Current Trends in Corporate Financial Reporting – A Study with reference to Infosys Technologies Ltd.

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I. INTRODUCTION:

A shareholder has the right to all financial data of a company so that he can evaluate its performance. Abridged balance sheets do not convey the full information required to be made available by the company. Nowadays cost is not a factor. It can be argued that the cost to companies in printing full balance sheets is nothing when huge amounts go in for expansion and diversification. The cost of detailed reports hardly works out to be one percent of turnover for companies. In any case, a shareholder has the right conferred by the Companies Act to demand a copy of the full balance sheet.

Not only have the shareholders, various other parties also have interest in corporate financial reporting. They are the users of financial reports. Those who are directly interested in the financial reporting are: Directors, Executives, potential investors, suppliers, trade creditors, financial institutions, employees and Tax authorities. The indirect users include: Financial Analysts, Trade Associations, Trade Unions, Researchers and Governments. All these people taken together (including shareholders) are generally called 'Stakeholders'. The Institute of Chartered Accountants in England and Wales remarked that the objective of corporate reporting is to communicate economic measurements of and information about the resources and performance of the reporting entity, useful to those having reasonable rights to such information. Hence financial reporting must be fair, full and adequate.

1.1 FAIR DISCLOSURE:

It implies that the accounting and the other information are unbiased and impartial. Its objective is to provide equal treatment to all the potential financial statement readers.

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1.2 FULL DISCLOSURE :

It implies published financial statements and the related notes should include any economic information related to the accounting entity that is significant enough to effect the decisions of informed and prudent users of financial statements. It is also aimed at clarity, quality and quantity of economic data disclosed by the accounting entity.

1.3 ADEQUATE DISCLOSURE:

The most commonly used concept of disclosure is 'Adequate disclosure'. The task of defining the term 'adequate disclosure' is more difficult because the adequacy of disclosure cannot be tested accurately and precisely since no definite test to measure of it exists in financial reporting and moreover it is a subjective term. In very comprehensive terms, a disclosure can be said to be an 'adequate disclosure' when it entails the answers of "To whom, why, how much, what and when the information to be disclosed'.

2. EXTENDED REPORTING:

Traditionally, 'external accounting' has been concerned with reporting through Corporate Annual Reports to the owners on the 'Stewardship' of managers. In recent years, however, the scope of accounting for external users has witnessed a remarkable change. It is now widely agreed that every company enters into two distinct contractual agreements with society. One is 'legal' and the other is 'social'. In fact, the social contract theory states that a company is under an obligation to justify its existence in society in terms of both these agreements. As per social contract theory, companies are now under an obligation to meet legally mandated as well as additional informational needs of the 'shareholders' in general. Such a supply of additional information over and above the mandated under the laws has been variously terms as 'extended reporting', 'discretionary reporting' and 'Voluntary reporting' in the accounting literature.

3. SCOPE AND OBJECTIVE OF THE PAPER:

The methodology followed in this paper is case study approach. The present paper is a case study of the Technology Major, the Infosys Technologies Ltd which is powered by intellect and driven by values. The objective of the paper is to highlight as to how the Technology Major is responding to the current requirements of corporate financial reporting and how its reporting pattern reflects the current trends prevailing in financial reporting by India Inc. The paper is not concentrating on the routine aspects of Corporate Financial Reporting but focuses only on the new perspectives in this context. The data for the paper is mainly collected from Annual Report of Infosys for the year

2006-07. Relevant SEBI documents and Accounting Standards issued by Institute of Chartered Accountants of India (ICAI) are also referred to.

The present paper deals only with the following select aspects of Financial Reporting by Infosys :

4. DISCLOSURE UNDER GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

The financial statements of Infosys are prepared in accordance with Indian GAAP under the historical cost convention on the accrual basis. GAAP comprises mandatory accounting standards issued by ICAI, the provisions of the Companies Act, 1956 and guidelines issued by SEBI. Accounting policies have been consistently applied, except where a newly issued accounting standard is initially adopted or a revision to an existing accounting standard requires a change in the accounting policy hitherto in use. Management evaluates all recently issued or revised accounting standards, on an ongoing basis.

As an investor friendly company, committed to the highest standards to disclosure, Infosys voluntarily provides unaudited financial statements prepared in substantial compliance with the GAAP requirements of Australia, Canada, France, Germany, Japan and the United Kingdom, besides those of the U.S. The financial statements are in the respective national languages of these countries. Infosys is also providing information about its annual reports as per Form 20-F of United States Securities and Exchange Commission.

