



Objectives of Financial Reporting by Business Enterprises

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ABSTRACT

Financial Reporting is the reporting of accounting information of an entity (individual, firm, company, government enterprise) to its stakeholders. Financial Reporting objectives in accounting literature has focused on general purpose financial reporting which aims to satisfy the information needs of all potential users. If accounting reports are to become a universal means of communication, action must be taken to harmonies the worldwide efforts to meet the international user's needs. Company law provisions in almost all countries of the world have consistently accepted the utility of general purpose financial reporting.

KEYWORDS

Financial reporting, General purpose, Management activities

Introduction

Financial reporting may be defined as communication of published financial statements and related information from a business enterprise to third parties (external users) including shareholders, creditors, customers, governmental authorities and the public. It is the reporting of accounting information of an entity (individual, firm, company, government enterprise) to a user or group users. Company financial reporting is a total communication system involving the company as issuer (preparer); the investors and creditors as primary users, other external users; the accounting profession as measures and auditors and the company law regulatory or administrative authorities. Firstly, the cost of developing specialized reports to satisfy special requirements of specific users may exceed the benefits when the company financial reporting policy is determined in its totality. Secondly, specialized needs of specific users cannot be ascertained with any degree of certainty. Thirdly, issuing multiple reports about the financial results of an enterprise can create confusion among various users. Fourthly, multiple reports may not be desirable and practicable from the standpoint of information economics.

Harmonization and Financial Reporting:-

Harmonization simply means maintaining uniformity in financial accounting uniformity in financial accounting standards and practices at the international level. It implies international harmony in transactional financial reporting to investors. It emphasizes to narrow the areas of difference and to eliminate undesirable alternative practices in financial reporting. Uniformity expedites the training of accounting of accounting practitioners, increases the reliability of accounting reports and tends toward a rational development of accounting theory. Flexibility, the opposite of uniformity, allows better adaptability of accounting methods in each firm, each industry, or each type of transaction. Besides, the absence of a single method provides scope for further experimentation. New and better theories may results. As international trade and investment multiplies, accounting's international dimension broadens. Due to growth in trade across national frontiers, international financial reporting has become more important as the tool of communication among traders, entrepreneurs, financiers, and investors. At the same time, variations are evolving in accounting principles, audit practices, financial statement presentations, and professional standards. If accounting reports are to become a universal means of communication, action must be taken to harmonies the worldwide efforts to meet the international user's needs.

Objectives of financial reporting:-

The following may be described as the primary objectives of financial reporting:

1. Investment Decision- Making
2. Management Accountability

Investment Decision-Making

The basic objectives of financial reporting are to provide information useful to investors, creditors and other users in making sound investment decisions. The Trueblood Committee stated that... "The basic objective of financial statements is to provide information useful for making economic decisions." Recently, the FASB (USA) in its Concept No.1 also concluded that "Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit and similar decisions."

Management Accountability

A second basic objective of financial reporting is to provide information on management accountability to judge management's effectiveness is utilizing the resources and running the enterprise. Management of an enterprise is periodically accountable to the owners not only for the custody and safe-keeping of enterprise resources, but also for their efficient and profitable use and for protecting them to the extent possible from unfavorable economic impacts of factors in the economy such as technological changes, inflation or deflation. Management accountability covers modern performance issues based on efficiency and effectiveness notions. The management accountability concept includes information about future activities, budgets, forecast financial statements, capital expenditure proposal etc. Accountability is beyond the narrow limits of companies' legal responsibilities to shareholders (and sometimes debenture holders and creditors). It obviously includes the interest of persons other than existing shareholders.

Management accountability is of very great interest not only to existing shareholders and other users but also to potential shareholders, creditors and users. A company generally offers shares, debentures etc to the respective investing public and therefore it should accept accountability responsibilities to prospective investors also. Certainly annual and other financial statements are intended to play a major role in this regard.

