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The Measurement and Recognition in the Financial Reporting Disclosures

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Abstract: This research aims to examine the importance of completing annual reports properly. It also tries to understand the causes of complexities the business faces while creating reports. It has been identified that there are different types of intangibles and there is no particular method to measure them. This creates complexity while creating reports. Accounting measurements are relevant for preparing financial statements, and these statements are cornerstones for decision-making by the various stakeholders in any economy. This research analyses lessons that can be learned from different aspects involving accounting measurements in financial reporting, with significant reference to intangibles, leasing, goodwill, and pensions. It considers the relevance of these items, their influence on the balance sheets alongside profit, and secondary issues related to them. Hence, the essay leverages previously published or existing studies, amply demonstrating how these aspects of accounting are entwined. With the help of this analysis, the future perspective of the accounting measurements concerning examples like IFRS and US GAAP is explored along with the recapitulation of the thesis statement.

Keywords: Financial Reporting, Accounting Measurement, Business Decision-Making.

1. Introduction

Financial reporting refers to the process of identifying and recording financial activity happening within a business organization. Money is the main driver of every business organization. Without sufficient money, a business or the whole market can't function properly. Due to this reason, it becomes essential to manage the financial activities of a business properly. The first stage of maintaining finance is accurate financial reporting [1]. Money flows from one entity to another entity or multiple entities. If money flows are not recorded properly then it can result in financial scams. transparent financial reporting ensures the well-being of the stakeholders such as creditors, investors, government bodies and even customers. This essay aims to understand the complexities and significance of various accounting aspects such as intangibles, leasing, pensions and more. These types of accounting factors are hard to identify due to their nature. Due to this reason, proper judgment is essential to show this item properly in the financial reports.

Financial reporting reflects the internal financial health and performance of the business. Financial reporting follows strict rules, the majority of which were built more than 100 years ago [2]. At that time, business operations were not very complex compared to modern business operations complexity.

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As a result of the increased complexity, it becomes difficult for the accounting process to follow the modern business operation. On the other hand accounting measures themselves are also not straightforward in various aspects. For example, long-term assets, intangibles, leasing and other accounting factors follow complex calculations. Due to this reason, maintaining accounting clarity in the current scenario is a major challenge for the business. However, it should be mentioned that despite the challenge it is essential for businesses to create financial reports every year. If a business fails to prepare a financial report or includes wrong information in it then legal issues can arise. For example, the government may freeze bank accounts and start enquiring about the business [3]. Stakeholders such as investors, and suppliers may also withdraw their investment from the business to secure their funds. Considering this factor, it can be said that accounting and financial reports are mandatory tasks that every business needs to complete at the end of every year without fail.

The thesis refers to the assumption made before conducting a study. The study aims to prove the thesis or assumption. This essay argues that intangibles, leasing goodwill and leasing measurement are significant for financial reporting. The essay also argues that measuring these factors is complex due to the current complexities present in business operations and market functionalities [4]. The report suggests that these items need to be measured with the help of sophisticated measurement techniques and careful consideration. After measurements, the items also need to be included in the financial statements. Items should not overprice or underprice the financial condition of the business.

2. Intangibles

Intangibles refers to the non-physical factors that can be measured in terms of money. Intangibles can be two types such as intangible assets and intangible liabilities. Intangibles that bring financial benefit to the business are considered intangible assets for example, patents, trademarks, copyrights, software and more. Examples of intangible liability are future lawsuit payments, false advertising fines and more. intangibles carry special importance for the sectors that do not produce physical products and focus on creating services [5]. For example, the healthcare sector, the entertainment sector, the IT sector and more. The output of this sector is determined based on the value it is providing to the customers rather than the actual value of the materials it is using. For example, in the Information technology sector. software are developed that are stored within hard drives. The price of the software is decided depending on the service it can provide rather than the storage it consumes and the price of building the storage device. In the healthcare sector also, price is determined by considering the skill level of the employees and the facility they are providing directly to the patients [6]. Considering this factor it can be identified that intangible assets are the main concern of the business. The number of intangible assets that health businesses carry is negligible. For example, health business is not expected to face a legal penalty in future.