5. SEGMENT REPORTING:

The Institute of Chartered Accountants of India has issued Accounting Standard 17 – Segment Reporting (AS-17). It came into effect in respect of accounting periods commencing on or after 1-4 2001 and is mandatory in nature from that date, in respect of the following:

- Enterprises whose equity or debt securities are listed on a recognized stock exchange in India.
- All other commercial, Industrial and business reporting enterprises whose turnover for the accounting period exceeds Rs.500 millions.

AS-17 has classified the segments of an enterprise into business segment and geographical segment.

5.1 BUSINESS SEGMENT:

A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments.

5.2 GEOGRAPHICAL SEGMENT:

A geographical segment is a distinguishable component of an enterprise that is engaged in providing products of services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments.

At Infosys, Business Segments are termed as Industry Segments and are primarily financial services comprising customers providing banking, finance and Insurance services, manufacturing companies; companies in the telecommunications and the retail industries and others such as utilities, transportations and logistics companies.

The geographical segments of Infosys are North America, Europe, India and Rest of the world. North America comprises the United States of America, Canada and Mexico; Europe includes continental Europe (both the East and the West), Ireland and the United Kingdom, and the Rest of the world comprising all other places except, those mentioned above and India.

As per P & L A/C of Infosys for the year ended 31st March 2007 the operating profit was Rs.3756 crores. Now let us see how the same is presented under Segment Reporting.

Industry Segments – year ended March 31, 2007 (Rs in crores)

	Financial Services	Manu-facturing	Telecom	Retail	Others	Total
Revenues	4951	1805	2409	1386	2598	13149
Identifiable operating Expenses	2139	767	1016	588	1111	5621
Allocated Expenses	1244	454	605	348	652	3303
Segmental operating Income	1568	584	788	450	835	4225
Unallocable Expenses	-	-	-	-	-	469
Operating Income						3756

Geographical Segments – year ended March 31, 2007 (Rs.in Crores)

	North America	Europe	India	Rest of the world	Total
Revenues	8395	3393	214	1147	13149
Identifiable operating Expenses.	3636	1314	53	618	5621
Allocated Expenses	2110	853	53	287	3303
Segmental operating Income	2649	1226	108	242	4225
Unallocable Expenses					469
Operating Income					3756

Source : Infosys Annual Report 2006 -07

Because of segment reporting, industry segment wise and geographical segment wise break up for operating profit is made available. This is an era of transparency and through an analysis of segment results, more insight into the working and performance of Infosys can be gained.

6. CORPORATE GOVERNANCE REPORT

"Creating an ethical culture means instilling and maintaining a commitment to doing the right thing, this time and every time – so much so that it becomes entwined in the essential DNA of the firm"

- William H-Donaldson, Chairman U.S. Securities and Exchange Commission.

Corporate governance is about commitment to values and ethical business conduct. It is about how an organization is managed. It is a system of structuring, operating and controlling a company with a view to achieving long term strategic goals to the best interest of all the stakeholders. Corporate governance guidelines and best practices have evolved over a period of time. The Cadbury Report on the financial aspects of corporate governance published in the United Kingdom in 1992 was a land mark. In India the Confederation of Indian Industry (CII) took the lead in framing a desirable code of corporate governance in April 1998. This was followed by the recommendations of the Kumaramangalam Birla Committee on Corporate Governance appointed by SEBI. The recommendations were accepted by SEBI in December 1999 and are now enshrined in clause 49 of the Listing Agreement of every Indian Stock Exchange. SEBI also instituted a committee under the chairmanship of Mr. K.R.Narayana Murthy, the Chief Mentor of Infosys, which recommended enhancements in corporate governance. SEBI has incorporated the recommendations made by the Committee in clause 49 of the listing agreement, which came into force from January 1, 2006. In addition, the Dept. of company affairs constituted a 9 member Committee under the Chairmanship of Mr. Naresh Chandra, former Indian Ambassador to the U.S. to examine various corporate governance issues. The Committees recommendations are now mandatory.

6.1 CORPORATE GOVERNANCE COMPLIANCE BY INFOSYS:

A well publicized survey by MC Kinsey & Co. in this regard highlights the importance given to governance by investing community. In the survey, about one-fifth of the institutional investors in the sample expressed preference towards corporate governance over financials, while deciding their emerging market portfolios. Further, around two-thirds felt corporate governance is almost as important as the Balance sheet. Realizing this, Infosys is 100% complying to the various requirements of Corporate Governance. Even they declare that they indeed go beyond all these recommendations. They believe that sound corporate governance is critical to enhance and retain investor trust. Their corporate governance philosophy is based on the following principles.

