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ACCOUNTING FOR FINANCIAL REPORTING

ABSTRACT:

The main purpose of this study is to know about the financial reporting with regards to Indian Financial Reporting Standards, their scope, importance and functions. It is used to determine, forecast and evaluate the best of economic conditions and company's performance in the future. Financial reporting refers to standard practices to give stakeholders an accurate depiction of a company's finances, including their revenues, expenses, profits, capital, and cash flow, as formal records that provide in-depth insights into financial information.

INTRODUCTION:

Financial reporting involves the disclosure of financial information to management and the public (if the company is publicly traded) about how the company is performing over a specific period of time. Financial reports are usually issued on a quarterly and annual basis.

In any industry, whether manufacturing or service, we have multiple departments, which function day in day out to achieve organizational goals. The functioning of these departments may or may not be interdependent, but at the end of the day they are linked together by one common thread – Accounting & Finance department. The accounting & financial aspects of each and every departments are recorded and are reported to various stakeholders. There are two different types of reporting – Financial Reporting for various Stake Holders & Management. Both this reporting are important and are an integral part of Accounting & Reporting system of an organization. But considering the number of stakeholders involved and statutory & other regulatory requirements,

Financial Reporting is a very important and critical task of an organization. It is a vital part of Corporate Governance.

Financial Reporting involves the disclosure of financial information to the various stakeholders about the financial performance

and financial position of the organization over a specified period of time. These stakeholders include – investors, creditors, public, debt providers, governments & government agencies. In case of listed companies the frequency of financial reporting is quarterly & annual. Financial Reporting is usually considered an end product of Accounting.

Financial reporting is the disclosure of financial results and related information to management and external stakeholders such as investors, customers, and regulators about how a company is performing over a specific period of time. It is a way of presenting data about a company's financial position, the company's operating performance, and the flow of funds over an accounting period.

According to ACCA, the objectives of Financial Reporting Standards (FRS) are defined as follows – "The overall objective of the FRS is to require all entities falling within its scope to highlight a range of important components of financial performance to aid users in understanding the performance achieved by an entity in a period and to assist them in forming a basis for their assessment of future results and cash flows."

And moreover, the American Financial Accounting Standards Board defines Financial Reporting as follows – "activities which are intended to serve the informational needs of external users who lack the authority to prescribe the financial information they want from an enterprise and therefore must use the information that management communicates to them".

Based on above mentioned definitions, it is understood that a company's financial information should be communicated to its relevant stakeholders such as shareholders, investors, government, lenders and others who are making business, financial and credit decisions.

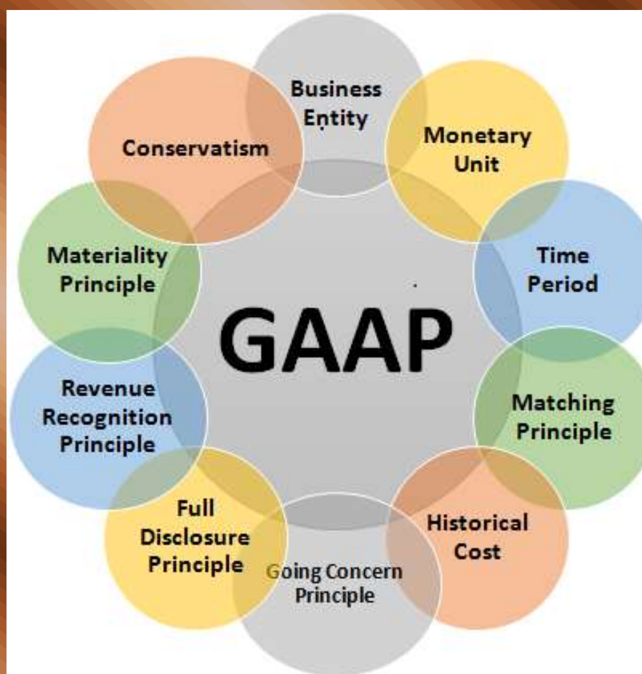
However, as globalization is intensifying and creating multinational companies and organizations, accounting practices and regulations became different across different countries and the consistency became a very important and critical issue. It became difficult to measure income and expenditure in the income statement, as well as measuring and recognizing assets and liabilities in the balance sheet.

