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Corporate Accounting and Financial Analysis

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Preface

Accounting plays a decisively significant role in the realm of modern corporate management. The accounting information is quite useful to various players in the corporate management system *viz.* owners, creditors, suppliers, potential owners, creditors and suppliers, professional managers, tax authorities and consumers directly and financial analysts, stock exchangers, lawyers, regulatory authorities, bankers, trade associations, trade unions etc. indirectly. Since, accounting information serves the interest of quite a large segment of population, there is an imperative necessity that the information is reported in the financial statements of corporate enterprises in a manner as would serve and promote the interest of stakeholders. This assumes special significance especially in the context of increasing liberalization, privatization and globalization of the economies of the world.

To allow an orderly presentation and disclosure of such information, the Institute of Chartered Accountants of India (ICAI) come out with accounting standards periodically. These standards prescribe the fair mode of reporting the accounting data in the annual financial statements.

Although, there is a regulatory body like the ICAI making corporates, in many cases, mandatory, the reporting in their financial statements a lot of accounting information, the response and compliance from companies is lukewarm. It is exactly on this most current and highly debated topic, we have ventured into editing a book entitled "Accounting and Financial Analysis." The book includes a wide variety of articles touching upon the various facets of the growth, development and adoption of

Despite the fact that the preparation and the presentation of consolidated financial statement provide multifarious advantageous to the users, it is unfortunate that no effort seems to have been made by the Government and the authorities concerned to make it obligatory on the part of the parent company to prepare and present the consolidated financial statements. They merely present the financial statements of their subsidiaries in their annual reports. It is, therefore, suggested that necessary changes be brought about in the proposed amendments to the Companies Act, 1956, to make the consolidation reporting compulsory.

In this connection, the Working Group on the Companies Act, 1956, has observed that before consolidation is made mandatory for holding and subsidiaries companies, the banks and financial institutions should agree to lend on the basis of group leverage and the I.T. Act should recognise consolidation for tax purposes. Moreover, if a group chooses to consolidate on a voluntary basis, then it should not be required to annex the accounts of its subsidiary companies under Section 212 of the Act as necessary at present.

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Chapter: Eight

Corporate Financial Reports: Users Expectations

—M. Selvam*

Introduction

The rapid growth in modern industrialization has brought considerable expansion in the supply of capital through investment markets. Investment markets not only provide investment opportunities but also help in directing the flow of capital into business firms which can use capitals most effectively. There is a strong feeling that the availability of reliable financial information through financial reports is inadequate and may not fulfil the changing expectations of the users.

Financial Reporting—Concept

The term 'financial reporting' denotes communication of published financial statements. It is the communication of accounting information of an entity (individual, firm, company, Government enterprises) to all users. It contains both qualitative and quantitative information. In the past financial statements were prepared primarily for shareholders because companies

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were internally financed; outsiders had no interest in the affairs of the corporation. Subsequently other parties such as investors and their advisers, tax authorities, employees, creditors, customers, governmental agencies, general public etc., have become interested in financial reports.

Fundamental Objectives

The fundamental objective of financial reporting system is to communicate the information regarding the position and performance of an entity to the readers. Such information should be true and fair. There should be adequate disclosure at the right time, so that, the readers can make a sound analysis and take a judicious economic decision.

Financial Reports—Statutory Requirements

It is a known fact that in the form of business organisation, published accounts and other related information have become inevitable. The forms and contents of reports have undergone vital changes from time to time. In India, various rules and regulations have been made in connection with form, content and time of preparation of corporate financial reports. Otherwise, corporate management may ignore many information and present the reports in their own form at their own time. Besides, in view of the changes according to the needs and expectations of the users and the practice followed abroad, appropriate amendments have been made in the Act now and then. It is mainly for the purpose of enforcing healthy practice in providing adequate information in the financial reports. The various Laws/Acts were : Indian Companies Act 1882, Indian Companies Act 1913, Companies (Amendments) Act 1936, Indian Companies Act 1956, Amendments in 1961, Amendments in 1973 etc. Further, Sachar Committee—(a high powered) was also constituted to suggest various information to be included in the financial reports.