- Satisfy the spirit of the law and not just the letter of the law. Corporate Governance standards should go beyond the law.
- Be transparent and maintain a high degree of disclosure levels. When in doubt, disclose.
- Make a clear distinction between personal conveniences and corporate resources.
- Communicate externally, in a truthful manner, about how the company is run internally.
- Comply with the laws in all the countries in which the company operates.
- Have a simple and transparent corporate structure driven slowly by business needs.
- Management is the trustee of the shareholders 'capital and not the owner'.

At the core of Infosys Corporate Governance practice is the Board, which overseas how the management serves and protects the long – term interests of all the share holders of the company. They believe that an active, well-informed and independent Board is necessary to ensure the highest standards of Corporate Governance. Majority of the Board, 8 out of 15, are independent members. Further they have compensations, nomination, investor grievance and audit committees, which are comprised of independent directors. To illustrate, a brief explanation about two committees viz Audit Committee and Investor Grievance Committee is given below:

6.2 AUDIT COMMITTEE:

In India, Infosys is listed on the BSE and the NSE. In the U.S. it is listed on the NASDAQ. In India clause 49 of the Listing Agreement makes it mandatory for listed companies to adopt an appropriate audit committee charter. The Blue Ribbon Committee set up by the US Securities and Exchange Commission (SEC) recommended that every listed company adopt an audit committee charter. This recommendation has been adopted by NASDAQ also. The Audit Committee of Infosys in their meeting on May 27, 2000 adopted a charter which meets the requirements of clause 49 of the listing Agreement with Indian Stock Exchanges and the SEC.

6.3 INVESTOR GRIEVANCE COMMITTEE:

This committee is headed by an independent director and has the mandate to review and redress shareholder grievances. Four meetings of the committee were held during the year and the committee expressed satisfaction with the company's performance in dealing with investor grievances and its share transfer system. Details of complaints resolved during the year 2006-07 are as follows:

Number of complaints:

Received during the year	:	859
Resolved during the year	:	859
Closing	:	NIL

Source: Infosys Annual Report 2006-07

As part of its commitment to follow global best practices, Infosys complies with the Euro share – holders Corporate Governance Guidelines 2000 and the recommendations of the Conference Board Commission on Public Trusts and Private Trusts and Private Enterprises in the U.S.

6.4 CORPORATE GOVERNANCE RATINGS:

In addition to incorporating clause 49 to the listing agreements, SEBI has also initiated Corporate Governance ratings and the two leading rating institutions viz. CRISIL and ICRA have started giving ratings. CRISIL gives ratings as: GVC Level-1, GVC Level-2, etc. GVC refers to Governance and Value Creation. ICRA assigns ratings as: CGR 1, CGR 2, etc. CGR refers to Corporate Governance Rating.[7] CRISIL assigned "CRISIL GVC Level 1" rating to Infosys. This rating indicates Infosys capability to create wealth for all its stakeholders while adopting sound corporate governance practices. ICRA assigned CGR 1 Rating to Infosys Corporate governance practices. This rating is the highest on ICRA's scale of CCR-1 to CGR-6. Infosys is the first Indian company to be assigned the highest CGR by ICRA.

Infosys getting the highest rating from both CRISIL and ICRA stands testimony to the 100% Corporate Governance Compliance by it. No wonder it is the number one company in Technology sector.

7. VALUE REPORTING

As already pointed out, in terms of social contract theory, companies are under an obligation to meet legally mandated as well as additional informational needs of the stakeholders in general. What are all reported so far in the present paper pertain to legally mandated requirements. But – the current trend in Corporate Financial Reporting is that competitive corporate bodies have gone for disclosure of more information than as required by law and Infosys is no exception. Now the paper turns to additional informational needs which are highlighted under the heading value reporting.

8. THE VALUE REPORTING DISCLOSURE MODEL AT INFOSYS.

Infosys believes that the adoption of the principles of transparency and openness facilitate gaining competitive advantage. To bridge the gap between the information available to the management and the information available to the stakeholders, it provides several non-financial and intangible performance measures to its stakeholders, such as:

- Brand Valuation
- Economic value – Added (EVA) Statement
- Intangible asset scorecard
- Current – cost – adjusted financial statement
- Human Resources accounting and value – added statement.

The above reports form part of the annual report. Here EVA statement, current – cost – adjusted financial statements and Human Resources Accounting and value – added statement are reported.

