AN INTERNATIONAL PERSPECTIVE UPON THE IMPACT OF FINANCIAL STATEMNT FORM ON THE BUSINESS DECISION MAKING PROCESS

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Abstract: *In the context of globalization, where traditional borders of trade have been increasingly cast aside, the accounting information users are met with difficulties in reaching their individual interests in relation to a given economic entity, as a result of the use of more than one financial reporting system. The development of the International Financial Reporting Standards and its various degrees of adoption seeks to create a unique common language for economic activities, which would be unanimously recognized by users regardless of their multi cultural background. The present paper shows that this effort is far from being complete as the transition from traditional reporting standards to IFRS has a number of consequences on the form of the accounting information, and thus on the way it is perceived by the each individual user.*

Key words*: IFRS, ballance sheet, income statement, decision making process, financial analysis*

INTRODUCTION

Accounting information is the basic source of intelligence in aiding, both, the internal and external users' behavior when dealing with an economic entity. This information is rendered by means of a reporting system, which represents a language of economic activity [6], whose descriptive value influences decision makers toward a certain course of action. Specifically, the decision maker undertakes a certain analysis of all the accounting information available and related to a specific entity in order to determine its financial position and performance. For a better understanding of the phenomenon, it is firstly necessary to narrow down the definition of the decision making process from a broad sense strictly to the specifics of the term pertaining to the business activity. To this end we seek to answer a number of questions such as what does the business decision making process involve, who are the main users involved in this process and how does the financial information analysis benefit the undertaken course of action.

Once settling this issue we turn our attention on the above mentioned analysis, which identifies itself with a popular concept met in the accounting world. The financial statement analysis, therefore, represents a middle step between the accounting information structured in regulated statements, and the final decision of the user. Given the fact that the users' main concerns are the position and performance of a certain company, it is important to focus the effort of the present research on the balance sheet and statement of income. As a result of applying the IFRS, the Anglo-Saxon reporting system and the continental reporting system, noticeable variations in fundamental principles and differences in the form of financial statements will be highlighted, all having a lasting effect on the decision making process in international and multicultural instances. In order to narrow down the research in the form of a comprehensible model, we have chosen to compare the two statements as shaped by applying the IFRS in its unaltered form, to the Anglo-Saxon FASB regulated US GAAP, and the continental normative Romanian

accounting principles. The year of reference is 2009, as it is representative for both the US (SEC public statement announcing support for IFRS convergence efforts) and Romania (OMFP 3055/2009 being a first reformative step toward IFRS harmonization). The results will also take into account any modifications in principles, as regulated by each country's governing institutions, and legislation from 2009 to present day.

Based on the conceptual comparative model we draw conclusions regarding the manner in which the presentation of financial statements influences the business decision making process, be that in a direct fashion or in less obvious ways.

MATERIALS AND METHODS

The business decision making process. In a broad sense, the decision making process is the logical thought process conducted in an organizational setting by a person with lawful power of decision, who with the aid of all specialized parties, seeks to prepare, manage, implement and control a certain decision. In the business context, the entity with lawful power of decision is the executive body of the company, and its decisional motivational factor is the desire to change or improve a certain matter of fact [2]. Considering the following corollary to be valid: the main purpose of any company's top management is to maximize profit for its investors [1], we determine a company's executive board to be the main party responsible for the business decision making process. Prior to establishing a certain operational routine, it is understood that management established a working model compatible with the parent company's culture and domestic legislative acts, having set a clear policy regarding personnel responsibility and payment. Therefore, with the exception of extraordinary circumstances, such as bankruptcy, tax evasion, infringement on certain employee rights, etc. the business decision making process involves the government and the employee base to a lesser extent. Occasionally management must make decision regarding the two parties, but the level of involvement should be kept to a minimum as long as the decision maker is up to date with the inter-personal relationship dynamics within the company and it involves the competent departments in order to avoid any sort of legal conflict [3].