Therefore, it is often really hard for anyone making business and financial decisions, to decide when comparing two companies' financial statements especially if they are located in two different locations.

Nobes and Parker (2008) also state that if a number of accountants from different countries, or even one country, are given a set of transactions from which to prepare financial statements, they will not produce identical statements.

Even if they all follow a set of rules and regulations, whether implicit or explicit, there is no format or set of rules that completely covers every eventuality to the minutest detail, which makes financial reporting inconsistent.

One of the clearest examples for inconsistencies in international reporting systems was in the case of GlaxoSmithKline and Diamler Chrysler.



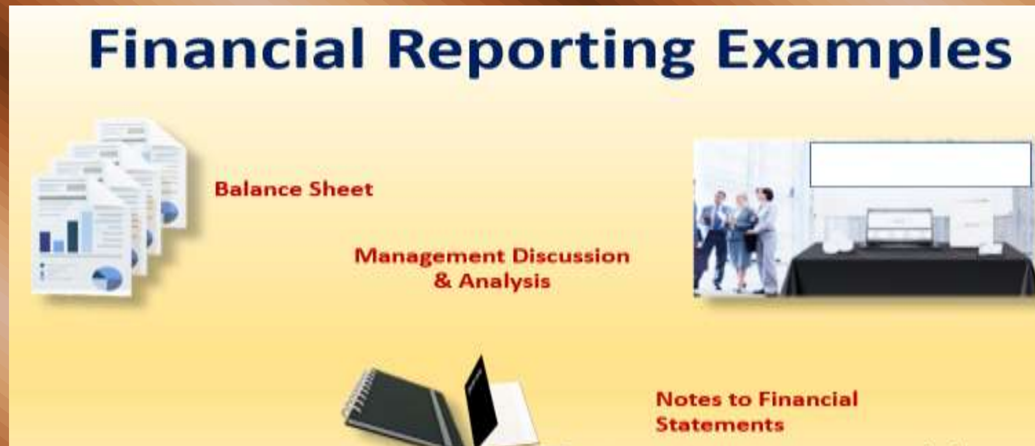
Before its merger with Chrysler Daimler, Benz obtained in 1993 a listing of their shares in the US and in so doing needed to report under both US Generally Accepted Accounting Principles (GAAP) and German GAAP.

It is usually expected that the profit reported under the same principles would be the same but the company reported a loss of $1 billion under the US GAAP and a profit of $370 million under German GAAP (Greenwood & Eyles 2005).

And International Accounting Standards Board as the international regulator has been trying to ensure that companies meet the standard requirements in the preparation of their financial statements and their presentations. However, this does not entirely solve the problems of financial reporting as different countries have different factors such as their cultural environment that shape up financial reporting in each country.

There has been an impressive attempt to reduce them particularly by the IAS who is the issuer of International Financial Reporting Standards (IFRS). The aim of this body is to achieve harmonization in accounting practices so as to enhance globalization in capital markets.

COMPONENTS OF FINANCIAL REPORTING:



1. The financial statements – Balance Sheet, Profit & Loss account, Cash Flow statement & Statement of changes in stock holder's equity
   - ***Balance sheet:***

     A balance sheet is a financial statement that reports a company's assets, liabilities and shareholders' equity. The balance sheet is one of the three (income statement and statement of cash flows being the other two) core financial statements used to evaluate a business.
   - ***Profit and Loss Account:***

     The Profit and Loss (P&L) statement is a financial statement that summarizes the revenues, costs, and expenses incurred during a specified period, usually a fiscal quarter or year. These records provide information about a company's ability or inability to generate profit by increasing revenue, reducing costs, or both.
   - ***Cash Flow statement:***

     A cash flow statement is a financial statement that provides aggregate data regarding all cash inflows a company receives from its ongoing operations and external investment sources. It also includes all cash outflows that pay for business activities and investments during a given period.
   - ***Statement of Changes in Stock Holder's Equity:***

     The statement of changes in stockholders' equity is where you find certain technical gains and losses that increase or decrease owners' equity but that are not reported in the income statement. It serves as a columnar footnote for the various

owners' equity accounts in the balance sheet. The components of stockholders' equity include the par value of outstanding shares, the amount of retained earnings, the value of any treasury stock and any additional paid-in capital.

