2.1 Introduction

"Financial Reporting", which is also called ‘Corporate Reporting’ or ‘Corporate Disclosure’ is the much talked about subject all over the world. This is so because of the emergence of the concept of ‘stakeholders’ diversified interests and voluminous increase in their informational needs; increasing public interest in the securities markets and their regulation by the government; amendments in disclosure laws in various countries and the standards on disclosure which have been issued by various professional accounting bodies in India and abroad.

Accounting and Reporting may be viewed as the two blades of a scissors- one without the other is ineffective and meaningless. They are mutually dependent on each other. Generally, it is impossible to report until something is accounted for. Where accounting refers to identifying and recording of financial data of a particular set of economic events of an entity, this recorded data are then processed, arranged, summarized and ultimately put into a presentable form.

Accounting has two important functions- firstly, measuring and recognizing the economic activities and, secondly, communicating the results of this process to different interested parties. Initially, the first phase relates to encompassing record keeping and preparation of accounts and the second is dissemination of accounting information. But now the boundary of accounting has extended. Accordingly, the purpose of accounting has been redefined as- to provide useful information and to observe transparency in financial disclosures which are potentially useful for making economic decisions.

Thus ‘Financial Reporting’ requires the presentation of financial data in some prescribed format. It refers to the systematic and analytical ventilation of financial facts and figures designed to meet the diversified needs and aspirations of various stakeholders to help them undertake profound decisions concerning their investment portfolios.
Information disclosed by companies in their annual reports is used for making various types of decisions by a vast number of users. There are existing and prospective shareholders and share brokers who use this information for making investment decisions. Then, there are individuals and financial institutions who analyse this information to judge the creditworthiness of their client companies. So, ‘Corporate Reporting’ is significant from the viewpoint of the ‘Investing public’, companies and the nation as a whole. It reduces uncertainty in the market and helps the users in selecting the best portfolio for their investments. Transparency in financial reporting has gained much significance during the recent years. This has been because of various compelling factors, such as: the expansion and growth of the company form of organisation which requires greater informational needs for the shareholders and amendments in disclosure laws in various countries.

The objective of financial reporting is to communicate to the users of the information relevant and appropriate economic information about the utilization of resources and performance of the reporting enterprise. Financial statements should reflect the economic realities of the enterprise as on the reporting date. The information contained in the financial reports should not provoke uncertainty in the minds of users over the financial position and performance of the business. For this purpose, the business enterprises should have to prepare financial statements. Financial statements are accounting reports prepared in order to communicate information about the financial performances. Financial statements are still viewed as the core of the financial reporting practices.

Business houses usually prepare four major financial statements: The Balance Sheet, the Profit and Loss Account (or the income statement), Cash Flow Statement (or the changes in cash position), and the Statement of Retained Earnings- Besides these, the listed companies are required to furnish Corporate Governance Report. In addition to the above, some interim reporting is also required to provide complete financial information of the entities.

The annual reports and accounts offer the unique opportunity to inform a large number of people about the reporting enterprises. Corporate enterprises are under legal obligation to prepare specific accounts and reports to convey the requisite
information to the diversified stakeholders to help them undertake appropriate business decision to run organizations effectively and fruitfully to best satisfy them and to protect their interests which in turn help effectively to build investors’ confidence and loyalty with the enterprises.

2.2 Importance of Financial Reporting

Financial reporting provides quantitative financial information about the business enterprises that is useful to various user groups for making economic decisions. The Institute of Chartered Accountant of England and Wales has remarked that the objective of corporate reporting is to communicate economic measurements of and information about the resources and performance of the reporting entity, useful to those having a reasonable right to such information. The importance of financial reporting is enumerated below:-

- Financial reports provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions.
- The financial reporting gives a true and fair view of company’s financial position and results of operations. The true and fair view concept is essential for every business organizations.
- Financial reporting provides useful information about the economic resources of the enterprise.
- It provides useful information to potential investors and creditors in making rational investment decisions.
- It provides useful information to the shareholders relating to the affairs of the company.
- Financial reporting provides useful information to the Government to assess taxability of business enterprises.
- Financial reports also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it.
Corporate financial reporting also provides much useful information to the existing and potential investors in evaluating their past decisions and making changes in their investment policies, creditors in assessing the company's creditworthiness, profitability and liquidity, and the government in administering the system of imposing tax on assesses. Thus the major objective of financial reporting is to supply information for resourceful decision making.

