

# Annual Financial Statements as a Financial Communication Support

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## Abstract

*Economic entities, irrespective of their legal status, show a permanent concern for communicating the financial information useful to their environment. Financial communication is achieved through a variety of means, but the most relevant and credible instruments are the annual financial statements.*

*Annual financial statements are synthetic documents used to provide information on the financial position and performance of an economic entity.*

*The balance sheet is an important component of the annual financial statements and is used as an accounting instrument that reflects the entity's patrimony and the results of its activity during a financial year.*

*The new accounting regulations consider the balance sheet a synthetic instrument that synthesizes the financial position of an economic entity, that is to say the balance sheet gives a true image of the entity's entire patrimony at a given moment.*

**Key words:** financial communication, economic entities, annual financial statements, communication support.

**J.E.L. Classification:** G19, M41

## 1. Introduction

The annual financial statements are an important instrument in the process of substantiating and communicating the decisions made by the managerial structures to guide current and future activities of the entity.

The annual financial statements, due to their structure and implicitly to the economic and financial information they contain and communicate, reflect the activity carried out by each economic entity during a financial year, by comparing it to the previous one and respecting the unitary methodological norms, in a systematic and synthesized manner.

The balance sheet emerged into the world of economic theory and practice as a model of synthesizing at a given moment in a monetary form the relations of equilibrium established between the assets and liabilities of patrimony, considering it in its totality and its structure.

There was a time when the determination of content and form of presentation of synthesis documents was a decision of the management team. In the last decades, however, this problem has entered more and more in the sphere of concern of specialized bodies. Thus, for the understanding and application of financial reporting by as many users as possible, IASB (International Accounting Standards Board) has developed International Financial Reporting Standards (IFRSs). In order for the financial and accounting information contained in these reports to be useful globally, the European Union and the Accounting Standardization Institutions from the USA and the United Kingdom decided in 2002 to launch an ample process of convergence between the different accounting systems and the development of new standards applicable in all countries.

According to IFRSs stipulations, the report between accounting information, based on IAS (International Accounting Standards), and financial information is in balance.

## 2. The Role of Annual Financial Statements in Financial Communication

The international legislation has established a normative framework that aims to communicate concentrated financial information necessary for users to acknowledge and understand the entity's financial position, performance, profitability and effectiveness of operations, variations in its treasury resources and changes that occur at the level and in the structure of equity during a financial year. In this respect, we can assume that the entity's financial information and communication is based on three axes:

- *financial transparency, market discipline and continuity of activity shown by the economic entity* - which refers to the accessibility of securities market operators to the information regarding the level of entity's equity, as well as information to assess the level of risk;
- *accounting standards* emphasize the substance's prevalence over the presentation form;
- *quantitative and especially qualitative growth* of the financial information regarding the entity and the development of its relational system.

The accounting regulations in force have adopted the vertical balance sheet format, in which the asset items and liabilities are presented first. Equality in the balance sheet must be grafted on the components of economic patrimony presented in Figure 1 (Avram et al, 2017, p. 115).

The annual financial statements as synthesis documents give a true, fair and complete image of the patrimony, financial position and performance or nonperformance of the economic unit. The annual financial statements are the most important synthesis documents, which ensure the centralization and generalization of the economic agents and public institutions' data, in a systematic and unitary form, which allows an overview, a detailed analysis and a control of the activity carried out and the results obtained at the end of each management period. The financial position of a company is influenced by the economic resources it controls, its financial structure, its liquidity and solvency, as well as its ability to adapt to the changes in the environment in which it operates (Bătrâncea, 2006, p.67).

Figure no. 1 Economic Patrimony

	Economic Patrimony	
<b><i>Patrimonial Assets</i></b> Fixed assets Stocks Claim rights Financial liquidities		<b><i>Patrimonial Liabilities</i></b> Short-term debts Debts with a maturity of more than one year Equity
↓	BALANCE SHEET	↓
←		→
ASSETS		LIABILITIES

Source: (Avram et al, 2017, p. 115).

The role of annual financial statements in the financial communication is reflected in the following aspects:

- represents for the boards of directors, the general meetings of the shareholders or associates and the fiscal institutions a means of knowing, controlling and analyzing the activity of economic agents, which allows the communication of relevant and fair accounting and financial information;
- the information they contain ensures the analysis and communication of the evolution in dynamics of the economic and financial indicators for two consecutive years;
- the information communicated is the basis for issuing decisions for the current and prospective activity;

- it is an important factor in communicating the information necessary for organizing and managing bookkeeping.

### 3. Quality Conditions of the Annual Financial Statements

Annual financial statements can fulfill their important role in the communication process only to the extent that they meet certain requirements. The fundamental condition to be met by the annual financial statements is to reflect the reality of the assets and liabilities existing at the disposal of the economic entity. For this purpose, it is necessary for the economic operations to be fully and correctly recorded and in due time on the basis of the supporting documents in which they were registered. It is also necessary to periodically compare the transactions in the accounts with the situation on the ground and to verify the accuracy of records in the accounts. For this are used accounting procedures, in this case the classical procedures being the inventory and the verification balances.

