The Board of Directors and the Responsibility for Preparation of Final Accounts

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Abstract

Shareholders and other stakeholders have key interest in the financial standing and results of an entity which are detailed in the financial statements. This article therefore focuses on the board of directors and the responsibility for the preparation of final accounts. The words final accounts and financial statements are used interchangeably in this paper as they have similar meanings.

The details in this article are entirely collected through secondary research due to the specialized nature of the paper. Reference was specifically made from scholarly articles in finance and management, various text books in finance and management, and journals from professional bodies such as AAT, ACCA and CIMA.

Keywords: The Agency theory, The Agency relationship, The Board of Directors, Shareholders, Shareholder’s wealth maximization, Delegated authority.

Introduction

This article discusses the responsibility of preparation of final accounts as is stated in the title “the board of directors and the responsibility for the preparation of final accounts”. It details the agency relationship between the board of directors and the shareholders as well as the specific roles of the board of directors and the shareholders. Furthermore it also details how authority is delegated until the actual preparation of final accounts. Finally the article concludes by detailing justification about who is charged with the responsibility of preparing final accounts.

The Agency Theory

Agency theory is frequently used to explain the relationships between the several interested parties in a company and is an aid to explaining the various duties and conflicts that occur. The agency relationship occurs when one party, known as the principal, who hires another party, referred to as an agent, to perform a task on their behalf.
Agency theory can be applied to the agency relationship deriving from the separation between ownership and control. Companies that are quoted on a stock market such as the Lusaka Stock Exchange are often extremely complex and require a substantial investment in equity to fund them, i.e. they often have large numbers of shareholders. Thus separation between ownership and control is huge in such companies. The commonest and most important agency relation is between the directors acting as agents on behalf of shareholders who are the principals.

The board of directors as professional managers usually attains the delegated authority to manage the affairs of the company on behalf of the owners (the shareholders) and to have control over the company from the shareholders who are the owners of the company. The specific roles of the shareholders as the principal and the board of directors as agents are discussed below.

**Role of the Board of Directors**

The boards of directors have an interest in an entity as they are managers of the entity because they are conferred with the responsibility of managing and governing the entity. The management role of the board of directors is drawn from the agency relationship between shareholders and the board of directors already discussed above. The essential and primary aim of the board of directors is to maximize the wealth of the shareholders as they are owners of the entity. To enable them fulfill this role, the board of directors carry out duties, notably the formulation of short term, medium term, and long term strategies of an entity, they engage in various forms of decision making and finally they plan and control activities of an entity.

The role of directors in the present day world has changed to not only managing the entity in the best interest of the shareholders, but also taking into account the needs of other stakeholders, compliance with rules and regulations, respect for communities, respect for employees, and also observing human rights. By doing so, the board of directors will be managing the entity in a responsible manner. An entity is socially responsible if it takes into account ethical matters in its operations. Research indicates that there is usually a lot of pressure on the managers of a socially responsible entity to exercise good governance and ensure efficiency in management of an entity.

**Shareholder’s Role**

The shareholders are the owners of the entity and they get to have ownership in the entity by acquiring shares, thereby providing the needed capital in form of share capital. The shareholder’s interest in the company is to ensure that they are obtaining adequate returns on the funds they have invested. Their objective is to ensure that their investment is not static instead they want, but it should grow i.e. their wealth should be maximized. The Directors (agents) have a fiduciary responsibility to the shareholders (principal) of their organization
(usually described through company law as 'operating in the best interests of the shareholders'). Therefore the shareholders will be interested in holding the board of directors accountable for the results and the state of affairs of the entity. This enhances the primary objective of shareholder’s wealth maximization.

**Shareholder’s Wealth Maximization**

The usual assumption in financial management for the private sector is that the objective of the company is to maximize shareholders’ wealth “BPP Learning Media, Page 45, 2008”. It is a fundamental principle in corporate finance. Like stated above companies are owned by shareholders who get ownership by injecting funding into the company through the acquisition of shares. It is because of this, managers in companies place emphasis on shareholder’s wealth maximization as their primary objective.

The signals of shareholder’s wealth maximization are increase in the share price and/or dividend payout. To maximize the wealth of shareholders, directors usually take four types of decisions, namely investing decisions, dividend decisions, financing decisions, and risk management. For instance, through investing decisions, directors can make decisions to invest in various ventures that will yield the much needed cash flow in the company and this may be reflected in the rise of the share price and increase in dividend payments to shareholders.

**Delegated Authority**

Delegation means the conferring of a specified authority by a higher authority. It is the process of entrusting authority and responsibility to others throughout the various levels of the organization. In essence, it involves a dual responsibility. The one to whom authority is delegated becomes responsible to the superior for the job, but the superior remains accountable for getting the job done. This principle of delegation is at the centre of all processes in formal organizations (BPP Learning Media, 2007, pp. 71).

Authority legitimizes the exercise of power within the structure and rules of the organization (BPP Learning Media, 2007, pp. 72).

One vital form of delegation is where the shareholders delegate control to professional managers (the board of directors) to manage the company on their behalf. After the board of directors is delegated with power to run the company, they further delegate their powers to various directorates or departments such as the human resources department, production department, and finance department, which are usually headed by a director to perform specified tasks, and they periodically produce reports which they submit to the board of directors. Our focus in this report is on the finance department.
The custodian of financial resources of the company is the finance department. The department develops annual budgets, financial controls, financial management systems, and reports on the overall performance of the company. The finance department prepares financial accounts for external reporting and internal purposes. The director of finance is the overseer of all financial matters in the organization as the head of the finance department. Through reporting structures, the finance department assigns a finance officer or accountant in charge of the preparation of final accounts.

**Conclusion**

There is misinformation on who is charged with the responsibility of preparing final accounts as most of members of the general public think it an accountant who is responsible for the preparation of final accounts. It is important to make it clear that the preparation of final accounts is the responsibility of the board of directors collectively and not that of an accountant despite the fact that he or she does the actual preparation of final accounts. The responsibility of preparing accounts by the board of directors is drawn from the agency relationship between shareholders and directors. The board of directors, being in charge of the results and affairs of the company, they also held accountable for the financial affairs of the company, and therefore they are responsible for preparing financial statements. In addition, the board of directors is also required to state the going concern status of the company. The board of directors is accountable to the shareholders to ensure that the primary objective of shareholder’s wealth maximization as stated above is achieved and that they take ethical matters into account while running the company.

The medium that the boards of directors use to present such information is the annual general meeting and general meeting. General meetings can also be arranged by a special notice for the purpose of presenting final accounts.

**References**