9. ECONOMIC VALUE – ADDED (EVA) STATEMENT:-

The EVA as a tool for measuring the value creation has been popularized by U.S. based Stern Stewart & Co. EVA is a method of determining the value created by the units of an enterprise. It assesses the potential of existing business strategies to provide acceptable return for investors. According to Stern Stewart.[8]

$$EVA_t = NoPAT_t - K_w + NA_{t-1}$$

Where

$NOPAT_t$ = Net operating profit after tax

K_W = Weighted Average cost of capital and

NA_{t-1} = Adjusted value of net asset base at the end of period $_{t-1}$

9.1 EVA MODEL AT INFOSYS:-

At Infosys, EVA measures the profitability of the company after taking into account the cost of capital. It is the post – tax return on capital employed (adjusted for tax shield on debt) minus the cost of capital employed. It is those companies which earn higher returns than cost of capital that creates value. Those companies which earn Lower returns than cost of capital are deemed destroyers of shareholders value.

Economic valued added analysis.

(In Rs. crore* except as stated otherwise)

	FISCAL	
COST OF CAPITAL	2007	2006
Return on risk free investment (%)	8.00	7.50
Market Premium (%)	7.00	7.00
Beta variant	0.99	0.78
Cost of Equity (%)	14.97	12.96
Average Debt/ Total capital (%)	-	-
Cost of Debt – net of tax (%)	NA	NA
Weighted Average cost of capital (WACC) (%)	14.97	12.96
Average capital employed	9147	6177
PAT as % of average capital employed	42.2	40.1
ECONOMIC VALUED ADDED		
Operating Profit (Excluding Extraordinary income)	3877	2654
LESS		
Tax	386	313
Cost of Capital	1369	801
Economic value added	2122	1540
ENTERPRISE VALUE		
Market value of equity	115307	82154
Add Debt	-	-
Less Cash & Cash equivalents	6073	4709
Enterprise value	109234	77445
RATIOS		
EVA as % of average capital employed	23.2	24.9
Enterprise value/Average capital employed (No.of Times)	11.9	12.5

Note (*one crore is ten millions)

1. The cost of equity is calculated by using the following formula: Return on risk-free investment + expected risk premium on equity investment adjusted for beta variant.
2. The figures above are based on consolidated Indian GAAP Financial Statements.

Source : Infosys Annual Report 2006 -07

10. CURRENT COST ADJUSTED FINANCIAL STATEMENTS:-

There is a growing realization that historical cost based accounting system does not adequately serve the needs of users of accounting information, in view of high inflationary pressures. Now all concerned agree that time is ripe to include statements of price level changes in annual reports of companies. But the bottleneck is an appropriate method. The two popular methods that are highlighted in this regard are: Current Purchasing Power method (CPP) and Current Cost Accounting method (CCA). Out of these two, CCA has evolved to overcome the limitations of CPP Method. CCA which is the result of recommendation of U.K.s' Sandiland's Committee[9] has found favor with our ICAI, which has issued Guidance Note in this regard.

CCA seeks to state the value of assets and liabilities in balance sheet at their fair value, and measure the profit or loss of an enterprise by matching current costs against current revenues. CCA is based on the concept of 'operating capability', which may be viewed as the amount of goods and services that an enterprise is capable of providing with the existing resources during a given period. To maintain its operating capability, an enterprise should remain in command of resources that form the basis of its activities. Accordingly, it becomes necessary to take into account the rising cost of assets consumed in generating these revenues. CCA takes into account the changes in specific prices of assets, as they affect the enterprise.

The consolidated balance sheet and profit and loss account of Infosys and its subsidiary companies for fiscal 2007, are prepared in substantial compliance with current cost basis. The methodology prescribed by the guidance note on accounting for changing prices, issued by the ICAI is adopted, in preparing the statements.

To show the effect of current – cost adjustment, abstracts of consolidated balance sheet and profit and loss account for fiscal 2007, prepared under historical cost system (HCA) and CCA, is presented below.

ABSTRACT OF BALANCE SHEET		**(Rs. In crores)**
	HCA	CCA
Total Funds/Assets	11162	11272
ABSTRACT OF P&L ACCOUNT		
Net profit after tax, exceptional item And minority interests	3783	3756

From the above abstracts, it can be seen that total funds/assets are more in CCA by Rs.110 crores whereas profits are less by 27 crores as compared to HCA.

