

Class: MSc

Subject : Business Finance

Chapter: Unit 3 Chapter 3

Chapter Name: Introduction to financial reporting

Today's Agenda

1. Define an annual report
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 2. Why is there need for sustainability reporting?
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1 Define Annual report



An annual report is a document that public corporations must provide annually to shareholders that describes their operations and financial conditions

1.1 Annual Report Constituents

- Directors Profile
- Financial Statement Highlights
- Comparative of Financial Numbers
- Review of Operations
- Material Disclosures
- Director's Report
- Auditors Report
- Statement of Accounting Policies
- Financial Statements
- Notes to Accounts

1.2 Auditor's report

- Auditors must comment on whether, in their opinion, the statement of financial position and statement of profit or loss have been properly prepared in accordance with the Companies Acts and relevant accounting standards, and whether, in their opinion, the accounts give a true and fair view.
- The fundamental purpose of the audit report is to add credibility to the financial statements.
- Audit Report includes:
 - Responsibility matrix between the Management and the Auditor
 - Compliance to regulations, accounting standards, etc.
 - Basis of Audit Opinion

1.3 Variations on the standard report

The wording of the standard report can be modified if the auditor wishes to highlight areas of uncertainty or is unable to express an unqualified opinion that the financial statements give a true and fair view.

There are various degrees of qualification:

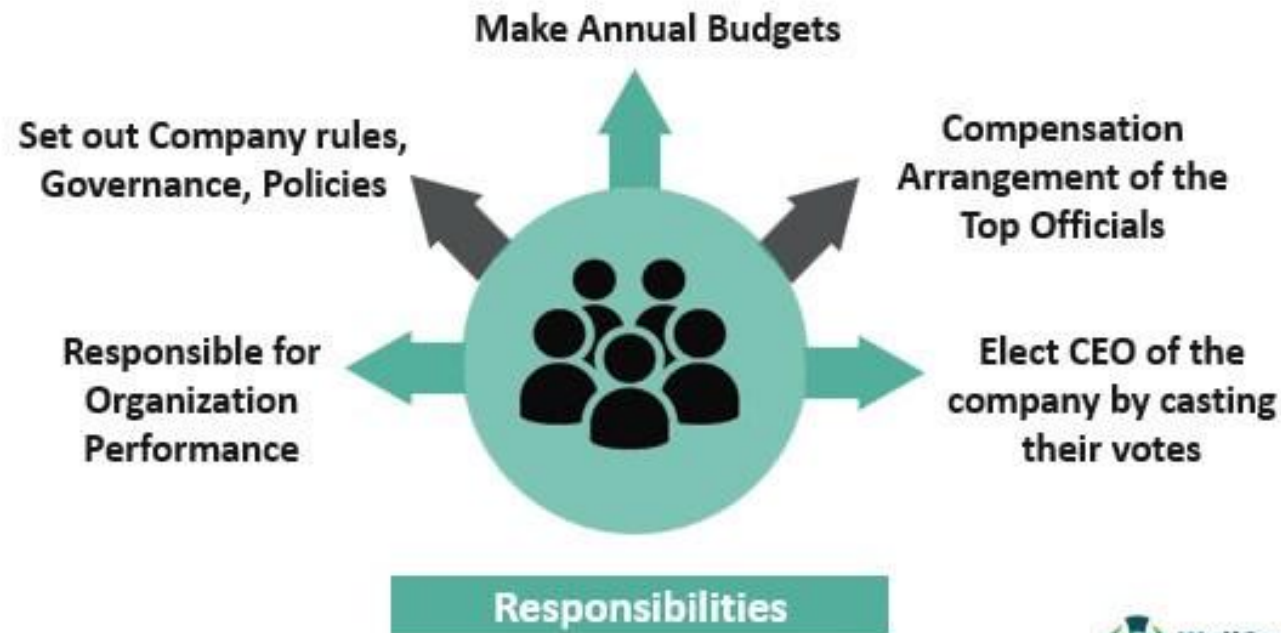
1. emphasis of matter paragraphs
2. qualified opinion
3. disclaimer of opinion
4. adverse opinion
5. Unqualified opinion

1.3 Variations on the standard report

1. Emphasis of matter paragraphs – Significant uncertainty, doesn't warrant a qualified opinion but worth reporting to highlight to shareholders
2. Qualified opinion – Financial statements give a true and fair view 'except for' the problem that has been described in the body of the audit report.
3. Disclaimer of opinion – Extreme uncertainty about the financial statements that it is impossible to express an opinion then the auditor would issue a disclaimer instead.
4. Adverse opinion – Disagreement where the financial statements have been rendered so misleading that it must be stated that they do not give a true and fair view
5. Unqualified opinion – An unqualified opinion is an independent auditor's judgment that a company's financial statements are fairly and appropriately presented, without any identified exceptions, and in compliance with generally accepted accounting principles (GAAP).