2.3 Qualitative Characteristics of Financial Reports

The main purpose of financial reporting is to provide information useful for making economic decision. Here the qualitative characteristics are the attributes that make the information provided in financial reports really useful to users. It means the characteristics that make the information provided in the financial statements useful to users for assessing the financial position, performance and efficient utilization of finance of an enterprise.

Statement of Financial Accounting Concept (SFAC) no. 2 in ACCA Study and Revision Pack issued in May 1980 examines the qualitative characteristics of accounting information that makes the accounting information useful to users.

The statement concludes that the characteristics of information that make it a desirable commodity can be viewed as a hierarchy of qualities, with usefulness for decision making of most importance. According to this concept Relevance and Reliability are the two primary qualities that make accounting information useful for decision making. If either of these qualities is completely missing, the information will not be useful. Comparability, which includes consistency, is a secondary quality that interacts with relevance and reliability to contribute to the usefulness of information.
* represents Primary qualities of decision usefulness

+ represents Secondary qualities of decision usefulness

Relevance and Reliability of Accounting Information

Fig. 2.1
But Australian Accounting Standard Board in “AASB-FRAMEWORK” in July 2004 as “Framework for the preparation and presentation of financial statement” has described understandability, relevance, materiality, reliability and comparability as the main principal qualitative characteristics of financial reports.

**Understandability**

An essential quality of the information provided in financial reports is that it is readily understandable by users. Understandability focuses attention on the need for the users of information to be able to comprehend the massage or massages being communicated. Information can be useful to a reader only when it has been properly understood by him. 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. That means, the information should be presented in the financial statement in such a manner that it can be understood by average users. Understandability does not mean simplicity. Rather, it means the presentation of information in the crystal clear manner so that the users can make the best use of it. For this purpose, users are assumed to have a reasonable knowledge of business and economic activities and accounting.

**Relevance**

Relevance is the most important attribute of information to be disclosed. To be useful, information must be relevant to the decision-making needs of users. The information reported should help the users in making good and sound economic decisions. Relevance is a very important criterion for selecting purposeful information. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations. So, it can be said that the whole area of the corporate reporting is meaningless, if the information disclosed is not relevant to the needs of the users.

**Materiality**

The relevance of information is affected by its nature and materiality. Materiality determines which information should be presented in the financial
statement. It implies that the financial statements should disclose all the material items, i.e. all those items should be disclosed in the annual reports which are likely to influence the economic decisions of the users. The concept of materiality does not depend solely on the amount of information. There is no definite criterion for determining the materiality of information. Any type of information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial report. However, an item material for one purpose may not be material for another purpose. The judgment of the accountant is a strong factor in making material decisions.

**Reliability**

It is the most important characteristic of financial reporting. To be useful, the information must also be reliable. Information submitted in the financial statements shall be taken to be reliable if it is free from material error and is unbiased and can be dependent upon by users to represent event and transactions faithfully. So it is the responsibility of management to report reliable information in annual reports. Faithful representation, neutrality, completeness are the backbone of reliability. To be reliable, information must represent faithfully the transactions and other events. Like faithful representation, to be reliable, the information contained in financial reports must be neutral, that is, free from bias. Financial reports are not neutral if they influence the making of a decision or judgment in order to achieve a predetermined results or outcome. Again, to be reliable, the information in financial reports must be complete from every angle. An omission can cause information to be false or misleading.

