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of market economy management*

Sprawozdawczość finansowa w systemie wsparcia informacyjnego
zarządzania gospodarką rynkową

Key words: financial statements, system of indexes, users of financial statements, methodological basis of accounting

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Introduction

Financial and property status (market capitalization of assets) and the results of operation of most enterprises significantly worsened, which was partly caused by financial and economic crisis. During the last four years the sharp decrease of profits or losses, reduction of solvency and liquidity took place, as well as bankruptcy of large transnational corporations, etc. Worth noting is also the fall of share prices not only of individual companies but a collapse of investment, financial and stock markets as well.

Naturally the following questions arise:

- 1) Why did successful companies bankrupt that had obtained positive results?
- 2) Were the results, reflected in the financial statements (confirmed by audit), and confirmed by the market mechanism of equity valuation, expressed as the rate of issued securities (stocks and corporate bonds), real?

These arguments indicate that the present dataware distorts real financial position and performance of businesses in the market economy. One of the important tools of dataware of business subjects in the market economy is the financial reporting.

The purpose of reporting is achieved not only by getting a full, impartial and reliable information on current financial position and results of the business operation on it basis, but also, if it possible to predict the future potential of business development, on the basis of reporting. German scientists consider that the correct analysis of reporting using a system of indicators should allow to predict a crisis of the company three years before it starts¹.

However, the fact of the modern financial and economic crisis undermines this statement: either the current financial statement does not provide the opportunity to achieve its purposes or this tool of management service has not been used timely and fully to predict the negative trends in the global economy.

Theoretical, methodological and organizational regulations of the formation, representation and control of financial reporting and disclosure of financial information have been investigated by many scientists in their works. They have paid attention to the methodology of financial reporting and its harmonization and standardization, consolidation, auditing, information provision and so on. The evaluation of the role and qualitative characteristics of financial reporting in market economy, orientation of the conceptual framework of its development differ among scientists.

It is worth to agree to the opinion of a Russian scientist K. Tsygankov, who notes that “they have failed to create a concept of accounting, which would determine its complex information creation and idea that would unite all items of a statement”. He correctly notices that “instead of definitions there are only descriptions of reporting forms that have been formed historically, as well as lists of chapters and items to include in the literature (...) There are no generally accepted definitions of certain accounting items such as equity, capital gains, intangible assets, reserves, etc., that is the information which should be reflected in financial statements²”.

Despite a number of proposed improvements by scientists, issues of adequacy of financial reporting, the level of objectivity and transparency remains unsolved, due to particular unclear conceptual and methodological basis. Conceptual Foundations of International Financial Reporting Standards are presented in a very general and speculative way. It suffices to note that the own capital standard is not even formulated in a theoretical sense, though this standard should be the basis for fixing the property between the various stakeholders (shareholders, including minority, investors, creditors, etc.).

¹ Й. Бетге, *Балансоведение*; пер. с нем.: Научн. редактор В.Д. Новодворский. М.: Изд-во “Бухгалтерский учет”, 2000, р. XIV.

² К.Ю. Цыганков, *Теория и методология бухгалтерского учета капитала: автореф.* Дис. доктора экон. наук: спец. 08.00.12 – бухгалтерский учет, статистика. Новосибирск, 2009, pp. 3–4.

Coordination of the goals and principles of financial reporting

In our opinion the main purpose of the public financial statements is to provide the information needs of its external users concerning financial and property status of a company and the effectiveness of its activity. Such basic information and its interpretation is needed for management decisions concerning the acquisition, possession, sale of securities and the equity of the enterprise, assessment of its liquidity and solvency, security commitments, profit distribution, regulation and so on.

There are different users of financial statements such as owners and investors of the company, its management, workers and employees, business partners, the organs of state and international regulation and control, financial analysts and advisors, civil organizations, trade unions and others.

From a single nonpublic company (even very large) viewpoint list of users of its financial reporting is relatively limited, and their interests in this enterprise and related information needs are predictable. In this case, the financial reporting is “a mechanism for information exchange between interested users and the company”³. However, national or global financial reporting by business entities, especially important public companies or corporations, directly or indirectly obtains the society importance through various social organizations such as pension funds, insurance companies which are the largest investors and participants of stock and other financial markets, central and local governments, international organizations and others.

Thus, the financial statements are socially important form of information provision of the economic regulating. Its format should be determined by information needs of external users to enterprise data, not its management, which has other mechanisms for obtaining information. The paradigm of asymmetry of information contained in financial statements and its reticence in these cases is not revealed sufficiently.