Development of financial reporting objectives

The subject of financial reporting objectives has been generally

recognized as very important in accounting area since a long time. Many accounting bodies and professional institutes all over the world have made attempts to define the objectives of financial statements and financial reporting which are vital to the development of financial accounting theory and practice. This section describes developments in this area at the international level, particularly USA, UK and Canada.

The true Blood Report

In view of the criticisms of corporate financial reporting and the realization that a conceptual framework of financial accounting and reporting was needed, the AICPA formed two study groups in 1971....one was called The Study Group on the Establishment of Accounting Principles, headed by Francis M. Wheat (its recommendations, which led to the establishment of the FASB and the other was called 'The study Group on the Objectives of Financial Statements', headed by Robert M. True blood. The report of the second group, called the True blood report was published in October 1973. 'This committee was asked to consider the following four questions:

- 1. Who need financial statements
- 2. What information to they need
- 3. How much of the needed information can be provided by accountants
- 4. What framework is required to provide the needed information

The committee was charged with the development of the objectives of financial statements. The committee comprised nine members representing industry, the accounting profession, the academics, and the Financial Analysts Federation. The staff was drawn from academicians, practitioners, and consultants. Views of more than 5000 corporation and other organizations were solicited by the Committee. It conducted more than 50 interviews and held 35 meetings with interested institutional and professional groups.

General Purpose Financial Reporting

Generally speaking, the term financial reporting is used to mean general purpose external financial reporting. Often it is said that the purpose of financial reporting is the preparation of general purpose reports for external users. Despite the fact that financial reports are mainly intended (legally) for shareholders, they can be, and are, used by a number of other external users. Existing and potential shareholders use company annual reports to evaluate the investment potential of a company's shares, creditors and lenders to assess the creditworthiness and liquidity, government to administer the company law provisions, employees to decide matters like collective bargaining and employment prospects, etc. In addition, information provided to meet investors and creditors needs is likely to be generally useful to members of other user groups who are interested in essentially the same financial aspects of business enterprises as investors and creditors.

Table: 1 Decisions made by different users Groups

User groups	Decisions
Shareholders	Share purchase or sale decisions; takeovers and mergers; assessing management performance.
Investment analysis	Analysis for advising clients on share purchase or sale decisions, takeovers and mergers, assessing management performance.
Creditors and other suppliers	Credit granting decisions; bankruptcy risk assessments; terms for credit.
Competitors	Assessment of financial performance for competitive advantage.

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The basic objective of financial statements is to provide information useful for making economic decisions:-

- An objective of financial statements for governmental and not-for-profit organizations is to provide information useful for evaluating the effectiveness of the management of resource in achieving the organization's goals. Performance measures should be quantified in terms of identified goals.
- An objective is to provide a statement of financial activities useful for predicting, comparing, and evaluating enterprise earning power. This statement should report mainly on factual aspects of enterprise transactions having or expected to have significant cash consequences. This statement should report data that require minimal judgment and interpretation by the prepare.
- An objective of financial statements is to provide users with information for predicting, comparing, and evaluating enterprise earning power.
- An objective of financial statements is to supply information useful in judging management's ability to utilize enterprise resources effectively in achieving the primary enterprise goal.
- An objective of financial statements is 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.

Suggestions:-

- Company financial reporting, in future, will continue to adhere to general purpose reporting system to aid investors, creditors, and other external users in their economic decisions.
- Meanwhile, in order to achieve the objectives of financial reporting (through general purpose reports) there is a continuous need to investigate many vital aspects relating to general purpose financial reports.
- Identifying potential users and user groups
- Identifying needs of such users, determining the feasibility of providing general purpose information to meet these needs.
- Determining the manner of reporting such information, and having a feedback from the users regarding the use and relevance of general purpose information.
- Financial reporting is not an end in itself but is intended to provide information that is useful in making business and economic decisions.
- Financial reporting is not designed to measure directly the value of a business enterprise, but the information it provides may be helpful to those who wish to estimate its value.
- An objective of financial statements is to report to those activities of the enterprise affecting society which can be determined and described or measured and which are important to the role of enterprise in its social environment.