2.1. Technology Sector

In the technology sector, patents, software technology, and algorithms are considered intangible assets. The study by El-Haj *et al.* mentioned that this type of asset represents a major portion of a company's value [7]. types of tangible assets that technology companies carry are buildings, furniture, digital systems and more. This type of asset only supports employees indirectly. For example, the building provides the space to work. However tangible assets in technology companies do not receive priority and they are not considered as sellable in the market. However, in the case of developed software, patented technologies can be sold into the market to bring revenue. Software development costs can be amortized over their useful life [8]. This impacts the balance sheet and income statement of the business. Considering this factor it can be said that intangible assets play an important role in

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technology companies. Here, a case study of Apple can be taken. Apple provides significant value to the technologies and patents it holds. This helps the business to increase its financial value.

2.2. Healthcare Sector

In the case of the healthcare sector, intangibles include intellectual properties such as drug patents, R&D infrastructure capability, employees working skills, service quality and more. This type of asset ensures that patients are receiving proper treatment. However, the price of the intangible assets remains higher than the materials used to develop this asset. The research of Corrado et al. mentioned that intangible assets of healthcare sectors need to be included within the balance sheet to understand its actual brand value [8]. The material owned by this sector cannot represent the value it is producing or the value it owns. If intangible assets are not included then the earning of this business will go excessively high compared to the tangible assets. This indicates accounting errors. In the case study of AstraZeneca which is a drug manufacturing and developing company, it can be seen that the business has different types of drug patients. The business uses this patented formula to create unique medicine. This helps the business to increase its value in the market.

2.3. Entertainment Sector

In the case of the entertainment industry items such as copyrights, trademarks, brand reputations and others are considered as the main intangibles. Businesses sell these properties to earn money. These properties are converted or included into films, characters and other such movie-related factors and sold to the market [5]. Without the presence of these types of intangibles, entertainment businesses will lose their identity and customer base. Due to this reason, it becomes essential for the entertainment businesses to maintain and protect this intangible. If a business fails to portray these intangibles properly then the business may become overpriced or underpriced. Both of these factors may harm the goodwill and financial condition of the business. Due to this reason, it is essential to measure these intangibles properly after recognition. In the case of Disney and Pixar, both these companies have the right to vary cinematic characteristics. The business uses these characters to create movies. Due to this reason, right on these characters provide value to this business.

3. Leasing

Leasing is well practiced across the business sectors where many organizations use substantial equipment without directly acquiring ownership of it. This financial strategy is especially important in industries such as airlines and manufacturing because some expenses are central to business [9]. The analysis given below breaks down the concept of leasing, especially operating leasing, and examines the profound effects it has on financial statements.

3.1. Aviation Sector

Operating leases are quite common in the aviation industry where airlines may use this method to manage their fleets. This approach helps the airlines to use the aircraft without having to buy them which is usually capital intensive. Historically, operating leases have allowed airlines to have relatively younger fleets, achieve operational agility, and match the fleet supply with the demand [10]. Nevertheless, its costs are relatively high where these leases are involved especially relying on the statement of financial position. A new element in the practice of accounting was that operating leases did not feature on the balance sheets hence raising off-balance-sheet liabilities [11]. This exclusion has been found to influence the investor's and analysts' view of an airline's health since major assets and liabilities remained unreported. New standards like IFRS 16 and ASC 842 require that lessees

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place leased assets and corresponding obligations on their balance sheets [12]. This change is adopted to give a better picture of the financial position and profitability which also complicates financial statements. For example, under the new standards, a firm such as Delta Air Lines needs to record the right-of-use asset and lease obligation for the aircraft it leases [13]. This change has dramatically impacted the balances of the company's financial statements in terms of asset and liability rates.

