.7 Accounting Standards Board- 1991

The Accounting Standards Board of the U.K. issued a “Statement of Principles” in July 1991. It states that the objective of financial statements is to provide information about the financial position, performance and financial adaptability of an enterprise that is useful to a wide range of users in making economic decisions (Porwal, 2007).

The above statement shows that the objectives of financial statements issued by the IASC and ASB are almost similar. The ASB also stated that to meet the informational needs of the users is the basic objective of financial statements, which can be fulfilled by preparing and presenting the general purpose financial statements (Singh, 2009).

1.3.8 Institute of Chartered Accountants of India (ICAI) - 2000

Institute of Chartered Accountant of India (ICAI) have also contributed in the formulation of the objectives of financial reporting. The Accounting Standard Board (ASB) of Institute of Chartered Accountants of India (ICAI) issued a framework for the preparation and presentation of financial statements in July 2000. Following are the objectives of financial statements given in the framework for preparation and presentation of financial statements by ICAI:

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

- Financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all the information that users may need to make economic decisions since (a) they largely portray the financial effects of past events, and (b) do not necessarily provide non-financial information.

- Financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they may make economic decisions; these decisions may include, for example, whether to
hold or sell their investment in the enterprise or whether to re-appoint or replace the management.

ICAI has also stated four qualitative characteristics in its framework for preparation and presentation of financial statements i.e.

- Understandability,
- Relevance,
- Reliability
- Comparability

According to the Institute of Chartered Accountants of India, there are three constraints on relevant and reliable information i.e. timeliness, balance between benefit and cost and balance between qualitative characteristics. These are explained in detail under the head qualitative aspect of financial reporting.

**1.3.9 Financial Accounting Standards Board (FASB)-2006**

According to the preliminary views on conceptual framework for financial reporting issued by Financial Accounting Standards Board (FASB) of the Financial Accounting Foundation, the proposed objectives of financial reporting are as under:

- Providing information useful in making investment and credit decisions.
- Providing information useful in assessing cash flow prospects
- Providing information about an entity’s resources claims to those resources, and changes in resources and claims.

Besides these objectives FASB has also mentioned various qualitative characteristics of decision- useful financial reporting information in the conceptual framework i.e.

- Relevance,
- Timeliness,
- Verifiability,
- Comparability
- Understandability.

These characteristics are defined within the two constraints of materiality and benefit and costs. ([www.fasb.org](http://www.fasb.org))
1.4 Annual Report-The Most Useful Source of Financial Reporting

There are many media adopted by the companies for dissemination of information to outsiders. These include prospectus, press releases, statutory reports, interim reports, financial dailies and magazines, interviews between management representatives and the professional financial analysts and the published accounts i.e. the ‘annual report’ (Chander, 1992). Of all these media, annual report is the most significant channel of disclosure. It is the prime medium for projecting a company at its audience and is the most effective voice in corporate communication (Haggie, 1984). Annual report is generally related with the performance of the company during a particular accounting year. The Companies Act, 1956 provides the guidelines in connection with the preparation and presentation of the statutory part of annual reports through its various sections leaving a vital zone of information to the discretion and culture the companies may prefer to use (Datta, 1990).

Annual report is the end product of the accounting information process and set of accounting measurement rules. It reflects a combination of recorded facts, accounting conventions and personal judgments of those who write up the accounts (Jiloka and Verma, 2006). Annual report is really directed to the community at large to whomsoever it may have been formally addressed. All groups have access to it; their attitude may be influenced by it. It is the single most important document in corporate reporting. It is a benchmark for measuring performance, a periodic summary of progress and an auditing checkpoint (Bhattar, 1995). There are several important reasons for treating the annual report as a valuable source of information to the shareholders and other users. Firstly, annual report, being the audited document, provides authenticated information about the issuing entity and thus creates confidence among the public. Secondly, it is relatively more and easily accessible than any other source of information. Thirdly, annual report is the single document, which contains besides financial statements, some other valuable information such as highlights of the year, historical data, significant performance ratios, accounting policies, price level adjusted statements, human resource accounting, segmental information, company’s present and future policies, etc., which is not provided by any other single medium (Chander, 1992). Thus, annual report is the communication tool that is the reflection of corporate performance, accomplishments, objectives and mission.
1.5 Qualitative Characteristics of Financial Reporting

Information which is reported to facilitate economic decisions should possess certain qualitative characteristics. Qualitative characteristics are the attributes that make the information provided in the financial statements useful to the users (Devarajan, 2008). One of the basic qualities of published accounting information is that it should be credible or it should be believed by its users. If it does not possess the quality of credibility, it will not be used (Bhattar, 1995). The Accounting Principles Board of U.S.A suggested seven qualitative characteristics of published accounting information i.e. relevance, understandability, verifiability, neutrality, timeliness, comparability and completeness. Similarly the Trueblood Report also suggested seven qualitative characteristics which financial statement information should possess: these are relevance and materiality, substance rather than form, reliability, freedom from bias, comparability, consistency and understandability. FASB (1980) in SFAC No.2 on ‘Qualitative Characteristics of Accounting Information’ has described these attributes as the ingredients that make the information useful and the qualities to be sought when accounting choices are made. These attributes can be viewed as a hierarchy of qualities, with usefulness for decision making of most importance. Without usefulness, there would be no benefits from information to set against its costs (Chander,1992). The various qualitative aspects of financial reporting are discussed as under:

1.5.1 Relevance

Relevance is a dominant criterion in taking decision regarding disclosures of information (Gupta and Mehra, 2002). Relevant information is that which satisfies the informational needs of the users and helps them in evaluating the management and its policies for the purpose of their decisions (Jiloka and Verma, 2006). It implies that all those items of information should be reported that may aid the users in making economic decisions. (Saeed, 1990) information is relevant if it has the capacity to confirm or change a decision maker’s expectations. First of all, purpose for which the information is sought, should be identified, only when the information is purpose oriented and it becomes useful in making rational decisions (Bhattar,1995) The Accounting Principle Board has described relevance as the primary qualitative objective of financial accounting information. FASB in its concept No.1 has stated that relevant accounting information must be capable of making a difference in a decision by helping
users to form predictions about the outcomes of past, present and future events or correct expectations. The True Blood Report, the Corporate Report London and the Financial Accounting Standards Board in its conceptual framework 2006 have also mentioned relevance as the qualitative characteristic of decision-useful financial reporting information. The whole of the exercise of corporate disclosure is futile, if the information disclosed is not relevant to the needs of the users (Chander, 1992). Thus the information, which is not relevant, is useless for the users.

1.5.2 Reliability

Reliability implies that information communicated should represent what it purports to represents and further being free from error and bias also (Bhattar, 1995). The True Blood Report and the Corporate Report London also emphasized reliability as one of the qualitative features of financial reporting. Reliability helps in decision making process. Reliable information can create confidence in the minds of the users. It is need for reliable information that underlies the requirement that financial reports be audited by independent auditors (Jiloka and Verma, 2006). Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent (Chander, 1992). For information to be reliable; it must be verifiable to some degree, and it must be free from bias, i.e. objectivity or neutrality. The AAA committee says that ‘verifiability requires that essentially similar measures or conclusions would be reached if two or more qualified persons examine the same data’. Freedom from bias means that facts have been impartially determined and reported. It also implies, that the events or results should be reported in the financial statements without the bias or prejudice of the persons concerned with reporting such information (Chander, 1992). Thus financial reporting should provide information that is useful to the present and the potential investors and creditors and other users in making rational investment, credit and similar decisions.

1.5.3 Understandability

The Accounting Principles Board of America in its statement No.4 stated understandability as the qualitative objective of financial reporting. It implies not only that the selected information must be intelligible but also that the users can understand it. The True Blood Report, the Corporate Report London and the conceptual framework
issued by FASB have also suggested understandability as an important characteristic which financial information should possess.

The information must be understandable, so that one can make use of it without any specific knowledge of the subject (Bhattar, 1995). The information should be presented in reports in such a way that it can be understood by reasonably well informed as well as by sophisticated readers (Chander, 1992). Accounting information is more understandable if it is quantifiable, is consistent, is comparable with similar information, and is simple. So consistency and comparability are the two significant attributes of information which make it understandable and hence useful to the users. Consistency refers to use of identical accounting practices, procedures and concept by the enterprise from one period to another. Consistency is an important criterion in disclosure mechanism. It makes the information comparable and thus helps the users in decision making. However, it should not prove a bottleneck in bringing improvements in accounting practices and policies. Whenever users; needs change over a period of time and require improvements in accounting policies and practices, the new practices or procedures should be adopted and followed. Thus consistency is desirable until a need arises to improve practices, policies and procedures (Bhattar, 1995).

Comparability is an outcome of consistency. It can be viewed from two angles, i.e. comparability of information between periods in case of a single firm and comparability between firms (Chander, 1992). To make the information comparable an enterprise should adopt the generally accepted accounting principles and accounting standards, make disclosure of changes in accounting policies and explain about company’s accounting policies. Understandability does not necessarily mean simplicity or using elementary terminology. It means the presentation of information in clearest form so as to help in making best use of information by the users and avoid confusion in their minds (Bhattar, 1995).

1.5.4 Materiality

Concept of materiality is a basic accounting concept. The True Blood Committee in its report has also suggested this as an attribute of financial reporting. This concept implies that not all financial information should be reported, immaterial information may be ignored while doing financial reporting (Gupta and Mehra, 2002). Information is said to be material if its omission or misstatement would influence the economic decisions of users on the basis of the financial statements (Chander, 1992).
Kohler’s dictionary defines materiality as the characteristics attaching to a statement, fact or item whereby its disclosure or the method giving it expression would likely to influence the judgment of a reasonable person (Singh, 2005). Materiality involves the use of judgment. No generally accepted guidelines have been established for judging materiality. These judgments should be made considering the significance of information and its impact on user’s economic decisions (Saeed, 1990). It is significant to note that some items though very smaller in size and quantity, may be material because the materiality of an item not only depends on its relative size but also on its nature or combination of both (Saeed, 1990). Thus information is material if it is relevant to the decisions of the users, as materiality and relevance both are defined by reference to the needs of users in making economic decisions.

