# **Informational Limits of Financial Situations**

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### **Abstract**

Financial reporting plays a significant role in the business environment by providing relevant information about the work carried out over a period of time by economic entities that are a starting point in setting strategies. The detailed analysis of their content allows detailing the details that can favor the correct direction of the activity towards growth and development, and the forecasts made based on an economic and financial history reduce the degree of uncertainty in the economic activity and highlight the impact elements at the micro and at macroeconomic level.

Our conclusion leads to the fact that information supplied by financial statements must be trustworthy and accurate enough at the same time. Thus the overview of the financial statement must be in compliance with the crosspoint of these two characteristics.

**Key words**: financial reporting, information limits, quality, qualitative financial statements **J.E.L. classification**: C49, M19, M41

### 1. Introduction

The enterprise's financial reporting includes a wealth of information that many users consider to be valuable in evaluating its financial performance. The advantage comes, however, within the organization, from its management for which financial data is indispensable both to build and support the firm's strategy, but in this case the information is gathered not from the published financial statements but from the more detailed internal reports, and sometimes made daily, weekly, monthly, etc. Management communicates through financial reporting with outsiders and, depending on their expectations, puts the stamp of the strategy in the content of the published financial statements and made available to the outside environment. Companies that fully understand the importance of quality financial reporting, including transparent ones, are also able to understand the needs of their investors and their business psychology. This is where strategies are born when it comes to looking for resources for new investments: knowing what potential investors need, giving them exactly the information palette, which ultimately leads to the objectives and strategy of the enterprise. If potential investors would not have all the data and the reporting would be opaque, the investment risk would increase, the end being the failure to complete the transaction.

A company's financial statements are the most important means by which accounting information is made available to decision-makers. That's why companies are publishingfinancial statements, as explicitly as possible, to be understood by the interested reader.

#### 2. Literature review

In the literature, financial reporting is the subject of many books and articles. The way of presentation, as well as the content requires permanent improvements, which can be achieved by the contribution of specialists and big economists. The limits of the financial statements jeopardize

the good course of the business, but also the economy, the causes being often subjective. Eierle and Haller found that the majority of SMEs in Germany consider only to a less extent necessary or not at all to provide comparable financial information at an international level. (Eierle and Haller, 2009, p.195)

Coppens et al. (2007), analyzing data from Belgium, highlighted that adopting IFRS for SMEs will lead to the need for separate financial reporting for tax authorities by those firms applying IFRS for SMEs. In addition, both Coppens et al. (2007) and Haller (2003) noted that, according to experts, after the adoption of IFRS for SMEs, data collection and processing efforts in the company are likely to increase considerably due to the complexity of the standard.

SMEs need help from non-company accountants in implementing IFRS, increasing the cost of adopting them, says Coppens et al. (2007). The relative value of these costs will be high, especially for smaller companies, but the size effect is rather rare in assessing the costs and benefits of this particular accounting standard (Eierle, Haller, 2009, p.197).

In the literature (Ikäheimo et al., 2010, p.50), it is demonstrated that financial and accounting specialists who have encountered various situations or have even developed the cash flow situation during their professional careers are more receptive to implementations of the new IFRS accounting standard for SMEs.

## 3. Qualitative Financial Statements (Statements of Financial Accounting Concepts)

Business partners require accurate information in order to take decisions, this information is so vital that it needs to meet certain qualities. This need for financial information can be tracked back to the Great Depression in the United States that manifested as an economic, financial and stock market crisis in 1929, because investors lacked sufficient information. One of the first steps taken as a rection to this was to issue imposed financial rules on companies that issued tradeable securities.

The following conventions are considered as generally accepted by the FSAB: methods that are permanent and comparable, relative importance, prudence, accurate information, reliability. The relationships between the qualitative features of financial information and the conventions that are generally accepted are summarized in the following scheme (Figure 1):

Clarity Decision makers should interpret accounting information There are some conventions that facilitate interpretation: Utility comparability, An accountant must provide permanence, prudence, useful information in the **External financial** relative importance, decision-making process reports of general use good information, reliability Fiability Relevancy It refers to the value of the past It includes faithful image, the predictive value and representation, verifiability, the opportunity neutrality

Figure no.1. Relationships between qualitative characteristics of financial

Source: Own processing

The objectives of financial statements also depend on the adopted accounting system of a country. Thus the anglo-saxon accounting model focuses on the investor as a center point in formulating financial statements objectives, while the continental system the objective of financial statements is formulated in a much more general manner – supplying a faithful overview. In addition, further differences in formulating the objectives of financial statements appear if we take into consideration different cathegories of enterprises: small and medium enterprises, large enterprises or groups of entrprises.

Financial statements are the result of the interaction between three parts: businesses, as entities whose activities are subject to financial reporting, accounting information users and accounting experts or the accountancy profession, in general. Out of all of these parts, the role of improving the content of financial statements and improving the credibility of accounting information is attributed to the accountancy profession.

Even if enterprises would be inclined to disclose only certain information, the decision in this regard is conditioned by the expectations of accounting information users. They must be able to determine, based on received information, the metrics regarding the profitability, liquidity and solvency of the company.

# 4. Limits of financial statements and ways to improve their content

Financial accounting lies at the basis of financial statements; it involves information registration, classification and centralization in regards to events and transactions of an economic nature. The final product of accounting is financial statements, their quality depending in large part on the quality of the accounting processing. Three parties interact in order to produce financial statements: firms as they are subject to financial disclosure, accounting information users and accountants as weel as accountancy in general. Of them all, the accounting profession is most responsible with providing an improvement in the content and credibility of financial statements. (Berheci, 2005/2006, p.56)

Hampton (1977, p.67) states in his studies that financial statements are an organized data collection according to logical and consistent accounting procedures. By default, the financial statements present the results of the management of the company's resources, which in fact means the competence and legitimacy of this structure (Horomne, 2012, p.48).