**Comparability**

The information must be comparable, i.e. it must be prepared in such a way as to make it capable of being compared realistically with previous or similar information. Users must be able to compare the financial reports of an entity through time in order to identify trends in its financial position and performance. Users must be able to compare the financial reports of different entities in order to evaluate their relative financial position, financial performance and cash flows because users wish to compare the financial position, financial performance and cash flows of an entity over time. It is important that the financial report shows corresponding information for the preceding periods. An important implication of the qualitative characteristic of
comparability is that users be informed of the accounting policies employed in the preparation of the financial report, any changes in those policies and the effects of such changes. Users need to be able to identify differences between the accounting policies for like transactions and other events used by the same entity from period to period and by different entities.

**Timeliness in Reporting**

“Timeliness” is an essential attribute of corporate reporting. It emphasizes on the publication of the financial as well as non-financial information, as rapid as possible, to ensure the availability of current information in the hands of the investors and other interested parties. Timeliness in reporting is one of the important qualitative objectives of financial statements which require that at the end of an accounting period, the relevant information should be quickly passed on to the shareholders and other users of financial statements. The investors and creditors base their investment and credit decisions on the information supplied to them, therefore, the earlier they get this information the better because they can then make necessary changes in their portfolio before it is too late. So, the accounting information must be communicated immediately after the finalization of results to make it useful and meaningful. Timely reporting is an essential element of adequate disclosure. The annual reports are not an end in themselves but they intend to provide information to a large variety of individuals and institutions, which may use it in decision making.

Consistency and practicability are also the part of the qualitative characteristics of the financial reporting.

**2.4 The Users of Financial Reporting**

Accounting information is very much necessary in the present era to meet the needs of the various user groups. The information contained within accounting reports should reduce uncertainty in the minds of users over the financial position and performance of the business. For this purpose, the business enterprises should have to prepare financial statements. Financial statements are accounting reports prepared in order to communicate information about the financial performances. Financial statements are still viewed as the core of computing financial reporting.
The annual reports and accounts are regarded as a good opportunity to inform a large number of people about a company. Normally, the companies want to keep in touch with their shareholders and other prospective investors. They also wish to appeal to potential creditors, clients and customers, and they may be increasingly concerned about maintaining the confidence of their own employees.

According to ‘The Australian Accounting Standard Board’ in “AASB-FRAMEWORK” in July 2004 as “Framework for the preparation and presentation of financial statement” the users of financial reports include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They use financial reports in order to satisfy some of their different needs for information.

Now the question is who are the main users of financial information relating to a business enterprise?

For accounting information to be useful, an accountant must be clear about for whom the information is being prepared and for what purpose the information will be used. There are likely to be various user groups with an interest in a particular organization, in the sense of needing to make decisions about that organization. The most important groups that use accounting information about private-sector businesses are shown in the following figure –
Main Users of Financial Reporting Relating to Business

Fig. 2.2
Generally there are two types of financial statements users- Internal users and External users. The internal users are management personal; employee’s representatives, labor union, employees etc. and the external users are customer, competitors, tax authorities, Govt., public, creditors, investors etc. Now these can also be shown as in the following sets:

![Diagram of financial statement users](image)

**A Set of Financial Reporting Users**

Fig. 2.3
It is an established fact that different sections of the people like shareholders, lenders, creditors, customers, employees, government and the general public are interested in the financial reports of the business enterprises. In this respect, many corporate houses have taken it to be a regular feature to disclose their operational activities in the form of financial statements.

Financial reporting reflects the economic activity of the firm. Its purpose is to allow users to understand its situation in global and synthetic ways. It produces information for managers as well as for third party stakeholders. There are many uses of financial reporting and they have different needs and expectations. The first user of financial accounting information is the firm itself. Then there are different user groups who can use those. The different users and their different needs may be highlighted as follows:

**Investors**

Investors are the external users of financial statement. They are the providers of risk capital. Different financial reporting information help them to determine whether they should buy, hold or sale the securities. Shareholders are also interested in information which enables them to assess the ability of the entity to pay dividends. Shareholders generally get this information from financial statement.