1.4 Role of directors

Board of Directors



2 Corporate frauds

Satyam computer (Satyam)

Satyam was the first major fraud of its kind, which shocked the country and led to tightening of regulations, reporting and governance mechanisms. The fraud had the same shock and awe effect like what Enron and Lehman brothers had in the USA. The enactment of strictest ever regulation, namely, Sarbanes and Oxley, was the outcome of these frauds and many countries followed with enactment of similar regulations.

Promoters of the company had devised ingenious methods to commit frauds with large scale dummy billings for services rendered to foreign clients. As a logical step forward, fake proceeds were shown to have been received in multiple bank accounts, opened in various countries. Many of these accounts were later found to be non-existing.

The company was consistently showing large bank balances in its financial statements, which were not consistent with other IT companies considering the size of its business. The whole of these operations was overseen by the promoter with the assistance of a separate staff working on this, what I would call a fraud factory.

At the closure of financials and to satisfy auditors, fake bank confirmations and statements were generated and produced as evidence of balances to auditors. The amount involved in the fraud was around USD 1 billion.

2 Corporate frauds

Surprisingly, Satyam received awards for excellence in corporate governance, conferred by some reputed organisations. Its promoter had over a period acquired respect of the industry and an overwhelming persona. In this background, sudden admission of fraud by the promoter, came as a rude shock to the country, All said and done, Satyam had a sound business model and portfolio of large international clients. Government had to initiate an unprecedented rescue mission to save the company, by first dismissing the board members of the company, followed by the appointment of professionals as board members led by Deepak Parikh. Ultimately, the company was sold to Mahindra group and is now a major part of the successful technology business of the Group.



<http://www.lawstreetindia.com/experts/column?sid=488>

3 Reporting on sustainability



Sustainability reporting enables organisations to measure, understand and communicate the economic, social and environmental effects of their activities. A sustainability report also presents the organisation's goals, values and model of governance.

A sustainability report can be produced:

As a non-financial report (other reports under this category would include corporate responsibility reports, environmental reports, social reports and strategic reports),

or

As an intrinsic element of integrated reporting, a more recent development that combines the analysis of financial and non-financial performance.

3 Reporting on sustainability

Advantages and disadvantages of sustainability reporting

Sustainability reporting is advocated because it:

- compels organisations to recognise that actions taken now have implications for the future
- helps organisations to consider and communicate their sustainability vision and strategy in the context of their overall goals
- recognises the variety of stakeholders that are involved in the organisation and encourages businesses to consider the overall public interest in the decision-making process
- demands greater transparency, which then enables and empowers businesses, governments, consumers and citizens to make informed decisions.

3.1 Global Reporting Initiative (GRI)

The major contributor to the development of international standards is the Global Reporting Initiative (GRI), an international independent organisation, which provides the world's most widely used standards on sustainability reporting.

Its guidelines, first reported in 2000, are broken down into three categories

- economic
- social
- environmental

with various 'aspects' under each category.

3.2 Why is there need for sustainability reporting?

Companies do so because it:

1. enhances the company's image and reputation
2. attracts and retains employees
3. encourages stakeholder involvement
4. creates competition within the industry.

However, there are many potential problems of sustainability reporting, including:

1. The difficulties of measurement and projection, eg estimating the effect of water pollution and projecting these effects into the future.
2. There is a danger that companies report the good news and hide the bad. Such behaviour leads to a lack of credibility in the reports.

3.3 Alternatives of Financial reporting

There are two main alternatives:

1. non-financial reporting
2. integrated reporting.

3.3.1 **Non - financial reporting**

Non-financial reports, such as sustainability reports, are sometimes required in addition to financial statements.

There is an increasing trend for companies to produce such additional voluntary reports relating to matters of significant public interest. For example:

- in the UK, companies are now required by law to publish a directors' report and a strategic report
- international accounting standards offer guidance on the preparation of a management discussion and analysis (MDA) report.

Currently the UK strategic report requires companies to explain their strategic plans, business models and the main business risks they face, as well as provide information on policies and practices on prescribed matters, such as the environment and employment.

3.3.2 Integrated reporting

The aim of integrated reporting is to communicate a rounded picture of an organisation's performance and prospects, so in an integrated report, the organisation needs to present not only its financial numbers but to place those numbers in a more holistic context.

As the name suggests, integrated reporting is not about financial reporting supplemented by non-financial reporting; it aims to produce a snapshot of the company that reflects how the company is affected by and manages the full range of influences on its performance and prospects.

The report will therefore cover issues such as:

- stakeholder relationships
- quality of governance
- use of natural resources
- quality of risk management.

In this holistic picture, the financials are still an important element but they are not the sole measure of performance.

Integrated reporting is being led by the International Integrated Reporting Council (IIRC). Its mission is to establish integrated reporting and thinking within mainstream business practice as the norm