Although a number of laws have been enacted and amended, much has to be done in order to enhance the quality and quantity of the disclosed information which may come up to the changing expectations and needs of the readers. Hence,

various expectations of the users are to be identified, in order to achieve the very purpose of preparing the financial reports.

Financial Reports—Content

As per the provisions of the Law, the following are the minimum contents of corporate financial reports.

- (a) Balance Sheets
- (b) Profit and Loss Account
- (c) Fund Flow Statement (Restricted to listed companies only in Pakistan)
- (d) Auditor's Report
- (e) Director's Report

It is left to the discretion of the corporate management to disclose the type and extent of information that has been prescribed by the law. In practice, forward looking and enlightened managements of an enterprise show much more than what the law prescribes as the content. Besides, several dimensions have been added in respect of disclosure of information relating to inventories, depreciation, information regarding subsidiary and holding companies etc. Even then one cannot come to a specific conclusion that financial reports fulfil all the expectations. Another important aspect to be included is the expectations of society. The society looks forward to receiving service from the corporate sectors. Therefore, contribution made to the society needs to be included in the financial reports.

Financial reports are the need of the users. The type of information needed to be reflected in financial reports may include many details. Some of the important aspects are summarized below:

- (a) Expenditure incurred on non-current assets *e.g.*, construction, rehabilitation, presentation cost of sites etc.
- (b) Cost of acquisition of equipments used for reducing pollution, recycled by-products, reduced energy etc.
- (c) Some technical matters need to be disclosed in financial reports *e.g.*, energy consumptions, noise levels, waste production and recycling.

- (d) Cost incurred on disposal of waste.
- (e) Rehabilitation cost of hazardous waste disposal sites.
- (f) Legal, consulting and administrative costs incurred to comply with environmental laws and regulations etc.

Table 8.1
Expectations of the Users of Corporate Financial Reports

Sl. No.	Type of Users	Type of Expectations & Needs
1.	Investors	: To ascertain profitability and risk
2.	Public	: To know about productive use of resources
3.	Lay Persons	: To understand the contents of financial reports in ordinary day-to-day language.
4.	Trade Unions	: To stay updated on profitability and productivity
5.	Tax Authorities	: To finalize tax assessment
6.	Creditors (a) Short Term	: To determine liquidity for repayment of loans
	(b) Long term	: To ensure liquidity, safety and repayment of loans
7.	Auditors (a) Internal	: To adhere to the internal policies of the enterprise
	(b) External	: To express an independent opinion on financial statement
8.	Regulators	: To ensure compliance of regulations relating to financial statements
9.	Competitors	: To get an idea about the strength of a corporate body
10.	Fund Managers	: To analyze for guiding of potential investors
11.	Academicians	: To undertake research
12.	Press	: For analytical and critical analysis
13.	Management	: For cost control, identifying negative trends
14.	Related parties	: For understanding inter relationships

Users Expectations

Financial report is a part of the information system of an enterprise. Several persons are using these financial reports for various purposes. Therefore, while preparing corporate financial reports, due weightage must be given to the changing needs and expectations of the users. A list of the possible expectations of users is given in Table 8.1. These are the identified expectations of the several users looked at from several angles.

It is also important to note that the challenges posed in our countries are:

- (a) Internationalization,
- (b) Universalization,
- (c) Globalization,
- (d) Deregulations,
- (e) Disinvestment,
- (f) Denationalisation etc.

Besides, competitive thinking is growing and the world is fastly becoming a global village. Accordingly the expectations and needs from corporate financial reports may vary. This should also be taken into account.

Conclusion

Developing countries like India need good financial reports which fulfil the changing expectations and needs of the users. In the same way developed countries like USA, Canada etc., have shown the way in this respect. Innovative initiatives will crystallize in reality to serve our government and society. This will meet the emerging challenges regarding financial reports of our country.