2. **The notes to financial statements:**

   Financial statement notes are the supplemental notes that are included with the published financial statements of a company. The notes are used to explain the assumptions used to prepare the numbers in the financial statements, as well as the accounting policies adopted by the company.

3. **Quarterly & Annual reports (in case of listed companies):**

   A quarterly report is a summary or collection of unaudited financial statements, such as balance sheets, income statements, and cash flow statements, issued by companies every quarter (three months).

4. **Prospectus (In case of companies going for IPOs):**

   A prospectus is defined as a legal document describing a company's securities that have been put on sale. The prospectus generally discloses the company's operations along with the purpose of the securities being offered.

5. **Management Discussion & Analysis (In case of public companies):**

   Management discussion and analysis (MD&A) is a section within a company's annual report or quarterly filing where executives analyze the company's performance. The section can also include a discussion of compliance, risks, and future plans, such as goals and new projects.

The Government and the Institute of Chartered Accounts of India (ICAI) have issued various accounting standards & guidance notes which are applied for the purpose of financial reporting. This ensures uniformity across various diversified industries when they prepare & present their financial statements. Now let’s discuss about the objectives & purposes of financial reporting.

OBJECTIVES OF FINANCIAL REPORTING:

According to International Accounting Standard Board (IASB), the objective of financial reporting 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 following points sum up the objectives & purposes of financial reporting –

1. Providing information to the management of an organization which is used for the purpose of planning, analysis, benchmarking and decision making.
2. Providing information to investors, promoters, debt provider and creditors which is used to enable them to male rational and prudent decisions regarding investment, credit etc.
3. Providing information to shareholders & public at large in case of listed companies about various aspects of an organization.
4. Providing information about the economic resources of an organization, claims to those resources (liabilities & owner's equity) and how these resources and claims have undergone change over a period of time.
5. Providing information as to how an organization is procuring & using various resources.
6. Providing information to various stakeholders regarding performance management of an organization as to how diligently & ethically they are discharging their fiduciary duties & responsibilities.
7. Providing information to the statutory auditors which in turn facilitates audit.
8. Enhancing social welfare by looking into the interest of employees, trade union & Government.

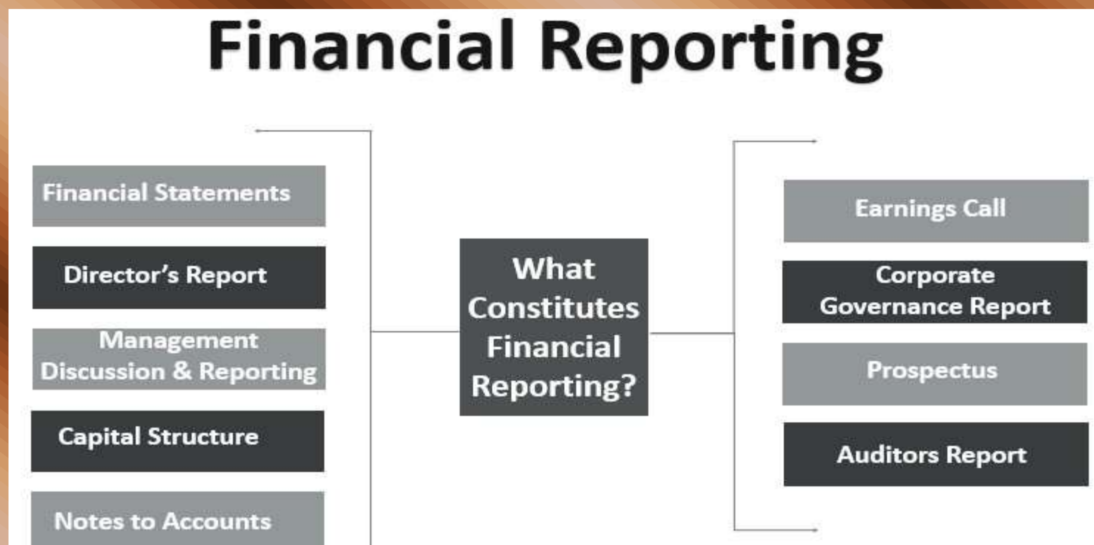
IMPORTANCE OF FINANCIAL REPORTING:

The importance of financial reporting cannot be over emphasized. It is required by each and every stakeholder for multiple reasons & purposes. The following points highlights why financial reporting framework is important –

1. In help and organization to comply with various statues and regulatory requirements. The organizations are required to file financial statements to ROC, Government Agencies. In case of listed companies, quarterly as well as annual results are required to be filed to stock exchanges and published.
2. It facilitates statutory audit, the Statutory auditors are required to audit the financial statements of an organization to express their opinion.
3. Financial Reports forms the backbone for financial planning, analysis, benchmarking and decision making. These are used for above purposes by various stakeholders.
4. Financial reporting helps organizations to raise capital both domestic as well as overseas.

5. On the basis of financials, the public in large can analyze the performance of the organization as well as of its management.
6. For the purpose of bidding, labor contract, government supplies etc., organizations are required to furnish their financial reports & statements.

FUNCTIONS OF FINANCIAL REPORTING:



- To monitor whether the accounts of certain classes of companies and other under takings comply with the companies act and IAS regulation.
- Developing policy regarding the imposition of levies on the authorities financial statement review constituency.
- Assisting the board to discharge its functions and as an advisor to the minister on accounting related matters.
- Identifying and maintaining under review, the composition of authorities financial statements review constituency.
- Liaising with other countries financial reporting monitoring bodies.
- Co-operating in the development of accounting standards and practice notes.

FINANCIAL REPORTING REGARD TO SOLE PROPRIETORSHIP:

A sole proprietorship is a business owned by one person. Many small service enterprises, retail stores and professional practices are operated as proprietorships. The owner is the legal owner of its assets, is legally liable for its debts and is entitled to all the earnings of the proprietorship. From

an accounting standpoint, however, the business is treated as a separate entity from its owner. The sole trader financial statements are the balance sheet, the income statement, statement of change in owner's equity and the statement of cash flows.

- ***The Balance Sheet***

  The balance sheet or statement of financial position reports the financial position of a business, including a sole proprietorship, at a specific point in time. The financial position of a sole proprietorship is shown by the amount of the assets held, its liabilities and the amount of the owner's capital. The balance sheet of a sole proprietorship indicates the name of the business, the name of the statement and the date of the statement. It can be drawn in horizontal or vertical format.

- ***Statement of Financial Performance***

  The statement of financial performance, also known as the income statement or trading account, reports the results of earnings activities for a specific time period, such as a month, quarter or year. The net income of the sole proprietorship is the excess of revenues over expenses for that time. If expenses exceed revenues, the sole proprietorship incurs a net loss. Revenues are the increases in owners' capital from the sale of goods or the performance of services.

- ***Statement of Changes in Owner's Equity***

  The statement of changes in owner's equity serves as a link between the balance sheet and the income statement by explaining the changes that took place in the owner's equity or capital during the period covered. The statement shows the beginning amount of equity, the events that increased it, i.e., new investments and net income, and the events that decreased it, i.e., net loss or withdrawals.

- ***Statement of Cash Flows***

  The fourth sole trader financial statement is the statement of cash flows, which describes where the cash came from and where it went during the period. It also shows how much cash was on hand at the beginning of the period and at the end. This information is crucial to the sole proprietor because good cash management is essential for the prosperity and eventual survival of the business.

FINANCIAL REPORTING TO PARTNERSHIP FIRMS:

The proprietorship form of ownership suffers from certain limitations such as limited resources, limited skill and unlimited liability. Expansion in business requires more capital and managerial skills and also involves more risk. A proprietor finds him unable to fulfill these requirements. This call for more persons come together, with different edges and start business. For example, a person who lacks managerial skills but may have capital.

Another person who is a good manager but may not have capital. When these persons come together, pool their capital and skills and organize a business, it is called partnership. Partnership grows essentially because of the limitations or disadvantages of proprietorship.

- **How to Prepare a Financial Statement of a Partnership Firm**

A partnership entails two or more individuals working together toward a particular objective. In some jurisdictions, there may be an upper limit to the number of partners. The main difference between accounting for partnerships and accounting for general organization firms is that the earnings have to be allocated to each partner. The revenue may be allocated according to the ratio of capital invested or an agreed upon fractional basis.