The above mentioned corollary is applicable only when management adheres to a rational economic model, analyzing all its decisions in terms of marginal cost and benefit, all while staying within the limitations of the ethical norms expected by the industry in which the company conducts its activity. Taking this one step further, in addition to the executive body's direct involvement in the process, the following information users are appreciated to be indirectly influencing the manager's course of action:

- Customers – management will consider client opinion, as this particular group represents the main income source for the company
- Creditors – representing the group that facilitates the financing leverage required for profit maximization
- Investors – the party that sets the benchmark of profit adequacy

In order to emphasise our point of view, we refer to the model proposed by figure 1. This does not only center the business decision making process around the involved users, but also hints towards the fact that a course of action is founded on hard figures and the analysis of the relationship that exists between them, rather than guesses or hunches. The model, similar to the fundamental corollary, is applicable only when users have a predictable behavior in accordance to the basic laws of supply and demand; and it does not take into account the hypothesis where the users act irrationally (Solomon normative model) or solely based on their level of understanding of the rules to which they are being subject (Jameson bureaucratic model).

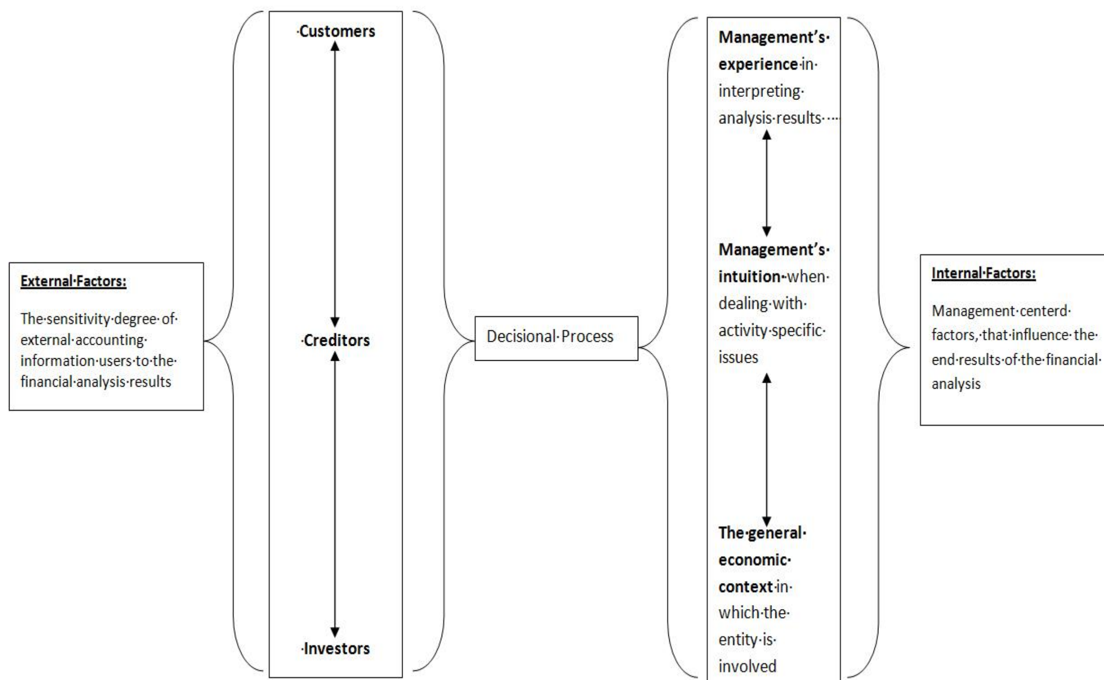

Figure 1 The business decision making process: its users and their involvement with the financial analysis

The role of statement analysis in the business decision making process. The basic unit of any financial analysis is represented by the accounting information, which is grouped in a number of highly regulated documents. These documents, further offer a platform for information users, on which they can base their decisions. While accounting information reveals a number of issues regarding the overall health of a business activity, it fails to bring added value in the absence of proper interpretation. Therefore, accounting information users base their decisions on the financial statement analysis, which is a mechanism that breaks down statements into component elements, examining both factors of direct impact and factors of indirect impact on a specific issue, to the end of determining what has caused a certain economic outcome [11]. In other words, as revealed by figure 2, the evolution of a decision maker's thought process from given information to a course of action, is bridged by a rigorous process of statement analysis.

