

## CONTENT OF FINANCIAL STATEMENTS AND THEIR INFORMATIVE VALENCES FOR STAKEHOLDERS

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### **Abstract**

*The qualitative characteristics of accounting information have a major importance in fundamenting stakeholders decisions in order to satisfy their interests. The financial statements, by their nature, provide synthetic information which shows the financial position and its modifications, the economic performance of the entity, the management of resources and other aspects that lead to rational decisions. Stakeholders interests are complex and sometimes divergent, that is why the content of the financial statements must be adapted in order to meet these interests. The present research analyzes how the information presented in the financial statements respond to the needs of the stakeholders. The analysis showed that there are some significant aspects for which the informational power of the financial statements is reduced. Also, using econometric processing, we have conceived a function that characterizes the correlation between the financial profitability of the entities activating in the energy sector and the profitability obtained in the stock exchange market. The conclusions of the research allowed us to propose some measures of improvement of the information from the financial statements, in order to create an adequate informational basis for the decisions of all the categories of stakeholders.*

**Key words:** *stakeholders, financial situations, information, decisions, IFRS.*

**JEL Classification :** *M40, M41*

### **1.Introduction**

The stakeholder concept and also the concepts derived of it are often met in specialized literature. Since the 80's, together with the advent of the first researches regarding this concept [8], the theory and practice from the business field have developed various approaches. Most of the specialized studies subscribe to the idea that stakeholder's decisions are influenced by the actions of companies and vice versa. From this approach emerges the idea that any information published by a company will be the basis of decision making by stakeholders. Most of the time, stakeholders from outside the company are making their decisions based on information provided by the annual financial statements.

At the same time, decisions can be also taken based on the compilation of information produced by accounting profession (that are found in annual financial statements) and information from other fields (technical, juridical, human resources, etc.). Moreover, it can be identified the emergence of a trend of accounting that adapts to other lines of business development. An example for this is the concept of sustainable accounting (durable accounting, environmental accounting, emission's accounting), whose analysis and dimension is required especially in energy sector. This concept (which can open new research directions) is only a component of the approach known as „sustainable development” [13].

Regarding the quality of the information provided by the annual financial statements, the question that we want to answer is “Do annual financial statements provide appropriate information which can offer a base for optimal decisions?”. Obviously, the answer is “Not entirely”, because, if annual financial statements would provide adequate information, we wouldn't encounter any bad decisions. At the same time, we can assume that information provided by

annual financial statements are generally of adequate quality, but the interpretation and the modeling of them by stakeholders leads to bad decisions.

Another aspect to consider refers to the quantity of information provided by the annual financial statements. In our opinion, this aspect is far from providing satisfaction for stakeholders. Most of the time, it is not enough to understand the gross data found in annual financial statements, but stakeholders base their decisions on processing those data, depending of interests and informational needs of each stakeholder category. This varies from one category to another because different stakeholder categories have different perceptions of the same concept. For example, current and potential investors perceive the performance by the profitability of their investments, the managers are focused on the general performance of the companies that they manage, the employees perceive the performance by the profitability and the stability of their jobs, and the creditors manifests an interest in the stability of the organization [16].

Taking into account the assumptions stated above, we can say that the annual financial statements are far from being perfect; they are perfectible. Moreover, in economies where financial reporting is made by a rigid framework, imposed by the law (as it is the case of Romania), we can state that those financial statements are built to respond, rather, to a single category of stakeholders: the governments. This issue, and also the importance of information as a new production factor make us fight for the improvement of annual financial statements, so that they can answer as better as they can to all categories of stakeholders.

The central objective of this study consists in identifying the main information gaps that can be found by stakeholders in the annual financial statements of companies activating in energy sector. The obtained results show that there are various aspects, especially in the notes of the annual financial statements, which, due to their low informational power can lead to bad decisions. In this study, we used an econometric model in order to bring more information for current and potential investors.

## **2. Research methodology**

Taking into account the fact that the specialized literature abounds in various studies that treat the informational power of annual financial statements, the theoretical part of the research focused on presenting some significant concepts related to the topic, in order to highlight the actual state of knowledge in the field. The diversity of researches on this topic can be justified by the frequent changes occurred in recent years in the field of financial reporting, which is why accounting science considers that these studies are permanently actual.

For the documentation of the empirical analysis we used the information from the annual financial statements for 2013 provided by the companies listed at Bucharest Stock Exchange and activating in energy sector. The study methods consisted in comparative analysis of the annual financial statements provided by those companies in terms of form of presentation, especially regarding the information issued by the notes to the annual financial statements. In developing the functional model that characterizes the correlation between certain information derived from the annual financial statements we used the software Wessa P., (2013), Multiple Regression (v1.0.29) [20].

