THE CONTEXT AND PURPOSE OF FINANCIAL ACCOUNTING

Financial reporting plays a vital role in world economies. Its primary purpose is to provide relevant and useful information to the owners of a company where there is a division between the ownership and control of that company. This occurs mainly in public limited companies, where share capital is sold to the public through a stock market/exchange system. The diverse and potentially geographically dispersed shareholders do not get involved in the management of their company; they appoint directors to do this on their behalf. The owners receive an annual statement summarising the performance and position of their company so that they can assess how well their investment has performed during the reporting period.

Without this reporting system investors would be less inclined to part with their capital as they would have no way of monitoring how effectively the company is being run by the directors, the appointed stewards of the company who are supposed to be operating in the best interests of the shareholders.

In order to meet the needs of the users of the financial statements companies have to implement accounting systems that provide the information needed. It is also important that this system is regulated to ensure that the information provided to the users is in an appropriate format and that it is useful to their informational requirements. This is achieved through a financial reporting framework, the basis of which is a conceptual framework.

Financial Reporting

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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 department are recorded and are reported to various stakeholders. There are two different types of reporting – **Financial reporting** for **various stakeholders** & **Management Reporting** for **internal Management** of an organization. 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. Let’s discuss various aspects of Financial Reporting in the following paragraphs.

Definition of Financial Modeling

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. The typical components of financial reporting are:

1. The financial statements – **Balance Sheet**, **Profit & loss account**, **Cash flow statement** & **Statement of changes in stock holder's equity**
2. The **notes** to **financial statements**
3. **Quarterly** & A**nnual reports** (in case of listed companies)
4. **Prospectus** (In case of companies going for IPOs)
5. **Management Discussion & Analysis** (In case of public companies)

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 & purposesof 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.

Now let’s discuss few aspects about importance of financial reporting.

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.

Conclusion

So we can conclude from the above points that financial reporting is very important from various stakeholders point of view. At times for large organizations, it becomes very complex but the benefits are far more than such complexities. We can say that financial reporting contains reliable and relevant information which are used by multiple stakeholders for various purposes. A sound & robust financial reporting system across industries promotes good competition and also facilitates capital inflows. This, in turn, helps in economic development.