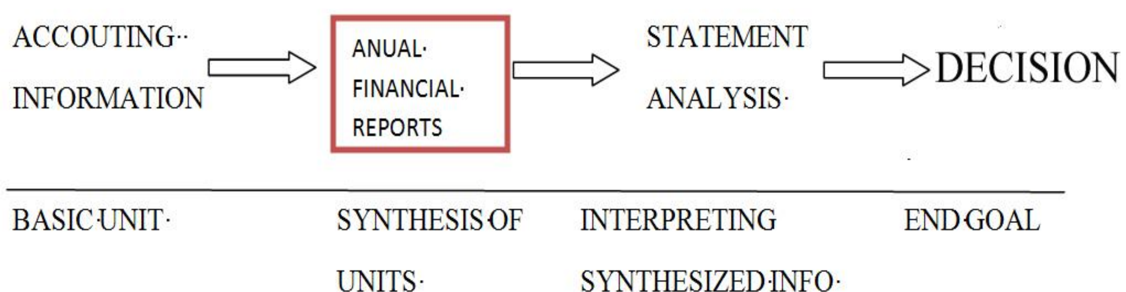

Figure 2 The linear evolution from accounting information to making a decision

In previous research we have pointed out that the quality characteristics of accounting information meets a rather large level of agreement across the Anglo-Saxon – IFRS – continental systems (as represented by the same countries used in the present research). We now focus our attention on the manner in which the annual financial statements are treated in the same comparative context. The role of the annual financial statements is to reveal the financial position and performance of a given entity, in a structured fashion, offering a clear picture on issues that include and are not limited to cash flows, changes in own capital, accounting policies, and additional information not included in the structured format. Since financial analysis, which is a vehicle of the decision making process, is based on the annual statements it is obvious that any differences in these documents from one reporting system to another will lead to a different outcomes in the course of action undertaken by any of the users involved in cross national economic activities.

RESEARCH RESULTS

Background. The manor in which financial statements are presented is probably one of the largest obstacles in the way of accounting harmonization. Often times, it is mentioned that behind the differences between national reporting systems sits a number of socio-cultural factors, that have prohibited a general consensus on the issue. For instance, the firm position of economic world powers, such as the United States and West European countries, against aligning their standards to IAS/IFRS have prevented a lean transition towards a unitary form of financial statements.

While the demand on behalf of the private sector for convergence towards a single set of accounting principles is long in existence, reform was only possible with the intervention of governmental institutions. From a chronological stand point, IAS 1 – the first international norm to regulate the presentation form of the financial statements, was published in 1975[4]. Convergence efforts to this standard, however, and amendment proposals coming from various national regulatory bodies were not initiated until the first decade of the 21st century. Once a sense of reform has been established, some major steps were undertaken towards finding compromises that would make financial statement presentation more similar across the line.

Table 1 summarizes these efforts, as of the end of the year 2009, comparing the similarities and differences in balance sheet and income statement presentation between IFRS regulations, and FASB – OMFP reformed regulations in the United States, and Romania respectively.