## **3. Literature review**

The worldwide trend of accounting harmonization is obvious. The direction in which it goes is the widespread adoption of IFRS, Ecobici, N., [7] assuming that there were about 100 states which require or aloud the application of IFRS. For these reasons the approach to the study was done by focusing on reporting under IFRS.

Nowadays, information means power and the way through which it is obtained is communication [10]. Assuming that one of the purposes of the annual financial statements is to ensure communication between companies and their stakeholders, we subscribe to the idea issued by Dănescu, T., [6] according to which the quality of this communication depends on the accounting culture of the participants at this communication process.

Any decision taken by the stakeholders must be based on relevant data analysis. For example, a decision of investing in the equity of a company from the energy sector must begin with an overall analysis of this sector. This consists of comparative analysis of information from annual financial statements of the companies activating in this sector, but to accomplish this analysis it is required the existence of financial statements that can provide comparative information.

In Romania, the comparability of information from annual financial statements was deeply affected by the existence of different reporting frameworks depending on whether entities are listed on a regulated market or not. Thus, since 2005, it has established the requirement that listed companies have to report under IFRS for the consolidated financial statements, which altered the comparability of information provided by those companies and that are not listed, or those which even they are listed, they were not preparing consolidated financial statements. Since 2012, with the introduction of OMFP 1286/2012 for approving the Accounting Regulations according to International Financial Reporting Standards [14] it was required for all listed companies (even if they were not preparing consolidated

financial statements) to report under IFRS. Thus, we can say that the lack of comparability was reduced to information provided by two different types of companies: the listed and unlisted ones. With the introduction of OMFP 1802/2014 for approval of accounting regulations regarding the annual individual and consolidated financial statements [15] we consider that the lack of comparability was considerably reduced. However, there are specialized studies stating that there may be gaps in terms of comparability of financial statements of listed companies in Europe, even if the appliance of IFRS was introduced on a large scale [4], offering details regarding the methods and statistical processing that should be the basis for ensuring the comparability of information.

If referring to the balance sheet, profit and loss account, the statement of changes in equity and the statement of cash flow, their frame is the same for most of the entities which report under the same framework (although there are slight differences from one entity to another), we consider that this thing does not apply to the notes to the annual financial statements. OMFP 1286/2012 only makes requirements regarding the notes, without creating a real source of information for other stakeholders categories excepting the state. This is detrimental for stakeholders which are interested in analysis from an entire activity sector because the information comparability is not ensured. According to studies [5] only 42% of those surveyed felt that European IFRS adoption ensures comparability of financial information.

Thus, we can state that one of the most important objective of annual financial statements (which, otherwise, is stipulated even in IAS 1 - Presentation of Financial Statements), namely the ensurance of the comparability with other entities, is not entirely achieved.

Specialized literature retains different types of information required by different categories of stakeholders. An example for this is the interest of clients in the compliance with the going concern principle [2]. The same bibliographic source states that other categories of stakeholders have other informational needs. For example, investors may be willing to know other information regarding the risk, while the suppliers and the creditors can be interested in information such as a company's ability to pay it's debts within the time assumed (analysis of liquidity and solvency of entities).

In order to strengthen the informational power of their annual financial statements, the entities have various means developed by the accounting theory and practice. Among these means we highlight the possibility (sometimes even the obligation) of auditing the annual financial statements.

In the process of taking decisions, stakeholders can base on gross information from annual financial statement, or on processings of those information. If regarding most of the entities we can assume that gross information from annual financial statements it can be offered a high-level ensurance provided by the report of an independent auditor, regarding the processings made over the gross information we have to discern over the source that provides those information. To do this, we can apply different instruments which are able to highlight the errors in a business evaluation [3]. These types of approaches are particularly useful when stakeholders such as actual or potential shareholders or creditors try to take decisions regarding the analyzed entities.

In order to see the practical way through which some stakeholders may perceive the information presented in the annual financial statements of the companies from the energy sector, we have realized an analysis of the companies operating in this sector which are listed at Bucharest Stock Exchange, and which are part of BET-NG index. The analyzed entities were Romgaz (SNG), Petrom (SNP), Electrica<sup>1</sup> (EL), Transgaz (TGN), Transelectrica (TEL), Nuclearelectrica (SNN), Conpet (COTE), Rompetrol Rafinare (RRC), Oil Terminal (OIL), Petrolexportimport (PEI), Dafora (DAFR), and the considered reports were those prepared in accordance with IFRS requirements (OMFP 1286/2012) for 2013.