About the presentation of information at historical cost as the limit of financial statements also writes (Sihna, 2009, p.89), which starts from the premise that they are analyzed to make decisions about present and future business, and even if historical cost dependency is justified in some circumstances, for forecasts should take into account the impact of these limits. Thus, even if the presentation of assets and liabilities at historical cost provides objective measures, decisions must be oriented towards the future. Taking into account this limit, users need to look for the necessary information from other sources to make the right decisions based on real bases.

But even if the different items of the balance sheet were judged to be fair, for example, at fair value, the total amount of equity would not indicate the enterprise's overall value, balancing fragmentation at the same time as the patrimony that generated the interaction of its various elements (Colasse, 2011, p.105).

First of all, it is absolutely necessary for the users of the accounting information to also have prospective information, given that the information contained in the financial statements relates to the past and the users' decisions take into account the future. Preliminary information may be presented in the form of budgets or forecasts. By budgeting, the company plans its activity, and the forecasts refer to the company's estimates of what is most likely to take place. The question is whether the provision of predictive information should be normalized or may be optional.

Obligation to provide forward-looking information would ensure comparability between firms, but at the same time would involve a number of risks in the sense that it could affect the confidentiality of information, generating competitive disadvantages, or sometimes, given the period for which the forecast is being made, it could be affected by a lack of accuracy, which implicitly leads to less credible information. However, the normalization of the provision of predictive information remains a way to improve the supply of accounting information, which must be based on the professionalism and responsibility of issuers.

The financial reports should also contain special information for employees, to be contained in a so-called social balance sheet. There are countries where a certain balance sheet is required by some businesses (for example, in France). In addition to quantitative information, employees also need information on education and workforce experience, collective relationships, job security, etc.; all these needs have made their presence felt with the evolution of society as a whole. To improve the quality of accounting information provided by businesses, users need to know the risks that lie on them. Interestingly, it would be the company that presented the risk situation that they might encounter and their management measures, a situation attached to the financial reports.

Relevance is considered one of the most important characteristics of accounting information in regards to quality and it makes reference to the capacity of influencing investors, creditors, etc. Information that is relevant helps users in assessing events from the past, present or future. This helps in realizing and correcting portential past errors.

## 5. Impact of financial reporting on the business environment

Decisions at the management level can look at certain segments, depending on the analysis perspective. From the point of view of the resources to be employed to make profits, managers' decisions concern resource investment and business operations using invested resources, as well as an appropriate mix of funding (Rao, 2011, p.239). These are also the reasons why the accuracy and depth of information should be at the top level.

The priority of accounting information in the decisional system and implicitly in the economic information system derives from the following particularities (Horomnea, 2012, p.48):

-it presents a level of certainty and relevance to the other information systems;

-from the "double representation", it reveals interdependent relations between the material substance of the property and its legal abstraction, their provenance;

-ensures by specific means and procedures both a global and aknowledge based analysis of the studied perimeters;

-funds the future economic strategies of the company, depending on the results achieved during the reported period;

-allows comparative analysis in time and space.

Thus, an organized information system exists at the enterprise level, which allows the strategic monitoring of the activity.

A quick and accurate decision making process, developing management skills, understanding and effectively using financial information and other information in business design and development, represent the most vital need for entrepeneurs and managers (Ghenea, 2012).

Research has pointed out the obvious role of accounting information in the decision-making process for shareholders who base their management on value.

Providing them with appropriate techniques, such as correct and complete financial statements, directs managers to decisions that aim to maximize company value.

### 6. Conclusions

The strategy of an enterprise is fundamentally grounded in the information that comes from financial statements. Because some countries in Europe have called for the significance of financial reporting and financial communications, imposing an increase in the information quality of mandatory financial communications in order to protect users but also to account for responsible behavior social management, would also be very useful in Romania.

The financial statements must present information on economic and financial indicators and also take into account factors of an internal and external nature that influence them, in order to represent reliable financial communication.

The privileged location of accounting information within the enterprise information system is given to it as the result of a large number of users of accounting information, even if not the entire information produced inside the enterprise after the processing of documents drawn up following the participation in various transactions economic and financial resources are available to them.

Managers, company managers are primarily responsible for complying with the accounting principles imposed by various normative bodies. In order to ensure adherence to the financial statements of the companies they represent, they can employ independent auditors to review their financial statements.

The presentation of information at historical cost rather than the real value of assets and liabilities, the exacerbated application of professional reasoning in the preparation of financial statements, the influence of taxation on the fairness of the presented accounting information but also other examples transform the financial statements into a vicious circle of informational limits that endanger the level of development of the enterprise in the first phase and the overall economic environment in the future. Effects are often irreversible and this is the main reason why steps must be taken to ensure transparency of information, valuation of balance sheet items at real value, disclosure of non-financial items in order to increase the range of information made available to users, and the inclusion of macroeconomic indicators or regionally relevant businesses for presenting and analyzing the results achieved over the set time period.

Putting into practice the solutions for reducing the information limits of the financial statements will help to reduce the gaps and uncertainties regarding the accuracy of the information presented. In future studies, we will identify the degree of influence of the breakdown of economic and financial information on the forecasting activity but also the significant variables that should be correlated with the financial indicators existing in the financial reports to increase the understanding of the company's activity and the level of comparing information in time and space.

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