Public financial reporting format stipulates stringent requirements on its content and presentation. The Ukrainian regulations (standards) of accounting requirements are set out in the following nine principles of financial reporting: autonomy of an enterprise, the continuity of its activity, periodicity, historical (actual) cost, charges and compliance with income and expenses, full coverage, consistency, diligence and prevailing of substance over a form, the only money measure. Moreover, they demand the following quality characteristics: understandability, relevance, reliability and comparability. In other conceptual frameworks (International Financial Reporting Standards, GAAP) similar requirements are prescribed as principles, qualitative characteristics, assumptions, constraints (requirements analysis of various conceptual

³ Я.В. Шевця, *Фінансова звітність у системі інформаційного забезпечення прийняття рішень*. Автореф. дисертації на здобуття наук. ступеня канд. екон. наук: спец. 08.00.09 – бухгалтерський облік, аналіз та аудит. Житомир, 2011, 21., р. 1.

frameworks, that was held by Andrienko Y.V.⁴, shows no significant differences between them, except for names).

At first glance, the principles of financial reporting, components of its qualitative characteristics should provide a sufficient level of objectivity about the financial condition and results of the enterprise. However, detailed analysis of the contents of conceptual and methodological bases of financial reporting standards, makes it possible to note the fundamental assumptions that allow to manipulate reporting indicators. According to national regulations (standards) of accounting, the information is accurate (reliable), if there are no errors and distortions that can affect the decisions of users reporting. IFRS treats the accuracy of the information as peculiarity of its completeness, neutrality, prudence, the prevalence of a substance over a form and a true picture of financial condition and performance. Given these definitions we can conclude that the accuracy is not an objective qualitative characteristics of financial reporting, but is “tied” to a format of conceptual basis of its formation. The financial statements of the same company, formed according to different approaches to the conceptual framework, may differ significantly from each other (e.g. adherence to concepts of financial or physical capital in determining earnings). In addition, using of alternative approaches to requirements (depreciation, evaluation of materials, stockpiling, etc.) does not enhance the quality level of reporting, each report will meet certain quality specifications in terms of compliance with accounting regulations and will be considered reliable. But which one will really objectively reflect the financial condition and results of business? Which one fully satisfies the information needs of users reporting?

Clarity (understandability) as another qualitative characteristics of financial reporting, assumes that the user knows and understands the reporting rules which it is made according to. Thus, regardless of accounting framework the user should clearly interpret its meaning and make appropriate conclusions. Of course, these facts do not confirm solving the problem of objectivity and transparency of financial reporting.

Different users of financial statements of an enterprise can have different information needs, which are determined firstly by the character of interest to the performance of functioning of such entity. Interests of different users of financial statements may not only differ, but even be diametrically opposed. That is why a question is posed whether financial statements can satisfy the information needs of all interested persons. In this connection, L.M. Kindratska notes: “(...) it is important to emphasize the existence of a large number of users with different interests. This gives grounds to consider the reporting information as a kind of accounting and economic goods produced in order to ensure demand for information”⁵.

⁴ В.О. Андрієнко, *Принципи формування фінансової звітності на підприємствах України та за кордоном*, в: Андрієнко В.О., Тютюнник П.С., *Вісник Житомирського державного технологічного університету*, 2009, № 3 (49), С. 12–15, pp. 13–14.

⁵ Л.М. Кіндрацька, *Звітність у загальній обліковій системі суб'єктів господарювання: розвиток та вдосконалення*. *Вісник Львівської комерційної академії*. Львів: Видавництво Львівської комерційної академії, 2011, Вип. 35, pp. 176.

Along with it the financial statements as an economic category is presented in many peremptory rules. It is the basis of profit distribution, paying dividends, calculation bonuses to management and so on. Thus, the reliability of indicators of financial statements of the enterprise implies the objectivity of the distribution of social income, investment attractiveness of a particular subject and the national economy in general.

It should be noted that some users of financial statements may have an impact on the process of its forming by some entities. In particular, the management or owners of the company. Executives (top-management) may be interested, for example, in the reporting of significant gains (because of their size, usually dependent premium, the so-called bonuses) of managers at this level or indicators that would be indicative of high level of solvency (for credits or other financial loans) and corporate rights holders – to increase the value of their shares. It is in favour of such users creativity can be applied in the accounting. Experts estimate that about 150 multinational corporations control over 40% of global income. Creative accounting of those corporations, any misrepresentation in their financial statements, in our opinion, can have significant negative consequences for the global economy.

However, the manipulation with users minds has place not only at the microlevel but globally as well. The process of standardization of financial reporting is influenced by global corporate structures. We agree with the opinion that the dominance of transnational corporations and various political forces in a country affect the decisions in the accounting sphere. This factor is well observed on the basis of development of balance sheet theories, expressed directly in the regulation of international financial reporting standards, a combination of incoherent conditions, assumptions and principles, which are not incorporated in a hierarchical structure⁶. This certainly indicates the subjectiveness of reliability as qualitative characteristics of financial reporting information.

