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THE TRANSFORMATION OF FINANCIAL REPORTING FROM THE PERSPECTIVE OF THEORY AND PRACTICE – MAIN DIRECTIONS OF CHANGES IN THE 21ST CENTURY

Abstract

The existing financial information, presented in a traditional financial statement is insufficient for the stakeholders functioning in the conditions of market economy focused on knowledge and information; therefore financial reporting is subject to transformation. The analysis of financial reporting theory and practice allows distinguishing several directions of the occurring changes. The transformation of financial reporting is dominated by the practice, which «dictates» the need for extended information. The theory still seeks a scientific justification for practical applications. The scope of presented information was extended from financial, numerical and retrospective information to non-financial, descriptive and prospective information. Therefore a financial statement is evolving towards a financial report and a business report, to end up as an integrated report.

Key words:

Financial reporting, transformation, directions of changes.

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Introduction

The development of market economy focused on knowledge and information, increased competition, globalization, the development of capital markets, the internalization of commercial exchange – represent the major reasons which resulted in more extensive information needs of stakeholders and changes in financial reporting. The traditional financial reporting does not meet the growing needs of stakeholders (particularly the external ones), who increasingly frequently expect information of prospective nature, referring to the market value of an enterprise and its environment. Moreover, critical opinions about financial reporting for the non-disclosure of crucial information and the valuation of assets at historical values contributed to searching for the ever new solutions in enterprise reporting.

The essence and transformation of financial reporting should be analysed in the context of its theoretical rules and practical applications, which co-create accounting as applied science. The 21st century financial reporting is subject to a multithreaded transformation aimed at meeting the information needs of various groups of stakeholders (e. g. investors, shareholders, contractors, clients, workers). The analysis of changes occurring in enterprise reporting allows identifying both advantages and disadvantages of this phenomenon. The purpose of the article is to analyse the process of transformation from the perspective of both theory and practice and to determine its main directions of changes. The analysis of subject literature and the author's considerations from both scientific and practical perspective based on the deduction method were used in the article.

The essence of financial reporting – theory and practice

The history of financial reporting, in evolutionary terms, is connected with the history of mankind and the development of business, its organizational and legal forms, as well as the accounting practice, which immediately reacts to the information needs of enterprise environment (Nowak, 2010, p. 30).

Financial reporting (including accounting and cost accounting) represents one of the accounting parts, in terms of its modern presentation, and simultaneously remains its final product (Samelak, 2004, p. 108). A financial statement has a justified theoretical background (e.g. static and dynamic balance doctrines), the principles of its presentation are specified in the accounting policy, along with the co-creating practice (taking stakeholders' needs into account). Therefore any considerations about the essence of financial accounting should be analysed from the perspective of theory, practice and policy of accounting.

A financial statement is the culmination of the activities occurring in the system of financial accounting (classification and valuation of business operations, their documentation, assignment and accounting) and aims at presenting a true, fair and transparent picture of the financial situation regarding enterprise assets and profits.

The theory of accounting identifies two solutions determining the objective of financial statements. They are (Gos, 2011, p. 38): the theory of transaction and the theory of value. In case of the theory of transaction an income statement is of basic importance, whereas in case of the theory of value it is balance sheet which plays the leading role. The solutions used in practice usually constitute the combination of the presented theories. The observation at an international level allows concluding that there is a shift of emphasis from the model of financial reporting based on the theory of transaction towards the model of financial reporting based on the theory of value (Samelak, 2004, p. 112).

The accounting policy is of particular importance in the process of preparing financial statements and should be understood as the set of rules/methods referring to the functioning of accounting (including financial reporting) and possible to apply by an enterprise board/management in accordance with the balance law in force. The scope, structure and forms of a financial statement are determined by the national legislation (e. g. The Accounting Act, National Accounting Standards) and International Standards («The Conceptual Framework» for International Financial Reporting Standards IFRS). They refer to the valuation and presentation of assets, liabilities, income and costs in a financial statement. It is crucial for «the Conceptual Framework» to determine the qualitative characteristics of useful financial information, which include: transparency, relevance (significance), reliability and comparability.