#### 4. Results and discussions

Regarding the information needed for satisfying the costumer's interest towards the going concern principle, this isn't proved in any section of the annual financial statement, except by mentioning that the financial statements have been prepared using the going concern principle. In our opinion, the going concern doesn't need to be assumed, but it has to be proven using forecasts on different time horizons, taking into account various facts (trends in energy consumption, national and international energy strategy, competition, own investments, etc.), if it is indeed plausible the application of going concern principle. Even if the law requirement regarding only the assumption of going concern principle is accomplished, we consider that entities should present more detailed information related to this goal. Any information issued in annual financial statements represent the starting point in realizing forecasts and a base for stakeholders in the process of making decisions [11].

From the analysis of the information which, however, are not included in the annual financial statements of those 11 analyzed entities, it has been noted that just 3 of them (Petrom, Transgaz and Transelectrica) provide documents that can allow stakeholders to acknowledge the main directions and investments that entities have planned on long-term (over 5 years term).

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<sup>1</sup> For this company the analysis were based on consolidated annual financial statements.

Having in view especially the interest of creditors and investors in analyzing the concepts of risk and solvability, it is found that in the explanatory notes of the annual financial statements there is a lack of attention for them. From analyzing those 11 companies it was found that there is no uniform system for reporting these information. Moreover, the lack of regulation is easily perceived in the explanatory notes (each of those 11 analyzed companies has her own system of presenting the explanatory notes, being found accumulated over 140 types of explanatory notes, having in view that a single company provides about 31 explanatory notes), but this freedom of style of presentation has negative consequences over the availability of realizing comparative analysis on the entire energy sector.

In fact, after the empirical analysis made in this study it was found that a significant deficiency in the presentation of the annual financial statements occurs in the explanatory notes to the annual financial statements. The lack of certain requirements regarding the presentation of the explanatory notes is easily perceived, each entity having their own way of organizing the information in their explanatory notes. From this point of view, we subscribe to the opinion of Roberts, C., et al. [17] according to which there will always be different solutions results as long as an accountant will have to choose between different ways of approaching a problem.

From the analysis of the annual financial statements it was discovered that only two of the analyzed companies have presented an explanatory note related to deferred taxes. This fact creates doubts regarding the real value of assets (especially for the tangible fixed assets) towards the presentations from the annual financial statements. Considering the fact that in the analyzed sector the tangible fixed assets represent a significant share, it is hard to believe that for the other entities the carrying amount of assets is precisely equal with their tax base, so they don't generate a debt or claim regarding the deferred taxes. We tend to subscribe to the statement issued by Gust, M., and Panoiu, L., [9] according to which the only importance is given to the tax treatment of the issue, without having in view the principle of true and fair view.

The lack of information for stakeholders belonging to the investors category may also have a negative impact over the entities that provide those annual financial statements. Considering that all the analyzed entities are listed on Bucharest Stock Exchange, the lack of adequate information for investors will determine them to focus their resources on other opportunities, thus the entities will be affected by the inability to attract investors. A study published in 2015 shows that 25 from 114 possible investors (more than 17%) are refusing to invest in shares because the lack of transparent information [12].

Ștefea, P., et al. [18] highlights the idea according to which investors should give a high attention to the quality of information presented in the annual financial statements, arguing that it is known how sometimes the financial statements may be established so as to provide better information than they really are when there is such an interest. In supporting the above hypothesis and in order to help the stakeholders such as current and potential investors, authors are proposing four ways through which those involved in financial markets can be used in appreciating the analyzed entities beyond the information presented in annual financial statements. Among the proposed methods, the one that drew our attention was the analysis of the correlation between financial profitability of the entities and the profitability obtained on stock exchange market by investing in the shares of the analyzed entities, proposing a correlation with the following form:

$$R_t = a_0 + a_1 r_t + a_2 r_{t-1} + \varepsilon_t \quad (1)$$

In which:

- $R_t$  is the exogenous variable represented by the profitability obtained on stock exchange market by investing in the shares of the analyzed entities (in this analysis we considered that this variable is the the ratio net profit/share) for the year t;
- $r_t$  is the endogenous variable given by the financial profitability of the analyzed entities (in this case we used the indicator Return on Equity as being given by the ratio between the net profit and the shareholder's equity of the analyzed entities) for the year t; we have used this indicator in order to characterize the immediate effect of financial profitability which manifests itself on the ratio net profit/share;
- $r_{t-1}$  is the first endogenous variable which is given by the financial profitability of analyzed entities (in this case we used the indicator Return on Equity as being given by the ratio between the net profit and the shareholder's equity of the analyzed entities) for the year t-1; we have used this indicator in order to characterize the delayed effect of financial profitability which manifests itself on the ratio net profit/share;
- $a_0, a_1, a_2$  are the constant coefficients of the regression model;
- $\varepsilon_t$  represents the error variable.