**Employees**

Employees are the internal users of financial statement. They are interested in information about the stability and profitability of their employers. They are also interested in information which enables them to assess the ability of the entity to provide remuneration, retirement benefits and employment opportunities.

**Lenders**

Lenders are interested in information that enables them to determine whether their loans, and the interest income, will be paid duly or not. Lenders generally get this information from financial statements both historical and Performa (forecast) income statement.
Suppliers and other trade creditors

Suppliers and other creditors are interested in information that enables them to determine whether amounts owing to them will be paid in due time. Trade creditors are likely to be interested in an entity over a shorter period than lenders unless they are dependent upon the continuation of the entity as a major customer.

Customers

Customers have an interest in information about the continuance of an entity, especially when they have a long-term involvement with the entity. They also need the information about the going concern nature of the enterprise.

Government and other agencies

Government and their agencies are interested in the allocation of resources and, therefore, the activities of entities. They also require information in order to regulate the activities of entities, determine taxation policies and to form the basis for national income and similar statistical computation.

Management

The management of an entity has the primary responsibility for the preparation and presentation of financial reports of an entity. They are the internal users of financial reports. Management is also interested in the information contained in the financial reports.

Public

Financial reports may assist the public by providing information about the trends and recent developments in the prosperity of the entity and the range of its activities. Public may be directly or indirectly benefited by the corporate social activities of the different enterprises.

Although corporate reports should seek to satisfy as far as possible the information needs of these user groups, it is considered to be somehow impractical to cover all the needs of diverse users by general purpose reports.
2.5 Elements of Financial Reporting

Statement of Financial Accounting Concept (SFAC) no. 3 in ACCA Study and Revision Pack issued in December 1980, defines ten elements of financial statements of business enterprises, namely -

- Assets
- Liabilities
- Equity
- Investment by owners
- Distribution to owners
- Comprehensive income
- Revenue
- Expenses
- Gains
- Losses

As per the above concept assets are defined having the following three characteristics-

- ✓ Assets will give probable future economic benefits
- ✓ They have been obtained or controlled by a particular entity
- ✓ They have originated as a result of past transaction or events.

But in India, The Indian Companies Act of 1882 was the first comprehensive piece of legislation related to the disclosure of information in the financial statements. Mainly based on the British Act of 1862, it required compulsory preparation of balance sheet and its audit but preparation of profit and loss account and director’s report etc were governed by optional regulations which companies were not bound to adopt. The Companies Act of 1913 corrected the situation to some extent and revised the form of balance sheet though some provisions related to the preparation of profit and loss account, the director’s report, among others continued to be governed by optional regulations. These were made compulsory by the Companies Amendment Act of 1936.
The legal framework relating to companies was materially changed between 1882 and 1956. The quality and quantity of information reported in the financial statements underwent major and substantial changes. After the new Companies Act of 1948 came into force in the U.K, it was considered necessary to review the Indian Companies Act also and in 1950 the Government appointed the Bhabha Committee for this purpose. The Committee recommended the adoption of several other provisions which is considered necessary in the Indian context and suggested a standard form of Balance Sheet. The report of Bhabha Committee paved the way for the evaluation of Companies Act of 1956.

The part of the Companies Law relating to financial reporting was again amended in 1960, 1965 and 1969 and 1974 by passing Amendment Acts in 1961, 1971, and 1973 by issuing Notifications. But, no doubt, the information disclosed in the annual reports of companies today is far more exhaustive and useful than what was being reported before the Companies Act of 1956 came into force. But till now no empirical study has been made in India to find out what exactly are the information needs of people who actually use this information and to what extent these needs are satisfied by the information currently required to be disclosed. Generally financial reports contain two types of reporting: Mandatory disclosure and Non-mandatory disclosure.