For years the accounting theory and practice was functioning based on two components of a financial statement, i. e. balance sheet and income statement. Balance sheet was the first type of statement which initially played the role of an inventory and was prepared only to determine the profit. Over the time balance sheet, prepared to determine profit, was replaced by income statement, whereas balance sheet itself became of static nature and separated equity capital in the form of the original contribution made by the owner and the earned profit and also allowed for the presentation of enterprise assets.

Until the 30s of the XXth century the accounting practice recognized balance sheet as the basic source of information about an enterprise. In Great Britain balance sheet constituted the primary source of information about an enterprise for investors. In the United States and the European countries it was used by the credit providers to assess enterprise solvency. The great economic crisis in the 30s of the 20th century brought about investors' focus on the structure and level of the financial result, which caused an increasing interest in income statement. The growing information needs influenced the development of the subsequent part of financial statement, e. g. cash flow, which allowed presenting changes occurring in the particular assets and liabilities resulting from cash flow.

In the 21st century the accounting practice definitely prevails over the accounting theory, also in terms of financial reporting, which was subject to many changes resulting primarily from the information needs of stakeholders and macroeconomic determinants having impact on the operations performed by the economic entities. The significant part of the transformations carried out in reporting is of practical nature lacking the developed theoretical rules.

Financial reporting in traditional and modern presentation

The ongoing, quite significant changes occurring in financial reporting give way to the analysis and assessment of the discussed process from the perspective of traditional and modern financial statement. Such comparison allows e.g. identifying the imperfections of the traditional forms and suggesting changes to be introduced in modern presentations focused on disclosing much broader information extended by the additional knowledge about an enterprise and its operations. Table 1 presents the crucial characteristics of the traditional and modern financial statement.

Financial information is the dominating one in a traditional financial statement; however, it is increasingly frequently supplemented by the non-financial information disclosed in additional reports. Along with the traditional financial dimension of reporting the non-financial one has been developing, which is perceived as the information extension, supplementation and update by an enterprise market value (Walińska, et al., 2015).

Modern financial reporting has been evolving towards business reporting, which goes beyond the framework of the existing theoretical solutions and the accounting policy. The new proposals (supplemented by additional reports) do not result from the accounting records or the accounting rules/methods and the disclosed non-financial information does not co-create the assets directly in terms of an enterprise material and financial presentation and its financial result. Therefore a question arises whether the prepared reports can still be considered the components of accounting?

Table 1

The comparison of traditional and modern annual report

Criteria	Traditional report characteristics	Modern report characteristics
Basis	Legal regulations	Legal regulations and stakeholders' requirements
Scope of reporting	Financial reporting	Business reporting
Type of information	Basic standard information: 1. Financial 2. Numerical 3. Retrospective	Extended information: 1. Financial and non-financial 2. Numerical and descriptive 3. Retrospective and prospective
Components	Financial statement (full version in accordance with The Accounting Act: balance sheet, income statement, additional information, cash flow account, presentation of changes in equity capital, statement of operations)	Financial report (including financial statement), activity report, report of intangible assets, letters to stakeholders, risk report, prospective information
Orientation	Owners	Stakeholders
Focus	Carrying value of an enterprise	Market value of an enterprise

Source: author's compilation based on (Marcinkowska, 2004, pp. 10, 76).

The evolution of reporting is influenced by the changes in the priorities of modern business operations, e. g. from product orientation towards customer and market orientation. The keynote of the new approach to reporting is the presentation of an enterprise value creation process and its analysis. Business reporting is addressed to all stakeholders (and not just to shareholders), the provided information is of both retrospective and prospective nature and covers the internal and external environment of an enterprise.

Reporting has come a long way of evolution from a balance sheet to an integrated reporting, which is currently going through the preparation phase. Balance sheet was historically the first statement, later gradually extended by additional reports, which allowed developing a financial statement as the source of information about enterprise assets and performance. The extension of a financial statement by additional information and reports affected the development of a business focused financial report, which supplemented by the management board report and additional reports resulted in the development of a business report. More information needs influenced the development of different reports

(e. g. corporate social responsibility report, intellectual capital report). The expanding collection of statements and reports, presenting both financial and non-financial information became the precursor of an integrated report announced and created in the environment of accountants.