After applying the data of the analyzed companies (we have used only information provided by the annual financial statements settled up under IFRS in the last 3 years, resulting a sample containing 20 data series) over the

econometric model (1) we obtained the following form of the econometric model, which characterizes the evolution of those 3 variables:

$$R_t = 5,63604 + 0.0229807r_t - 0.0106206r_{t-1} + \varepsilon_t \quad (2)$$

The analysis of the functional relationship (2) between the variables revealed that there is a positive and higher influence of the current year ROE and a negative influence of the past year ROE. This fact characterizes the stability and the immediate reactions of the investors that are stronger than those based on historical information.

The validation of the model is reflected by the statistical tests as it results from Table no. 1.

Table no. 1 – Validation of the model

<b>Multiple Linear Regression - Regression Statistics</b>	
Multiple R	0.173203
R-squared	0.0299994
Adjusted R-squared	-0.0841183
F-TEST (value)	0.262881
F-TEST (DF numerator)	2
F-TEST (DF denominator)	17
p-value	0.771902
<b>Multiple Linear Regression - Residual Statistics</b>	
Residual Standard Deviation	10.5756
Sum Squared Residuals	1901.35

Source: Own processings using the Wessa P. software, (2013)

Regarding the informational needs of the employees, we subscribe to the idea issued by Ecobici, N., [7] that highlights the opportunity of introducing a so-called social balance sheet. Moreover, we consider that this should be one of the main purposes of the social responsibility principle. In the annual financial statements of the analyzed entities we have identified, at the level of the explanatory notes (not for all analyzed companies), some information related to the presentation of the amount of salaries and their accessories.

On the other hand, we note and recommend as a best practice example the way of informing on this subject used by Petrom which, in addition to the data issued in annual financial statements, in the document named „Resourcefulness 2013 Facts and figures”, has presented much more detailed the information related to human resources (including information about the conducted training programs, computer platforms available for employees to help them in their work, information regarding the security management of employees, figures about the number, structure and fluctuation of personnel, etc.).

We consider that such a presentation is necessary recommended if it cannot be made through the explanatory notes at the annual financial statements of the companies from energy sector, especially taking into consideration the fact that only in selected sample there are over 30.000 direct employees.

Starting from the idea that between the components of the annual financial statements there is an interdependence which must be taken in view by stakeholders in the process of taking decisions [1] and considering that annual financial statements should be read together with the independent auditor’s report, an important issue which often may lead to bad decisions is the size of materiality regarding the possible distortions. Even if this aspect is covered by the ensurance provided by the audit report, stakeholders do not know how and at what level was set the materiality, meaning that level over which is considered that an error from the annual financial statements can lead to distorted presentation. These information are found only in working documents of the auditors, without being known by stakeholders. We consider appropriate the disclosure of materiality taken in view by the auditors in order to enable to different stakeholders to fundament their decisions on known materiality, without having to make their own scenarios for the used materiality.

## 5. Conclusions and proposals

After developing this study, it has been found that, in general, the analyzed entities (with certain exceptions) are drawing up reports by strictly accomplishing the legal requirements. This type of reports are satisfying with priority the informational needs of only one category of stakeholders, namely the governments.

Thus, we can asset that the content of the explanatory notes of the annual financial statements is unsatisfactory. Correlating this with the conclusion presented by Jianu, I., et. al., [12] according to which the investor’s interest in Romania for the explanatory notes is one of low level, we can state that the informational needs of the stakeholders that are truly interested by the informational power of those components of the annual financial statements

won't be covered very soon. In our opinion, economic entities should have in view the advantages which could be generated by a set of annual financial statements with a high informational power for stakeholders. Currently, entities mainly focus on providing the necessary information for the state, without giving a big importance to the informational needs of other categories of stakeholders (eg. employees, investors, etc.).

Considering that the analysis refers to an area in which continuous investments have a very important role, especially for listed entities that entered into the study area, we believe that an adequate informing of all categories of stakeholders should compulsory include concepts as functional balance sheet, financial balance sheet and economic balance sheet.

To raise the informational power of the notes to the annual financial statements, we suggest supplementing them with detailed reports for each main category of stakeholders, by the model offered by Petrom mentioned in the study.

From the analysis of the econometric model determined in this study emerge relevant information to stakeholders according to which the return that can be generated by an investment in the stock exchange market for the analyzed companies is influenced by ROE indicator. In their decision making, various categories of stakeholders can make their own processings, according to their informational needs, based on the knowledge base consisting of the annual financial statements.

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