Mandatory disclosure refers to those reporting aspects that are legally binding to be disclosed to the users of financial reporting. These are the items which fall in the category of mandatory disclosures for listed companies. Some of the items are voluntary for non-listed companies like Fund Flow/ Cash Flow Statement, Report on Corporate Governance, etc.,

Non-mandatory or voluntary disclosures by its name suggests the disclosure practice that is not legally binding on the business houses to disclose but is required to be included to make the disclosure more appropriate, reasonable and purpose-oriented. Now, voluntary information often involves projections and other forward looking information, which in many cases is more important than the mandatory disclosure of historical information.
Now Mandatory and Non-mandatory disclosure can be shown as follows –

**Table -2.1**

<table>
<thead>
<tr>
<th><strong>Mandatory Disclosure</strong></th>
<th><strong>Non-mandatory Disclosure</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>- Balance Sheet and Profit and Loss account.</td>
<td>- Board of Directors.</td>
</tr>
<tr>
<td>- Schedule forming parts of Balance Sheet and Profit &amp; loss Account.</td>
<td>- Chairman’s Letter to Shareholders.</td>
</tr>
<tr>
<td>- Significant Accounting Policies and notes on Account.</td>
<td>- Environmental Information.</td>
</tr>
<tr>
<td>- Notice of A.G.M.</td>
<td>- Corporate Social Responsibility.</td>
</tr>
<tr>
<td>- Consolidated Cash Flow Statement.</td>
<td>- Economic Value Added</td>
</tr>
<tr>
<td>- Directors Report.</td>
<td>- General Shareholder’s Information.</td>
</tr>
<tr>
<td>- Management Discussion and Analysis Statement.</td>
<td>- Performance at a Glance (Min. Five Years).</td>
</tr>
<tr>
<td>- Consolidated Financial Statement.</td>
<td>- Earning Per Share.</td>
</tr>
<tr>
<td>- Schedule forming part of Consolidated Financial Statement.</td>
<td>- Reconciliation with US GAAP.</td>
</tr>
<tr>
<td>- CEO/CFO Certification of Financial Accounting and Reporting.</td>
<td>- Future Projection</td>
</tr>
<tr>
<td>- Report on Corporate Governance.</td>
<td>- Summary of financial results with maps and charts.</td>
</tr>
<tr>
<td>- Auditors Certificate on Corporate Governance.</td>
<td></td>
</tr>
</tbody>
</table>

### 2.6 Corporate Financial Reporting in India and Asia

Now a days, fast reporting practice is too much necessary to fulfill the required regulatory standards given by Security Exchange Commission (SEC). Under the US Sarbanes – Oxley Act, 2002 the SEC will cut filing periods in phase over 2003-2005. The deadlines for annual reports, for example, will be cut from the
original 90 days to just 60 days for the fiscal year ending on or after December 15, 2005. It can easily be anticipated that these new requirements will raise the bar on reporting standards and will put pressure on regulators in Asia to make improvements soon. In international scenario, Infosys Technology and Hughes software from India show fast reporting practices. Following is the name of some countries and average day taken by them to show their quarterly, semi-annual, annual report consolidated.