The problems of adequacy of the financial statements to present information needs of management and regulation of market economies

A complete accounting system, based on a traditional methodological basis, is not able to effectively serve the modern post-industrial (intellectual) economy, that is accounting methodology came into conflict with the realities of economic life⁷. This applies both to accounting of traditional registration items (assets, liabilities, revenues) and the requirements of modern realities concerning reflection in the financial statements, unusual at first glance items for accounting, such as goodwill of the enterprise and other kinds of intellectual capital, hidden and potential reserves, and so on.

⁶ І.Й. Яремко, *Балансознавство у контексті і форматі методології економічної науки*, в: Яремко І.Й., Федак Т.В., *Менеджмент та підприємництво в Україні: етапи становлення і проблеми розвитку*. Вісник Національного університету "Львівська політехніка" 2009, № 647, pp. 548.

⁷ І.Й. Яремко, *Економічні категорії в методології обліку: монографія*. Львів: Каменяр, 2002, pp. 178.

Despite the rapid development of intellectual capital and its widespread use in business (just imagine the development of computers and information technology!), the methodology of accounting intangible objects suffered little change since 1861 when the monography by G.V. Simon in the theory of accounting balance right was published, that was called by O. Shmalenbah the static balance theory. Concept 38 “Intangible assets” of International Accounting Standard is actually formed on the basis of static balance sheet theory. In particular, it concerns the principle of objectification by displaying intangible objects in the balance: G. Simon believed that non-material objects can be reflected in the balance sheet only if they are purchased from third parties for a fee⁸, and paragraph 63 of IAS 38 states clearly ‘internally generated brands, headings, publishing titles, customer lists and similar in substance items should not be recognized as intangible assets.’ Clearly these regulations do not suit to subject of businesses of market economy. For example, the value of the trademark “Coca-Cola” is estimated at more than 60 billion U.S. dollars. Will it be correct not to display it in “The Coca-Cola Company” balance sheet?

The method of evaluation of intangible assets is also problematic: evaluation by historical cost may lead to the accumulation of so-called “toxic assets” and the fair value has inclination to the dramatic changes that would be experienced directly in the market position of the company which is reflected in its balance sheet.

Thus, on the one hand, there is the problem of defining the real value of intellectual capital, on the other – the lack of sufficiently justified methodological base and principal approaches to the transfer of this value into the price of the product (depreciation).

Applying in accounting of principle of conservatism is on the one hand aimed at the preservation of capital but on the other causes uprising of hidden reserves, the elimination of which leads to the formation of profit in future periods. However, current financial and property status of the entity may be underestimated. Certainly one can not abandon the principle of conservatism, but the formation of hidden reserves once again proves the impossibility to satisfy the information needs of all users of financial statements.

A significant obstacle to the objectivity of financial reporting is a problem of acquiring of the methodological dualism as a result of evaluation of assets of the enterprise (for financial reporting purposes a lot of methods of evaluating the assets of tangible and intangible nature are stated). This problem is caused by the impossibility of simultaneous use of concepts of financial and physical preservation of capital. The content of many accounting conventions is reduced to the fact that assessing the financial and property status of the company, one can objectively determine the value of its profits (if assets are measured by historical cost), or value of the property, close to the fair (if assets are measured by present value). According to some scientists,

⁸ Й. Бетге, *Балансоведение*, пер. с нем.: Научн. редактор В.Д. Новодворский. М.: Изд-во “Бухгалтерский учет” 2000, pp. 11.

prevalence of estimates by historical cost caused the occurrence of major depression in 1929 and was the main reason of defaults and recessions in 1990s. in post-socialist countries⁹. This fact also led to underestimation of the cost of privatization of national enterprises that enabled some persons or financial-industrial groups to buy corporate rights of privatized enterprises from citizens for a song. This is largely the truth for the present crisis.

All these circumstances led to a reorientation of the information support of the market from the financial statements to other tools to assess the effectiveness of its subjects, based on non-formalized information. These tools include a list of individual for each company indicators defined, normally in an expert way and oriented to the expectations of future economic benefits. However, alternative to financial reporting mechanisms of evaluation of public companies results have a number of defects that directly affect the quality of the information formed, in particular:

- the use of informal indicators that are individual to each company, makes it impossible to compare the performance of different companies, so information becomes not comparable;
- results of evaluation of the effectiveness of the company for such alternative systems of indicators are not subject to independent monitoring, including public audit that calls into question their objectiveness.