The main directions of changes in financial reporting

In the opinion of E. Walińska (Walińska, 2009, p. 18) «Information needs of users have impact not only on the hierarchy of financial statements, but also their structure and scope», which fundamentally reflect the sense of the changes in reporting. Table 2 presents the main directions of changes in financial reporting of enterprises.

Currently, there are two dominating trends in financial reporting: extension and simplification. The first trend refers to large economic entities presenting financial statements the scope of which is insufficient against the information needs of potential stakeholders. The second trend is associated with micro, small and medium size enterprises, which aim at introducing simplifications in the reporting of entities operating on a small scale[1], because their capacity and information needs are much smaller than those of large enterprises.

Since the beginning of the 20th century the reporting of large enterprises has been following the concept of full disclosure of both financial and non-financial information, which have impact of enterprise value. In terms of disclosure the threat to enterprise existence, resulting from the loss of competitiveness, may turn out a serious problem. Therefore the provision of important and useful information in a transparent form should become the actual challenge rather than aiming at increasing the number of disclosures (Walińska, 2009, p. 164).

The changes in financial reporting of large enterprises also refer to the arrangement of forms, content and structure of the existing financial statement components.

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[1] The financial reporting of micro-entities, as well as small and medium entities, in accordance with the legal regulations in force (e. g. The Accounting Act dated 29th September 1994, Journal of Laws from 2013, item 330 as amended) is simplified. These entities can prepare a simplified balance sheet and a simplified income statement, after meeting the required quantitative criteria for such characteristics as: total assets in balance sheet at the end of the fiscal year, net revenues from sales of goods and products in a given year, average annual full-time employment. The discussed entities, operating on a smaller scale, also benefit from the possibility of accounting in a simplified form, for tax purposes. Their information needs revolve around determining both income and income tax.

Table 2

The main directions of changes in financial reporting of enterprises

The main directions of changes in financial reporting	The essence of changes
Information needs of enterprises vs. their size	Large entities – extension of the forms and scope to meet the needs of stakeholders Small entities – simplification of the forms and scope (smaller possibilities and information needs)
Standardization in large entities	The common concept of a financial statement according to the Council of the FASB and IASB The domination of standards in preparing financial statements
Voluntary supplement (extension) of the disclosed information scope for a specific purpose	Information disclosure in additional reports e.g. intellectual capital reports, corporate social responsibility reports, sustainable development reports
Moving away from the traditional and fundamental principles of accounting	The disclosure of additional information is not subject to the balance sheet method, does not result from accounting records, does not refer to an entity wealth and financial condition as at the balance sheet date, is not subject to the legal regulations in force
Two independent trends: financial dimension vs. non-financial dimension	Financial reporting (financial dimension) seeks changes in the information structure. Reporting (non-financial dimension) should aim at the development of a conceptual framework
Integrated statement	The statement including financial and non-financial, environmental, social and corporate governance information in order to obtain a comprehensive and transparent picture of enterprise activities

Source: author's compilation based on: (Bąk, 2015, p. 48).

For this purpose, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) suggested changes in the conceptual framework for preparing financial statements, having assumed the consistency of each segment in the statement from the financial position, in the statement from comprehensive income and in the cash flow statement *(Discussion Paper* 2009). Among the main reasons influencing the activities of the aforementioned Boards, in terms of the unification of the financial statement content and form, the following can be listed (Gierusz, 2010, p. 50): the gap between the harmonization of rules at the level of presentation and valuation and the lack of regulations concerning the presentation of information, poor relationships between the different parts of a financial statement, insufficient specificity of the disclosed information. The essential elements of a financial statement (balance sheet, income statement, and cash flow) function independently with only minor relationships between them; therefore it is important to standardize them in order to achieve consistent and high quality information.

The phenomenon of supplementing an annual report by additional statements/reports, prepared as a result of creative and voluntary activities by the board/management in terms of information disclosure for a specific purpose, which e.g. refer to human capital and environment protection aspects, is also important in financial reporting. The rules underlying such reports preparation do not have any theoretical background related to the accounting system, which constitutes an interpretational and formal problem in the process of all disclosed information consolidation and analysis.