**Average days gap between close of Books and Reporting**

Table – 2.2

<table>
<thead>
<tr>
<th>Country (Consolidated)</th>
<th>Quarterly</th>
<th>Semi-Annual</th>
<th>Annual-Report (Consolidated)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>20*</td>
<td>51</td>
<td>63</td>
</tr>
<tr>
<td>China</td>
<td>32*</td>
<td>60</td>
<td>90</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>18*</td>
<td>66</td>
<td>97</td>
</tr>
<tr>
<td>India</td>
<td>25</td>
<td>25</td>
<td>84</td>
</tr>
<tr>
<td>Indonesia</td>
<td>48</td>
<td>58</td>
<td>132</td>
</tr>
<tr>
<td>Korea</td>
<td>37</td>
<td>37</td>
<td>100</td>
</tr>
<tr>
<td>Malaysia</td>
<td>57</td>
<td>57</td>
<td>87</td>
</tr>
<tr>
<td>Philippines</td>
<td>49*</td>
<td>49</td>
<td>86</td>
</tr>
<tr>
<td>Singapore</td>
<td>42</td>
<td>40</td>
<td>83</td>
</tr>
<tr>
<td>Taiwan</td>
<td>30</td>
<td>52</td>
<td>114</td>
</tr>
<tr>
<td>Thailand</td>
<td>31</td>
<td>31</td>
<td>71</td>
</tr>
<tr>
<td>International Average#</td>
<td>35</td>
<td>N.A</td>
<td>59</td>
</tr>
</tbody>
</table>

*only 7 or fewer companies report quarterly in firms sampled.

# comprises 8 selected US and European Blue-chips.

*Source - JP Morgan Estimates as Reported in News Briefs, March 2005*
From the above table it can be understood that some Asian companies performed well against international companies in regard to timeliness of reporting. From the above table it is revealed that four countries namely, Indonesia, Taiwan, Korea and Hong Kong were the slowest reporters – taking long time of 132, 114, 100 and 97 days, respectively but Hong Kong was the fastest quarterly reporting country – just 18 days against International average score of 35. It is a matter of great pride that India stand out for being much faster (25 days) at quarterly reporting, while those in Taiwan (30 days) and Thailand (31 days) also do well. But when it comes to “Consolidated” annual reports, only one country i.e. Australia (63 days), comes closer to the international average of 59 days, while the Singapore and Indian firms report after an average of 83 and 84 days respectively. Unfortunately, Indonesian companies give investors the longest wait of 132 days. The above score has been depicted with the help of Column-chart as follows –
Chart-2.1

Average days gap between close of Books and Reporting

Source-Table-2.2
Asia’s Fastest Reporters in Days

Table -2.3

<table>
<thead>
<tr>
<th>Company</th>
<th>Country</th>
<th>Annual Report</th>
<th>Quarterly Report</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infosys Technologies</td>
<td>India</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Hughes Software System</td>
<td>India</td>
<td>15</td>
<td>15</td>
</tr>
<tr>
<td>SK Telecom</td>
<td>Korea</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Satyam Computers Services*</td>
<td>India</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>TSMC</td>
<td>Taiwan</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td>Capital Land</td>
<td>Singapore</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td>Astra International</td>
<td>Indonesia</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td>Celcom (Malaysia) Bhd.</td>
<td>Malaysia</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td>NC Soft</td>
<td>Korea</td>
<td>30</td>
<td>40</td>
</tr>
<tr>
<td>ST Engineering</td>
<td>Singapore</td>
<td>31</td>
<td>08</td>
</tr>
</tbody>
</table>


*Satyam Computer Services is detected as a biggest corporate fraud (Fudging accounts amounted to Rs. 7136 cr.) in the year 2009.

It is a matter of great pride that some Indian companies like- Infosys Technologies and Hughes software systems have shown their competence in quarterly and annual reporting within 10 days and 15 days respectively (Table -07) while some of the other Asian companies like – NC Software (Korea), TSMC (Taiwan), Capital Land (Singapore), Astra International (Indonesia), and Celcom Bhd. (Malaysia) took more time in quarterly and annual reporting. The above score has been shown with the help of Column-chart 2.2 as follows-
Chart-2.2

Asia’s fastest reporters in Days

Source: Table-2.3
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14. Purdy. Derek, “Pondering the principal : A personal general model of the psychology of users, providers and preparers of published accounts used to comment upon the Accounting Standards board’s draft statement of principles for financial reporting”, ‘Critical Perspective on Accounting’ (1988), Article ID- Pa980265, Dept. of Economics, University of Reading, Whiteknights, Reading RG6 6AA, UK, 9, 545-565 of p. 556-557.