11. HUMAN RESOURCE ACCOUNTING (HRA)

The importance of a human being as an asset has been realized since times immemorial. Vedvyas in the Mahabharata has stated: Nothing is superior to man. The great Chinese Sage Chung Tu said, as long as in the 7th Century:

If you wish to plan for a year, sow seeds.
If you wish to plan for 10 years, plant a tree and
If you wish to plan for a life time, develop man

To quote Milton Friedman: From the broadest and most general point of view, total wealth includes all sources of 'income' or consumable services. One such source is the productive capacity of human beings and accordingly this is one form in which wealth can be held. But it is an unfortunate thing that an asset which has been accepted so important has remained neglected, so for as its valuation and recording in the books of account is concerned.

11.1 HRA AT INFOSYS:-

However, things are different at Infosys which emphasizes: The definition of wealth as a source of income inevitably leads to the recognition of human capital as one of the several forms of wealth such as money, securities and physical capital. Hence, Infosys evaluates its human resources and report the same in its financial reports. Among the different models suggested for valuation of human capital, Infosys adopts the Lev and Schwartz model. The evaluation is based on the present value of the future earnings of the employees and on the following assumptions:

- Employee compensation includes all direct and indirect benefits earned both in India and abroad.
- The incremental earnings based on group/age have been considered.
- The future earnings have been discounted at 14.97%, the cost of capital for Infosys.

The valuation details and certain key ratios for the year ending March 31, 2007 are given below:

	(in Rs. Crore, unless stated otherwise)
Employees (No.)	72,241
Value of Human Resources	57,452
Total Income	13,893
Total Employee cost	7,112
Value added excluding exceptional items	11,879
Net Profits excluding exceptional items	3,861
KEY RATIOS	
Total income /human resources value (Ratio)	0.24
Value added /human resources value (Ratio)	0.21
Value of human resources per employee (in Rs. Crore)	0.80
Employee cost/Human resources value(%)	12.4
Return on human resources value (%)	6.7

SOURCE : INFOSYS ANNUAL REPORT 2006 -07

12. Value added Statement:-

The value added statement is prepared and shown as a part of corporate annual reports by many corporate enterprises as an additional information and Infosys is one among them. Value added represents that part of the value of products which are created in the factory and is computed by deducting from the ex-factory value of output all the gross value of inputs. The value added statement is expected to show clearly the;

- wealth creating ability of the enterprises
- The way the wealth created has been distributed among the employees, the human resources of enterprises,
- How much of the value added is allocated between the government, providers of capital, owners or shareholders and how much is retained for future expansion.
- How much of the value added is kept as provision for future investments including fixed assets.

12.1 VALUE ADDED STATEMENT AT INFOSYS:-

	Year ending March 31, 2007 (Rs. In crores)
Value Added:	
Income	13,893
Less: Operating expenses:	
Software development expenses	(-) 1,187
Selling and marketing expenses	(-) 371
General and administration expenses	(-) 834
Value-added from operations	11,501
Other income including exceptional items	378
Total Value Added	**11,879**
Distribution of value added:	
Human Resources:	
Salaries and Bonus	7,112
Providers of Capital:	
Dividend	654
Minority Interest	11
Taxes:	
Income Taxes	386
Tax on dividend	102
Retained in business:	
Depreciation	514
Income retained in business	3100
Total	**11,879**

Source : Consolidated Indian GAAP financial statements of Infosys for the year 2006 - 07.

When the consolidated P & L A/C of Infosys shows a profit of Rs.3856 crores, the value added is Rs.11, 879 Crores. Profit earned is significant only for the company concerned, whereas value added is significant for the entire nation. Thus Infosys has made a huge contribution to the nation and to the standard of living of the society.

13. CONCLUSION

In our university, we are offering M.Com (Business Finance) Program. One of the subjects for the program is **'Emerging Accounting Techniques'**, which deals with evolving areas in accounting like Inflation accounting, Human Resources Accounting, Accounting for ESOPS, Segment Reporting, EVA etc., To Supplement text book information, I bank upon Annual Report of corporates for practical cases. One company Annual Report which I greatly depend upon is that of Infosys. Be it regulatory disclosure or voluntary disclosure, Infosys gives maximum possible information. In the initial part of the paper, three forms of disclosure have been discussed: Fair disclosure, Full disclosure and Adequate disclosure. What sort of disclosure Infosys is making through its Annual report? I would say it is fair disclosure – it is full disclosure and it is adequate disclosure. As a frequent user of the report in my day to day class room teaching, I give Infosys Report 100% marks. Not only me any genuine user would do the same.

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