The analysed reporting changes, primarily covering large enterprises, occur with reference to four aspects (Marcinkowska, 2004, pp. 9–10): the financial information is supplemented by the non-financial one, numerical information is supplemented by descriptions, information disclosure is not only obligatory, but also voluntary, the provided information is of retro- and prospective nature.

Yet another problem in the area of financial reporting refers to standardization and harmonization[2] of the rules for preparing financial statements. It seems that the current changes in accounting prove paying particular attention to standardization rather than harmonization. As D. Dobija (Dobija, 2009, p. 42) rightly observes «It actually comes down to the processes focused on developing a uniform set of standards, commonly accepted by all countries. The critics of the current standardization processes offer a different solution, consisting in the harmonious coexistence of many (several) sets of standards and allowing the market to decide when and which standards should be used in preparing financial statements. Having taken such approach to harmonization processes one cannot speak about the process of developing a single and a commonly accepted set of standards. It is rather about allowing many different, sometimes complementary accounting standards to function in the global economy, in accordance with the etymology of the word harmony». It is actually true that the accounting policy and practice are currently dominated by standardization.

[2] Harmonization means coexistence of diversity while standardization is understood as unification (monopoly).

The domination of standardization in the process of financial statements preparation and its criticism influenced the development of an integrated statement concept aimed at combining financial and non-financial, retrospective and prospective, financial and environmental, as well as social and corporate governance information in the way which provides a comprehensive picture of the operations carried out by an enterprise, its strategic goals, care for the local community, natural environment and employees (Eljasiak, 2011, p. 100). Owing to integrated reporting stakeholders will be able to explore enterprise capacity for creating value in the future and observe how these information influence each other (Eccles, Krzus, 2010, p. 30).

The International Integrated Reporting Council – IIRC is an institution dedicated to the reconstruction of the reporting provided by companies towards integrated reporting. In line with IIRC an integrated report should combine crucial information about the strategy, management, efficiency and prospects of an enterprise in the way which allows reflecting its functioning in an economic, social and environmental context (Kobiela-Pionnier, 2012, pp. 77, 79).

The expectations of integrated reporting are enormous and predominantly concern the combination of financial and non-financial information into one entity, which meets the information needs of stakeholders and offsets the difference between the carrying value and the market value of enterprises. Moreover, negative opinions of stakeholders were heard regarding the complicated system of International Financial Reporting Standards along with the positive approach to the idea of integrated reporting as an incentive for further development of these standards.

The Management Board Comments, issued by the IAS Board (IASB), which perceive the non-financial perspective of an entity functioning are noteworthy. In the environment of people involved in integrated reporting it is observed as an important element on the way to its development, even though it is not a current standard. Furthermore, *The Management Board Comments* should play an important role in the development of mutual relationships between a financial statement and other reports and also provide supplementary and explanatory information referring to the events and circumstances having impact on enterprise operations, results and its overall financial situation.

Currently, one of the significant directions in the transformation of financial reporting is represented by its two dimensions – the financial and the non-financial one[3], which should supplement each other and co-create integrated information about the internal and external situation of an enterprise from accounting perspective. The mutual combination of these two dimensions into a compre-

[3] The financial dimension covers information of financial nature, mainly included in the financial statement, whereas the non-financial dimension is identified with the non-financial information which most frequently does not originate from accounting and does not result from the accounting records.

hensive system of information about an enterprise in such a way that financial information is supplemented and explained by means of non-financial information and vice versa, is one of the most important challenges for modern reporting and accounting. Unfortunately each of these dimensions keeps developing independently from the other. Although their «artificial» combination can be observed, the problem is dominated by two leading trends: the extension of the non-financial dimension, which does not correspond with the financial dimension and the reconstruction of classical reporting model in the financial dimension, searching for new solutions.

Ultimately, the needs of stakeholders influenced the development of a supplemented annual financial/business report, which currently is no longer satisfactory and orderly arranged. The attached reports can constitute a separate document of an annual financial statement or can represent its part as a separate segment, or can serve as the component of the statement of the board activities/comments.

Summarizing the changes in financial reporting one has to agree with the opinion of Z. Luty (Luty, 2010, p. 137) that «the multiplicity and diversity of information needs in the future will result in the development of targeted and dedicated statements».