Uncontrolled use of alternative financial reporting systems of performance assessment of public companies led to manipulations with them. As a result there is a considerable overvalue of enterprises due to inflated estimates of expected future earnings and intellectual capital: “The financial and economic crisis has exposed the falsity of informal measurement (assessment) of intangible (vast) component of the market value of capital, revealing in the majority of well-known multinational companies in the world all sorts of ‘bad’, ‘toxic’ and ‘problematic’ assets”¹⁰.

In the Ukrainian context the role of financial reporting in information support of management decision-making is less significant, due to the lack of developed stock market. Although formally most of the assets that were part of total state property have been corporatized and privatized as joint stock companies and virtually all citizens of Ukraine are (or at least were) holders of securities actually, the full stock market does not exist. If you do not take into account the financial sector, there are not many public companies in Ukraine. Most companies prepare financial statements only because of their obligation to satisfy the statistics offices requirements. Much more important for companies is to fulfil the tax office requirements, because any distortion of it results in substantial penalties. As a result, the organization of accounting in such firms is subjected to fiscal imperative, not financial reporting framework.

⁹ Н.А. Бреславцева, В.И. Ткач, В.А. Кузьменко, *Балансоведение: учеб. пособие*. М.: “Издательство Приор” 2001, 160 с, pp. 83.

¹⁰ І.Й. Яремко, *Капітал в методології обліку, Матеріали IV Міжнар. наук.-практ. конф. “Стан, проблеми та перспективи розвитку обліку, аналізу і контролю у контексті сучасних концепцій управління”*. Львів: Видавництво Львівської комерційної академії, 2011, с. 551–553, pp. 553.

Finally it is worth noting that the problem of the financial reporting adequacy to the information needs of society is not new. Already in 1910, Lvov scientist (the founder of accountancy econometric theory) P. Tsompa wrote: “Our balances are incomprehensible! Without a detailed examination of accounting books, in many cases it is impossible for the most versed specialists to determine immediately the value of all items only on the basis of balance, especially when there are reserve funds, reserves and accounts of the so-called mutual credits”¹¹.

Conclusions

The current financial and economic crisis demonstrated the importance of objective and transparent information provision with the state and efficiency of operation of modern companies for purposes of government of market economies in general and especially in the financial and investment segments. Evaluation of the state and performance of the economic subjects by alternative instruments that include determination of the complex formal and informal indicators and indices, has led to a significant distortion of financial information because such information is not subject to external control, and methods of use of alternative instruments poorly governed by state institutions. Meanwhile, the financial statements are based on national or international regulations, subject to mandatory (especially for public companies) external control, i.e. audit. But to really reflect the financial and property status of the company, it is necessary to improve the methodology of accounting as the basis for its formation, particularly in part of registration of intellectual capital, overcoming of methodological dualism of assets evaluation, etc., and to take standardization of financial reporting out of the influence of transnational corporations.

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¹¹ П. Цьомпа, Я. Гончарук, І. Копич, Г. Башнянин, І. Яремко, *Нариси економетрії і побудована на національній політекономії теорія бухгалтерського обліку*. Пер. з нім. Львів: Каменярь, 2001, 223 с.

6. Яремко І.Й. *Балансознавство у контексті і форматі методології економічної науки*, в: І.Й. Яремко, Федак Т.В., *Менеджмент та підприємництво в Україні: етапи становлення і проблеми розвитку*, Вісник Національного університету Львівська політехніка, № 647, 2009.
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Financial reporting in the system of information support of market economy management

The compliance of enterprise financial statements indexes with the modern informational needs of institutions that manage and regulate economy, market agents and external users is researched. The adequacy of financial and economic position characteristics of market economy subject by the indexes of public statements according to the methodology of accounting is analyzed. The conceptual direction of financial statements according to multivector informational needs of different users and the influence of global corporative structures on standardization processes are shown.

Sprawozdawczość finansowa w systemie wsparcia informacyjnego zarządzania gospodarką rynkową

Zbadano zgodność wskaźników sprawozdań finansowych przedsiębiorstwa ze współczesnymi potrzebami informacyjnymi instytucji, które zarządzają gospodarką i ją regulują, przedstawicielami rynkowymi oraz zewnętrznymi użytkownikami. Analizie poddano adekwatność charakterystycznych cech pozycji finansowej i ekonomicznej podmiotu gospodarki rynkowej za pomocą wskaźników sprawozdań publicznych według metodologii rachunkowości. Ukazano konceptualny kierunek sprawozdań finansowych według wielowektorowych potrzeb informacyjnych różnych użytkowników, a także wpływ globalnych struktur korporacyjnych na procesy standaryzacyjne.