3.2. Manufacturing Sector

According to real-life situations, leasing equipment in the manufacturing sector is always considered an efficient way of operation. The production line mainly incorporates various tools and gear that are costly as they cannot be acquired through lease [14]. As in the aviation industry also, the transition to recognize leased assets and liabilities on the balance sheet under the IFRS 16 and ASC 842 standards has had an impact on the manufacturing industries [12]. Earlier, the use of operating leases enabled corporations to non-disclose such transactions from their statements, hence providing a more comforting picture of the firm's financial health. Now, more information is disclosed through lease assets and liabilities which affects but enhances the reported number of debts. This change impacts some of the most relevant scenarios which are usually used while evaluating the financial performance of the company. For instance, the extent of liabilities that emerge from reported results can affect a firm's credit rating and cost of capital [15]. Furthermore, reporting depreciation expenses on lease assets, together with interest expenses on lease liabilities changes the format of the income statement and might impact the measures of profitability.

3.3. Impact on Financial Statement Disclosure

The above analysis reveals that the modification of the lease accounting standards has far-reaching implications on financial statements regardless of the business sector. Thus, IFRS 16 and ASC 842 also recognize lease assets and liabilities that level the playing field for being used to give some companies an off-balance-sheet financing edge [12]. It is more transparent which at the same time presents new challenges concerning the measurement and reporting of expenses. In case the lease liabilities have been added, companies seem to be highly geared. These perceived changes in the level of leverage can affect investor perceptions and a company's cost of capital. However, the identification of right-of-use assets and corresponding depreciation emends the asset base, which influences the return on the assets (ROA) and other indicators [16]. Perhaps, the most noticeable shift when it comes to evaluation ratios was the increase of the debt-to-equity ratio, which was caused by the recently acknowledged lease obligations. This shift brings out the dynamics and aspects of leasing which makes it very important to carry out financial analysis and management.

Leasing is generally problematic in financial reporting outcomes but it is even worse in operating lease methods. The changes in existing standards mean to provide better comparability by extending the recognition of leases on balance sheets. Although, this improves the reliability of financial statements the process of measurement and reporting becomes tedious.

4. Goodwill

Goodwill can be considered as the representation of brand value in financial terms. The main source of goodwill is a higher purchase price compared to the fair value of the business. The market value of a business changes over time depending on investors' opinions. Investors try to invest in the stocks that are expected to bring in profit. The fair value of the stock on the other hand is determined by the price of the asset a business is holding. Fair price can be considered as the price determined by the internal managers by evaluating the price of assets individually. If investors see profit then they start to invest in the stock. This increases the dependence of the stock hence resulting in a stock price

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increase. As the stock price becomes more than the fair price, the extra value is considered goodwill. The study of Salvi et al. highlights that to earn goodwill businesses need to earn the trust of the investors [3]. Positive goodwill helps a business collect capital from the market at a cheaper cost.

The study by Rahmati et al. mentioned that mergers often increase the goodwill of the business [1]. For example, as Facebook bought WhatsApp, the earning opportunity of Facebook increased. Considering this factor, investors became more interested in the stock of Facebook or Meta. This helped the business to increase its goodwill. The research of Salvi et al. highlights that goodwill keeps fluctuating depending on investors' interest [3]. Due to this reason, it becomes hard to identify the goodwill of the whole financial year.

Goodwill refers to a situation whereby the purchase price is higher than Net identifiable assets acquired at a business's balance sheet depicting future cash flow benefits. It is difficult to quantify and thus it has to be accurately tested for impairment to get a value closer to this indicator. The challenges mostly depict the case of Microsoft which acquired LinkedIn in a bid to achieve a strategic business venture. However, issues of impairment testing and future cash flows make it harder to derive a precise figure. Concerning the issue, proper accounting of goodwill is central to the correct reproduction of the financial statements.