Advantages and disadvantages of financial reporting transformation

The observation of financial reporting transformation allows distinguishing the most important advantages and disadvantages of this process (table 3), which cannot be evaluated unequivocally due to its complexity and diversity of the associated factors. One of the problematic issues is the accomplishment of the main reporting objective, i. e. providing stakeholders with appropriate and satisfactory information. Some find it impossible since there are groups representing diverse and mutually conflicting goals among the stakeholders.

While performing the synthetic assessment of reporting transformation it should be emphasized that the basic problem of financial reporting evolution consists in defining the direction of such changes. Should the foundations of traditional financial reporting be changed or should they be left unchanged and the concepts for new disclosures should additionally be developed? These dilemmas refer to balance sheet in particular, which is expected to present retrospective, current and prospective information. Perhaps the balance of the future should be used to supplement information about the entity's assets only (Walińska, 2007, p. 340). Until a single and universal position in this matter is adopted many options and proposals are still going to be created.

Table 3

Advantages and disadvantages of financial reporting transformation – examples

Advantages	Disadvantages
Reporting vs. entity size	
Searching for the solutions to satisfy information needs of economic entities in terms of their size and scale of operations.	Limitations in information disclosure for SME – e. g. simplified balance sheet or income statement forms. Complicated rules, extended forms in the reporting of large entities.
Standardization of reporting	
Standardized and common rules in different places, time and markets. Ensuring good quality of the disclosed information. International organizations and bodies active and cooperating in the standardization of reporting.	Standardization turns out counterproductive after exceeding a certain, difficult to determine, limit of standards. Monopoly reduces motivation for corrective actions and may result in the reduction of standards' quality. Standards offer the possibility of applying a particular solution, not necessarily the most appropriate one. The monopoly of international organizations in working and undertaking decisions about the changes in reporting.
Creating information	
Extending information by the new areas of knowledge. The possibility of creating additional reports depending on the needs.	The possibility of losing competitiveness. Unspecified basic characteristics for the information presented in additional reporting. Freedom in the voluntary disclosure might affect the manipulation of information (non-disclosure of adverse information).
Additional reporting vs. accounting	
Freedom and creativity in preparing reports, their forms, scope and information structure. Impact on the image and reputation of an entity.	No relationship with the accounting principles/methods. Information does not originate from the accounting records and is not subject to balance law.

Advantages	Disadvantages
Integrated reporting	
Integration of financial and non-financial information in one statement. Meeting the information needs of stakeholders. Bridging the difference between the carrying and the market value of enterprises. The development of standards.	Selective disclosure of information and the absence of details. Preparation and publication costs. No measurable benefits. The possibility of using the disclosed information by the competition. The risk of liability to stakeholders. The absence of commonly accepted models for integrated reports preparation. A large group of stakeholders and their different information needs. The need for interdisciplinary knowledge presented by accountants about an enterprise.

Source: author's compilation.

Final remarks

Currently, financial reporting is probably going through the most extensive changes of multithreaded nature, which results in a certain information chaos. The analysis of literature and practice gives incentives to ask the fundamental question: «where the financial reporting heading is and what function it is going to play in the future?»

Some changes go beyond the framework of the accounting system functioning, the integral part of which is financial reporting. It refers to the situation when enterprises disclose the extended financial and non-financial, retrospective and prospective information voluntarily. The presented statements/reports should be approached as the supplementary components of an annual report, which provide more information, meet the information needs of stakeholders and create the market value of an enterprise. The information they provide does not originate from the accounting records and is not subject to the balance sheet method. However, such information offered in additional reports is also important for creating future information presented in financial reports.

Summing up the presented discussion the following, basic conclusions can be drawn: 1) a financial statement has been and will persist the fundamental component of enterprise reporting, which requires changes resulting from the growing needs represented by the stakeholders, 2) the transformation of financial reporting is focused on e.g.: the expansion of the disclosed information scope and the integration of financial and non-financial information into a complex set of information about an enterprise, 3) the variety of suggested forms and scopes of additional reports has ultimately resulted in an information chaos and slowed down the development of enterprise reporting, 4) constructive changes in reporting should apply to both traditional financial reporting and its forms extended by additional reporting (taking into account both the accounting theory and policy).

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