The fractional partnerships clearly set out the percentage of earnings each partner can take home. When using the ratio of capital invested method, the partners receive a salary proportional to their percentage of equity in the firm.

- **How to Prepare Partnership Financial Statements**

Financial statements are prepared for partnerships the same way as they are for limited liability companies. For partnerships, the balance sheets are usually prepared with the cash and equivalents at the beginning, followed by the current and fixed assets and then liabilities.

The assets and liabilities on the partnership income statement are similar in structure and placement with other types of businesses, although there is a difference in owner equity entries. These are allocated to each partner according to the earnings allocation approach used by the organization. The changes are compiled in the statement of the partner's equity.

After the fiscal period, the fractional ownership interest of each partner is recalculated according to their contributions during the fiscal year. Limited liability companies do not have this element in their financial statements.

- **How to Prepare a Statement of Partners' Equity**

The statement of partners' equity is a report that illustrates the adjustments in the total partners' capital accounts during an accounting period. It illustrates increases and decreases within the accounts over the financial period.

The statement of partners' equity only lists transactions affecting the equity accounts. It uses net income or contributions during the fiscal year to ascertain the ending balance. The equity equation for these statements can be denoted as:

Ending Capital Balance = Beginning capital balance + net income + contributions – (net loss + distributions)

a. Determining the Starting Balance

The starting balance is most often derived from the ending balance on the capital account from the previous year. Should it be the business's first year, then the beginning balance is the partner contribution. After the first fiscal period, the ending balance is carried to the next season and becomes the future starting balance of the equity account. A partnership can have a single capital account for all involved partners with a supporting schedule that allows for the breakdown of the capital account for each party.

b. Maintaining Capital Accounts

It is easier to maintain separate capital accounts to avoid unnecessary friction. It makes it simpler to assess the amount to be distributed to each partner should there be liquidation or the departure of a partner. It also reduces the complexity in discussions over remuneration and liabilities among the partners. The payment given to a partner upon the liquidation of the business may not equal the balance in the partnership capital before the split.

When assets are sold and the liabilities are dealt with, their market values may affect the overall ratio of the distribution.

LATEST NEWS REGARDING FINANCIAL REPORTING:

ICAI plans to use AI to identify non-compliances in financial statements

Chartered accountants' apex body ICAI is planning to use artificial intelligence to identify non-compliances with respect to financial statements as part of efforts to boost its review process.

The Institute of Chartered Accountants of India (ICAI) through its Financial Review Reporting Board (FRRB) is gearing up for another technological advancement by way of utilizing Artificial Intelligence (AI).

"The proposed system will have capability of AI/analytics so that common non-compliance can be flagged using system AI on the basis of XBRL financial statement of the enterprise.

According to the release such a system will enable the automation of work flow of FRRB between various review levels as well as maintain repository of non-compliances observed by the board.

The system will also help in scaling up the number of cases being undertaken for review as well as in strengthening financial reporting practices in India.

The FRRB constituted in July 2002 seeks to improve financial reporting practices and quality of audit by Chartered accountants

CONCLUSION:

Financial reporting refers to standard practices to give stakeholders an accurate depiction of a company’s finances, including their revenues, expenses, profits, capital, and cash flow, as formal records that provide in-depth insights into financial information. Financial reporting uses financial statements to disclose financial data that indicates the financial health of a company over during a specific period of time. The information is vital for management to make decisions about the company’s future and provides information to capital providers like creditors and investors about the profitability and financial stability of the company. Financial statements provide various important financial information that helps investors, creditors and analysts evaluate a company’s financial performance. A lot of the financial information in financial reporting is required by law or by accounting standard practices. Financial reporting helps management communicate the past successes and future expectations of the business. Generally, financial reporting provides information about the results of the operation, financial position and cash flows of a business.

Readers review the statement to decide the allocations of resources. Financial reporting is a way of following standard accounting practices to give an accurate depiction of a company's finances. Financial reporting is typically viewed as companies issuing financial statements. A general purpose set of financial statements include a balance sheet, income statement, statement of owner's equity, and statement of cash flows, but financial reporting is much more broad than just as set of financial statements. Financial reporting may be subject to the requirements of the applicable accounting framework, such as GAAP or IFRS. Financial Reporting is a very important and critical task of an organization. It is a vital part of Corporate Governance.

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