5. Pension

Pensions constitute a major accounting problem given their longevity and the fact that they contain actuarial estimates [17]. Leading to inconsistency and confusion in financial reporting due to the way they accounted, affecting asset and liability accounts in the balance sheet. In this sub-section, the analysis goes deeper into explaining the issues of pension measuring and reporting.

Pension accounting involves, estimating the present value of the specified pension benefits and the fair value of the related pension plan's assets. Thus, to get the value for this process, one is required to make the following actuarial assumptions. Key assumptions include:

Discount Rates: The rate used to calculate the present worth of pensions to be paid in future. It has a very direct consequence on how pension requirements are assessed in the company (Ramm et al., 2020) The variability in discount rates can lead to substantial differences in the present value-calculations of future pension obligations. A lower discount rate results in higher pension liabilities, increasing the company’s reported obligations, whereas a higher discount rate reduces the reported liabilities, potentially understating the company's future commitments.

Salary Growth: Expected future salary revisions imply the benefits that will be paid in future hence determining the present value of the obligations [18]. Salary growth assumptions are subject to economic conditions and organizational policies, making them highly variable. Unexpected changes in salary growth rates can lead to significant revisions in pension liability estimates, as higher-than-expected salary increases elevate the future benefits to be paid, thereby increasing current liabilities.

Mortality Rates: Mortality rates are another critical factor, with variations in life expectancy directly impacting the duration and total amount of pension payments. Underestimating life expectancy can lead to underfunded pension plans, while overestimating it can result in overfunding, both affecting the company’s financial position [19]. These inconsistencies and uncertainties in the actuarial assumptions necessitate careful consideration and regular updates to ensure that financial statements accurately reflect the company’s pension liabilities and overall financial health.

Besides, under the actuarial models, the above-mentioned actuarial assumptions are significantly tied to the measurement of pension liabilities and assets. The discount rate alters the evaluation of pension liabilities whereby a high discount rate results in a low figure of the present value of the future cash [20]. The expected future salary increases are applied to impact the future benefits that are expected to be paid, which, in turn, impacts the current liability estimates. As with most insurance issues, mortality rates dictate the expected number of payments and, thereby, become a deciding factor in life expectancy [19]. Determining reasonable assumptions is crucial for making sure that the financial statements depict the pension liabilities of the company properly.

The nature of pension accounting is complex because of the length of time horizons and the use of actuarial estimates. These assumptions bring in variability and uncertainty in the estimation process which are hard to measure to report accurately. However, the inclusion of all these assumptions is very crucial and should be done to deliver the pensions adequately. In this rationale, it is argued that correct pension accounting enables several companies to give the right picture regarding the state of their financial health as well as the massive future obligations they have assumed on their employees. It can be seen that with proper assessment of pension liabilities and the pension fund, the businesses can get a hold of their position and encourage program efficiency to give satisfactory valuable information to the public.

6. Conclusion

This type of accounting measurement for intangibles, leasing, goodwill and pensions has been explained in-depth. These items individually raise concerns because of the issues of subjectivity and the use of judgment in the measurement to be reported. Items affecting revenue, indefinite fixed assets, natural resources and inventory are other examples of these items. For Delta, conversion to the IFRS 16 has had a transformative effect on its balance sheet, which recorded inflationary numbers of assets and liabilities. Hence, certain financial ratios are assessed to get influenced, such as the debt-to-equity ratio, by accounting measurements. Operating accounts are the most useful, enabling the companies to use the necessary equipment, and sparing them the costs of ownership and the responsibility for maintenance.

The future developments of the accounting measurements under the IFRS and the US GAAP will probably consist of a further degree of fine-tuning to increase the reliability of the measures. New technologies and tools such as big data and other emerging configurations may however help in managing the above complexities to make financial statements remain relevant and reliable for various users. In the future, with the constantly changing standards, they would help enhance the accuracy and clarity of its financial reporting.

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