1.5.5 Timeliness

Timeliness which is an ancillary aspect of relevance means having information available to decision makers before it loses its capacity to influence decisions. (Anonymous, 2006). The Accounting Principle Board (APB) in its Statement No.4 (1970) “Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises” has mentioned ‘timeliness’ as one of the qualitative objectives of financial reporting. According to this statement, “timely financial accounting information is communicated early enough to be used for economic decisions which it might influence and to avoid delays in the making of these decisions” (Kohli, 1998). Similarly the Corporate Report London (1975) issued by the Accounting Standards Steering Committee (ASSC) of the Institute of Chartered Accountants in England and Wales observed that if the reports are to be useful and to fulfill their fundamental objectives, they must possess timeliness as one of the characteristics. Further Financial Accounting Standards Board (FASB) in its conceptual framework in the year 2006 has also mentioned timeliness as one of the qualitative features of financial reporting. Timeliness means having information available to decision makers before it loses its capacity to influence decisions (Meena, 1995). Timeliness alone cannot make information relevant but a lack of timeliness can rob information of relevance it might otherwise have had (Singh, 2005). Timely disclosure is fundamental to good investors relations. If information would be disclosed timely, decisions could be taken by the users promptly and exactly (Jiloka and Verma, 2006). Thus the accounting information must be communicated before its usefulness is lost or when its decision is due, it should be available to its users. Information has its time value (Bhattar, 1995).
1.5.6 Completeness

The Accounting Principle Board of America in its Statement No. 4 mentioned completeness as the qualitative objective of financial accounting. According to this statement ‘completeness’ implies that all the information that is reasonably needed to fulfill the requirement of the other qualitative objectives should be reported. The True Blood Study Group in its report stated, “The qualitative characteristics of financial statements, like objective, should be based largely upon the needs of users of the statements. Information is useless unless it is relevant and material to user’s decision. Information should be as free as possible from any biases of the preparer. In making decisions user should not only understand the information presented, but also should be able to assess its reliability and compare it with information about alternative opportunities and previous experience. In all cases information is more useful if it stresses economic substance rather than technical form” (Bhattar, 1995). Similarly, Corporate Report London has suggested ‘completeness’ as an essential feature of financial reporting. The accounting information must be complete from the point of view of statutory requirements and materiality. The users of accounting must be provided with full information so that they may take right decisions at right time (Bhattar, 1995). However; completeness is relative because financial statements cannot show everything. To try to include in financial reporting everything that any potential user might want would not be cost beneficial and might conflict with other desirable characteristics, such as understandability. (Anonymous, 2006) Thus information disclosed through financial reporting must be complete within the bounds of materiality and cost (Gupta and Mehra, 2002). An omission can cause information to be false or misleading and thus unreliable and different in terms of its relevance.

1.5.7 Neutrality

According to Accounting Principle Board (APB), Neutrality means that the accounting information is directed towards the common needs of the users rather than the particular needs of specific users. The accounting information must be fair; it must be measurable and reported with as much objectivity and neutrality as possible. The information must be based on firm verifiable evidence and it must not tend to benefit a particular user at the cost of other users (Bhattar, 1995). Financial Statements are not neutral if, by the selection or presentation of information; they influence the making of a decision or judgment in order to achieve a predetermined result or outcome.
1.6 Constraints on Relevant and Reliable Information

1.6.1 Timeliness

If there is undue delay in the reporting of relevant information it may lose its relevance. To provide information on a timely basis it may often be necessary to report before all aspects of a transaction or other event are known thus impairing the reliability. Conversely, if reporting is delayed until all aspects are known, the information may be highly reliable but of little use to users who have to make decisions in the interim. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the information needs of users (Anonymous, 2000).

1.6.2 Balance between Benefit and Costs

The balance between benefit and cost is a pervasive constraint rather than a qualitative characteristic (Anonymous, 2000). The benefits derived from any information should exceed the cost of providing it. FASB says in its conceptual framework, “the benefits and costs from financial information are usually difficult or impossible to measure objectively. Different persons will honestly disagree about whether the benefits of the information justify its costs.” Furthermore, the costs do not fall on those users who enjoy the benefits. Benefits may also be enjoyed by users other than those for whom the information is prepared. For these reasons it is difficult to apply cost-benefit test in any particular case. According to Singh (2005), the major benefits of the financial reporting to the investors are the reduction of the likelihood that they will misallocate their capital. As far as costs are concerned he has classified them into three parts: The cost of developing and disseminating information, the cost of litigation attributable to informative disclosure, and the cost of competitive disadvantage attributable to disclosure.

1.6.3 Balance between Qualitative Characteristics

A trade-off between various qualitative characteristics is very much necessary. The relative importance of different characteristics varies from case to case. Generally the aim is to achieve an appropriate balance between the characteristics in order to achieve the objective of financial reporting (Anonymous, 2000).
References


www.fasb.org
www.icai.org