Introduction

Accounting identifies the transactions taking place in an organisation regularly and preparing relevant documents i.e. financial accounts. Reports such as the balance sheet, profit and loss account, income statement and the statement of cash flow, which shows or summarize the financial status and results of operations of a business entity are called financial statements. These statements are made on the basis of accounting standards, Companies Act, corporate governance and auditor's report. European Union (EU) and stock exchange also regulate certain rules and regulations on the basis of which financial statements are made.

Companies Act 1985

The present British statutory requirements are contained in an Act of Parliament known as the Companies Act 1985 (CA85). This Act is a consolidating measure and it includes the earlier Companies Act 1948, 1967, 1976, 1980 and 1981 respectively. It lays down the minimum amount of information that must be given to company shareholders. The Act requires companies to issue profit and loss account and a balance sheet. The Act lays down the specific headings and wordings or accounting principles for the presentation of the information. The financial statements must show a 'true and fair view'. The accounting principles of the CA85 are similar to the fundamental accounting concepts. The four concepts are embodied in the legislation under the heading 'Accounting Principles'. A fifth principle was added requiring the separate determination of value of each asset and liability.

Fundamental Concepts of Accounting

Accounting policies are the specific accounting practice issued and consistently followed by a business enterprise or an organisation as being, in the opinion of the management appropriate to its conditions and most suited to present fair results and financial statements. The fundamental concepts of accounting are:

1. **The Going Concern Concept:** This concept assumes that a business will continue in operational existence for the foreseeable future. It means that the profit and loss account and balance sheet are prepared on the assumption that there is no necessity to limit scale of operation significantly. There are certain conditions when going concern concept cannot be justified or valid. For e.g. if there is a strong possibility that lack of finance will result in the sale of significant part of the business. But in most cases financial statements are prepared on the basis of this concept and the directors justify the idea that such a basis is valid.

2. **The Accruals (or matching) Concept:** The accruals or matching concept is the principle that the revenue and costs are recognised as they are earned or incurred, are matched with one another, and are dealt with in the profit and loss account of the period to which they relate, irrespective of the period of receipt or payment. It implies that the profit and loss account reflects changes in the amount of net assets that arise out of the transactions of the relevant period. Revenue and profits dealt with in the profit and loss account are matched with associated costs and expenses by including in the same account the costs incurred in earning them. This concept is conceptually simple and do not have any practical difficulties.

3. **The Consistency Concept:** It is the principle that there is uniformity of accounting treatment of like items, within each accounting period and from one accounting period to the next. For e.g. in the case of depreciation of fixed assets, there is more than one accepted accounting treatment. A business may use one method, another may use another. As far as consistency concept is concerned, once a business has selected a method, it should use this method consistently for all assets in that class and for all accounting periods. Only in this way users of financial statements can draw a meaningful conclusions from reported results.

4. **The Prudence Concept:** In this principle revenue and profit are not anticipated, but are included in the profit and loss account only when realised in the form either of cash or of other assets, the ultimate cash realisation of which can be assessed with reasonable certainty. Provision is made for all known liabilities

whether the amount of these is known with certainty or is the best estimate in the light of the information available. For e.g. if liability has been estimated to be between £250 and £ 500, the accountant will make provision for the highest estimate on the basis of prudence.

5. **Separate Determination:** It means that the amount of any individual asset and liability that falls to be taken into account shall be determined separately. For e.g. the value must be determined for separate types of stock and then aggregated. In this way anticipated losses on one type of stock will not affect the expected gains from another.

6. **True and Fair:** It generally means presentation of accounts according to the accepted accounting principles using accurate figures as far as possible and arranging them so as to show within the limits of current accounting practice as objective a picture as possible free from wilful bias, distortion, manipulation or concealment of material facts. The balance sheet and profit and loss account shall give a true and fair view of the state of affairs and the profit and loss respectively of the company at the end of the financial year.

Director's Report

Directors are the most senior level of management. They are responsible for the daily working of the company and they answer to the shareholders. They are required to prepare a report of their activities and responsibilities. This is a statutory requirement of the Companies Act 1985. This report must contain a fair review of the development of the business and its subsidiary undertakings during the financial year and of their position at the end of it. It must also state the amount which they recommend should be paid as dividend and the amount which they advise to carry to reserves. The Act also require some other information to be disclosed such as, fixed assets, shares, employee involvement, business review, disabled persons, directors, etc.

Auditor’s Report

Auditors are independent qualified accountants who specialize in auditing work. They are appointed by the shareholders at the annual general meeting (AGM). So, the report prepared by them is called auditor’s report. According to the law most of the limited companies are required to get their books and annual final accounts audited by the auditors. These accounts consist of the profit and loss account and the balance sheet. There main aim is to give an opinion of, whether or not the accounts give a true and fair view of the state of affairs and the profit of the company and have been properly prepared in accordance with the Companies Act. If the accounts do not comply with the Companies Acts then it is the duty of the auditors to prepare a ‘qualified’ audit report. Their opinion is given in the auditor’s report which is attached to the final accounts. They generally state the matters on which they are reporting and how they have gone about forming their opinion. In the auditor’s report the attention of the reader is drawn both to the director’s and the auditor’s responsibility.