The annual financial statements must present the data *according to a unitary system*, according to the same methodological norms, which is another compulsory condition for fulfilling their role and also for the correct and comparative assessment of their activity and for the centralization of data by the interested institutions.

The quality of annual financial statements is also appreciated by *their clarity*, a desideratum necessary for the communication of indicators that reflect the activity and performance of each entity. Clarity is appreciated by the number of indicators the statement presents and which must be meaningful and orderly based on scientific criteria.

Among the requirements imposed for the annual financial statements there is one regarding their *completeness* in the sense that they must contain all the required forms, each filled in with the indicators they contain.

Another requirement to be met by the annual financial statements is *compliance with the methodology used for determining the indicators and the correlation between them. Their elaboration and presentation at deadlines* is an obligation for each economic entity, which imposes the compliance with deadlines stipulated in the norms elaborated by the Ministry of Public Finance.

Annual financial statements have great importance as means of communication with the shareholders and elaboration of financial analyzes useful to the entity's management, meaning that they have to present a true and fair view of the entity's financial position, performance, cash flows and changes in equity.

### 4. Non-financial Information and their Role in Financial Communication

EU Directive no. 34/2013 on the annual financial statements attaches significant importance to *non-financial information*, which is an increasingly important part of company's communication process with investors and other stakeholders, providing insights for the long-term success of the business. This initiative is consistent with other current developments aimed at changing the reporting patterns of entities.

The objectives of EU Directive's revision are to reduce administrative costs for small companies, increase transparency of payments to national governments and create a reporting requirement for each country. The aim is to stimulate debates in the business and professional environment of EU countries on how best to implement these directives in the national legislation.

The Directive's application domain includes certain economic entities, such as joint stock companies and limited liability companies. In addition, there are a considerable number of general partnerships and limited partnerships, whose unlimited liability partners are either joint-stock companies or limited liability companies and, therefore, such companies should fall under the coordination measures provided for in the Directive.

The Directive should also ensure that general partnerships or limited partnerships fall within its scope if the associates of a partnership or limited partnership which are not incorporated as joint stock companies or limited liability companies have, in fact, limited liability in terms of the company's obligations, as liability is limited by other companies found under the stipulations of EU Directive (<http://codfiscal.net/36657/directiva-201334ue-noua-directivă-contabilă-europeană>).

Among the major objectives underpinning the decision to amend the Accounting Directives is the need to reduce the administrative burden, especially for small businesses, with an impact on economic growth and job creation; the revision of European Community accounting requirements is aimed at increasing the relevance and intelligibility of financial reporting requirements, as well as the protection of information needs of different categories of financial statements users.

The annual financial statements, under the stipulations of Directive no. 34/2013 as well as the national regulations in force, with all their components, after they have been drafted and signed by the persons empowered to do so either the unit's general manager and the financial-accounting director or another person who performs this function, are subject to auditing (Bunget, 2010, p.19) and approval for their subsequent submission to the County Public Finance Agency. The annual financial statements should represent an image of top management's concern for risk management and ongoing research development programs (Avram et al, 2014, p.50).

The analysis and approval of annual financial statements is an indispensable condition for the fulfillment of their communication function. In connection with the presentation of annual financial statements, it must be noted that, after auditing and approval, they are submitted to the County Public Finance Agency in electronic format until the deadline set by the legal regulations.

## 5. Conclusions

As a financial communication support, the annual financial statements, in full format, after having been drafted and signed by the persons appointed for this purpose, are subject to auditing and approval by the Board of Directors and the General Meeting of Shareholders. It is a moment when the people in charge of governance communicate directly with the shareholders on all aspects regarding the entity. According to the legislation in force, the General Meeting of Shareholders has the obligation to discuss, approve or modify the annual financial statements on the basis of the reports submitted by the Board of Directors, respectively by the Directorate or the Supervisory Board, as well as by the statutory auditor.

The annual financial statements, as a communication support, must be comprehensible, credible, consistent with the format established by the applicable accounting referential and should represent a solid basis for their discussion and approval in full consent by the GMS's members. After approval and submission to the competent fiscal bodies, the annual financial statements become public on the Ministry of Finance website or other media and turns into a communication instrument able to directly or indirectly attract potential investors.

As a working instrument, the annual financial statements are synthesis documents that can present the company's assets and liabilities in the structure required by accounting regulations.

Presented in a standardized format and certified by independent auditors, the annual financial statements are in fact a universal and transparent financial communication support meant for supervisory authorities, investors, creditors, tax authorities, suppliers, customers and the general public.

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