FINANCIAL REPORTS USERS PERSPECTIVE ON THE ACCOUNTING INFORMATION NECESSARY FOR VALUING ENTERPRISES

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Abstract:
One of the main debates and topics for business development, entrepreneurship and economic globalization focuses on the quality of financial information and the possibility of improving accounting proceses and accounting disclosure. The primary users of financial statements need information about the resources of the entity and how efficiently and effectively the entity's management is using resources. There are many stakeholders with an interest in an entity's financial reports, including (but not limited to) existing and potential investors, employees, lenders, suppliers, customers, regulators and other Government agencies and the public.

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1. Introduction

The main goal of financial statements is to offer information relating to the economic enterprise that is required by the current and potential shareholders and creditors for their future decisions as capital providers (investors). According to the Conceptual Framework for Financial Reporting (Exposure draft, FASB, 2008) we agree that information which is relevant for decisions taken by investors may be useful to other users of financial statements that do not have this quality. Consequently, based on the framework mentioned above (common project of IASB and FASB) we reveal within this paper some interesting issues regarding financial reporting.

Financial reports are oriented to the needs of a large number of users. Financial reports need to inform users who are unable to extract financial information they need directly from the entity and should therefore fundament decisions at least in part on information provided by financial reporting.

Shareholders invest economic resources (most often money) in an entity and expect to receive back the money invested, they expect to receive back more money than they have invested in the form of dividends or share price growth or participation interests. Accordingly, shareholders are interested directly into the amount, timing and safety of future cash flows of the entity and how the perception on the entity's ability to generate cash flows affects the price of its shares. Shareholders are often entitled to vote on decisions of the management team and therefore are directly interested in the way in which the management team of the entity has exercised responsibility to use resources efficiently and profitably.

Financial creditors are providing financial capital to the entity. They are expecting to obtain earnings as interest rates. Financial creditors may be entitled to approve part of the decisions taken by the managerial team and consequently they might also be concerned about the way in which the management team is exercising responsibilities.

Other groups of creditors provide resources as a consequence of the relationship they have with the entity. For example, employees working for wages may have their incomes postponed for several years. Suppliers may provide facilities to pay for goods and services to facilitate their sale. Customers can pay in advance the goods and services provided by the entity. When employees, suppliers, customers and other groups make decisions on the provision of capital entity, they are providers of capital.

Managers and board of management of an entity (the entity's management) are also interested in obtaining financial information about the entity. The management is responsible for preparing the financial statements. Other users who need specialized information, such as suppliers, customers and employees (if not the quality of providers of capital), as well as governments or government agencies and other interested people can find useful information with the help of the financial statements.

2. The role of financial reports in making decisions

The financial statements reflect the view of the entity and not the view of shareholders, or of other persons who activate outside the entity. Usually, financial statements may provide quantity indicators such as income per share owned, which could be an important source of information for the potential buyers of the company's shares. An enterprise receives resources from suppliers of capital in return for rights over those resources. Based on these rights, capital providers are those who need information on the assets of the entity. Therefore, financial reporting should provide information on the entity's economic assets and on the entity's rights (liabilities). Capital providers are shareholders or financial creditors, who may have similar information needs.

Decisions taken by the capital providers include whether and when to allocate resources to certain entities and if and when to protect investments. In making these decisions, capital providers are interested to evaluate the entity's capacity to determine net cash inflows and also the ability of the management to protect and grow previous investments. Prospects for the cash flows depend on current available funds of the entity and, especially, the ability to generate enough money to pay employees and to meet operational needs, to pay the entity's obligations when due and to reinvest in new economic operations. Analysis undertaken by capital market participants on the entity's capacity to determine net cash inflows could generate volatility regarding the values of the shares. Therefore, these analyses can influence the entity's capital providers if they decide to sell their rights.

The management evaluation is accountable to capital providers of the entity in order to protect their economic resources, capital providers trying to be efficient and profitable. The management is also responsible for ensuring compliance of the entity with laws, regulations and contractual provisions. Performance made by management is particularly important for existing shareholders of the entity when they decide how to reward management for results obtained by the entity, how to vote on other shareholder proposals regarding management policies and other matters regarding the evolution of the management.

3. Limitations of financial statements when stating decisions

Financial statements of the entity represent only one source of information that capital providers need. These users of financial reports should take into account the relevant information from other sources, such as information relating to general economic conditions and economic prospects, political and social issues as well as the general company's circumstances. The users should also understand the characteristics of the financial reports and be aware of the limitations regarding the information provided.

Financial reporting information

Financial reporting should provide information on the assets and liabilities of the entity. Financial reporting should also provide information on the effects of transactions or other events that might determine changes regarding the assets and liabilities of the enterprise. This information is useful for evaluating capital providers entity's capacity to determine net cash inflows and also evaluating the efficiency with which management has fulfilled the responsibilities of management entity.

Information on the assets and liabilities of the entity - the entity's financial situation - can provide for a user of the entity's financial statements a better understanding of quantity, time and level of employment and the safety of the future cash flows. This information helps capital providers to identify financial strengths and weak points of the entity and to assess the liquidity and solvency of it. Moreover, it indicates the potential to generate cash flows and specify the amount of money that is needed to pay obligations towards most creditors of the entity.

Users also examine the efficiency with which management has proved management responsibilities towards the capital providers by considering the expectations of the capital providers. Some of the assets of the entity, such as customer loans represent direct sources regarding coming cash inflows. Moreover, several obligations towards creditors, such as debt securities represent future cash outflows. Anyway, it should be accepted that many of the cash flows determined by the entity's economic operations are the result of combining several of its assets to produce, deliver and sell services and goods to clients. Even if these cash flows can not be identified as the result of individual economic resources (or their rights), capital providers should find out the nature and amount for the available resources used in the business operations of the entity. This information can help those who are willing to determine the value for the enterprise. However, the financial statements are not designed to determine the value of the entity. Information about the entity's financial structure, as presented in its financial statements, enables users to estimate the credit needs of the entity or additional funding and likelihood of successful funding question. This information can help users of financial reports to estimate future cash flows.

Entity's financial performance shows data regarding the results obtained from the own economic sources of the enterprise. It is also important that for the future, an entity obtains positive results being able to determine net cash inflows and consequently to provide benefits towards the capital providers. Variability of these results is also important, especially in safety estimation of future cash flows, similar with important information on the structure and performance. Capital providers usually think that information about the entity's past financial performance is useful in predicting future results as the capacity of the entity to use its economic resources and to assess management performance.

Explanations of management

Financial reports should include explanations of management and any other information that enables users to understand information reports. Explanations of the management enhance the ability to assess performance and to assess the progress of the entity. Management has more information regarding the enterprise than external users and consequently the management team may increase the usefulness of financial reporting by explaining those transactions or circumstances that have affected or could affect further the enterprise. So, it is known that financial reporting could be often influenced by management estimates and analyzes. Capital providers can better analyze financial information when explanations are given on management assumptions and methods used, including presentation of the elements of uncertainty in the assumptions and estimates underlying the financial reports.

4. Conclusions

The main objective of financial reporting of general interest is to provide financial information related to the reporting enterprise that is useful to current and potential shareholders and creditors in their decisions as capital providers (investors). Qualitative characteristics are attributes that make financial information to be useful. They can be divided into fundamental characteristics and features of improvement, depending on how they influence the usefulness of the information. Regardless of how they are classified, qualitative characteristics contribute to the usefulness of the financial reports.

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