Stock Exchange

Stock Exchange is a market on which a company’s shares can be listed and be readily bought and sold. Only public or listed companies can offer their shares to the public or can be trade on the Stock Exchange. A private company cannot be a listed company therefore all listed companies must be public companies. In order to get listed a company has to provide a great deal of information about its history, management, financial conditions, objectives, strategic policies, etc. Once a company is listed it has to disclose or show its additional financial statement. So it must have strong and accurate financial statement.

Corporate Governance

“Corporate Governance is the system by which businesses are directed and controlled” (Cadbury Report, UK). Its main am is to improve the financial efficiency and investor’s confidence. It provides the shape through which the objectives of the company are set

and how they will be achieved. In other words, it is concerned with the performance of the company and ensuring that it has achieved its goal with due regards for the interest of all stakeholders. It also includes a set of relationship between a company's management, its board, its shareholders and other stakeholders. There are various contents or headings of corporate governance statements, such as going concern, internal control, directors' remuneration, annual general meeting, the board and its committees, etc.

The concept of corporate governance was adopted by both the business and the financial communities and the London Stock Exchange issued some guidance on the subject in its Combined Code on Corporate Governance. The first official approach to the governance of UK companies was the report of the Committee of the Financial Aspects of Corporate Governance, or the **Cadbury Report, 1992**, to which was attached a Code of Best Practice. This report was further developed one after another. **Greenbury Report, 1995** was produced with recommendations on executive pay and a Code of Best Practice. Then **Hampel Report, 1998** was produced with its Combined Code on Corporate governance, which had a number of provisions relating to internal control. This was further developed which resulted in the **Turnbull Report, 1999**. **Higgs Review, 2003** suggested amendments to the Combined Code and made proposals to reform the role of non-executive directors (NED's).

European Union

The subject of financial management in the European Union (EU) has now taken on a new and significant dimension, with the enlargement of the Union to 25 countries, including 450 million people. The finding treaties gave the EU authority to develop laws to regulate accounting and auditing for the member state. Its first attempt to establish common financial reporting requirements was the issuance of two Accounting Directives: the **Fourth Directive (1978)** and the **Seventh Directive (1983)**. A European Union Directive is a statement issued under the authority of the EU which must be incorporated into the law of the member state. The Fourth Directive sets out recognition and disclosure guidelines. It states financial statement formats as well as selected recognition and valuation issues. The Seventh Directive states consolidated reporting.

Conclusion

The concept of financial statement is defined as a set of accounts which contain the information about the activities of the company. This comprises two main statements: balance sheet and profit and loss account which is prepared at the end of every financial year. Its main objective is to provide financial information of the company to its shareholders and investors. These statements are prepared according to the rules and regulations laid down by the Companies Act 1985 and Accounting Principles. According to the Companies Act 1985 financial statement must give minimum information of the company to the shareholders and it must show a 'true and fair view' of company's affair. It takes priority over other legislative, professional and stock exchange requirements. Whereas, Accounting Principles lays down specific accounting practice adopted and consistently followed by a company, as decided by the management. The fundamental concepts of accounting are going concern, accruals or matching, consistency, prudence, separate determination and 'true and fair'. Director's and Auditor's Report are also prepared at the end of financial statement. Director's Report states the responsibilities and activities performed by the directors of the company. Auditor's Report confirms that the financial statement or accounts prepared by the company give a 'true and fair view' and ensures that is has been prepared in accordance with the Companies Act 1985. Corporate Governance and European Union (EU) also plays an important role in the preparation of the financial statement because corporate governance aims to increase the economic efficiency and investor's confidence. Whereas, European Union has established a common financial reporting requirement by issuing two Accounting Directives: the Fourth Directive (1978) and the Seventh Directive (1983).

References

Books

Dyson, J. (2004), Accounting For Non- Accounting Students, Sixth Edition, Prentice Hall, England.

Black, G. (2000), Students' Guide To Accounting And Financial Reporting Standards, Seventh Edition, Prentice Hall, England.

Gillespie, I., Lewis, R. and Hamilton, K. (2000), Principles Of Financial Accounting, Second Edition, Prentice Hall, England.

Thomas, A. (1992), An Introduction To Financial Accounting, Second Edition, Mc Graw Hill, London.

Website:

The CPA Journal (2005) *Citing references* [www] Available from: www.nysscpa.org (Accessed 8th November, 2005)

Institute of Directors (2005) *Citing references* [www] Available from: www.iod.com (Accessed 8h November, 2005)