Table 1
General differences in the form of the ballance sheet and income statement, between FASB-IFRS-OMFP (Ro) regulations, for year ended 2009

Subject Matter	*Ballance Sheet*			*Income Statement*		
	FASB	**IFRS**	**OMFP 3055/2009**	**FASB**	**IFRS**	**OMFP 3055/2009**
Fundamental Principle	Must present the required information necessary for the user to conduct analysis and estimates Fundamental equation: Total assets= Total Liabilities+ Stock holders' equity	Must present the required information necessary for the user to conduct analysis and estimates Fundamental equation: Total assets= Total Liabilities+ Stock holders' equity	The information must reveal a faithful financial position Fundamental equation: Total assets- Total liabilities= Stock holders' equity	No fundamental principle, aside the requirement to comply to SEC regulations on the issue of presenting a set o mandatory pieces of information	The information must present a faithful and real image of the financial performance	The information must present a faithful image of the financial performance
Document Format	Allows two formats: - horizontal - list	Allows two formats: - horizontal - list	Allows a single format: - list	Allows a single format: - list	Allows a single format: - list	Allows a single format: - list
Model for information rendering	Encourages a minimum use of information	Encourages a minimum use of information	Requires a maximum use of information	Encourages a minimum use of information	Encourages a minimum use of information	Requires a maximum use of information
Classificatio n of statement components	- current assets - property and equipment - current liabilities - long term liabilities - stock holders' equity	- current assets - non current assets - current liabilities - non current liabilities - stock holders' equit	- fixed assets - circulating assets - liabilties * - stock holders' equit	Classifies expenses by type or destination, extraordinary expenses are part of the document	Classifies expenses by type or destination, extraordinay expenses are are reported separately	Classifies expenses by nature, in the case of classifying espenses by destination additional explanatory notes are required
Presentation of assets	Sorted by liquidity, highest first	Sorted by liquidity, highest first (has exceptions)	Sorted by liquidity, lowest first	N/A	N/A	N/A
Presentation of liabilities	Sorted by due date, lowest first	Sorted by due date, lowes first (has exceptions)	Sorted by due date, highest first	N/A	N/A	N/A
Presentation of expenses and income	N/A	N/A	N/A	Ordinary – unusual nature or low rate or reccurance	Ordinary	Ordinary - extraordinary
General character of the stetement form	Allows form choice, depending on industry standard	No regulated form, offers certain form guidelines	Rigurous form, as defined by legislative act	Flexible form, allows for professional judgement	Flexible form, allows for professional judgement	Rigurous form, as defined by legislative act
Guidelines for information comparabilit y	Requires statement to be presented along side recorded values for the past 5 consecutive years	Requires statement to be presented along side recorded values for the past one consecutive years	Requires statement to be presented along side recorded values for the past 5 consecutive years	Requires statement to be presented along side recorded values for the past 2 consecutive years	Requires statement to be presented along side recorded values for the past one consecutive years	No explicit requirements towards this end

**OMFP 3055/2009, Section 3, article 24, letter D nd G define two individual classifications for liabilities: due date less than a year, and due date greater than a year. Within each section the legislative act defines an additional 16 tyeps of liabilities, this list being exhaustive of all liabilites that are allowed for recording.*

Result interpretation. The three accounting standards presented in *table 1* show more differences than similarities. This, in turn, will have a negative effect on the comparability issue of statement analysis, and according to the above rationale, the negative impact will have a ripple effect on the business decision making process. Let us consider, for example, a scenario in which an economic entity undertakes an identical

number of transactions, but reports its financial position and performance in compliance with each of the three systems quoted in *table 1*. Since the same transaction is treated differently depending upon the employed system, a decision maker will take a different course of action in each individual case. This fact is due to a lack consensus upon how the systems define or recognize certain elements that make out the financial statements [9].

Furthermore, *table 1* highlights the differences caused by cultural diversity, and the uneven evolution of accounting reform undertaken by each country. The instance of OMFP 3055/2009 Romania shows a more obvious difference from IFRS, since the legislative act has been more concerned with compliance to the European Union IVth directive, than IFRS. At a glance, IFRS seems to undergo a number of principles similar to its US GAAP counterpart, as hinted by the flexibility in allowing professional judgment, combined with the liberty it allows in its general form of statement or by lacking a minimal requirement for the level of information the statements should contain. By contrast, the Romanian legislation highly regulates the form and content of the statements, fact that is seeking to aid the government and its fiscal authority, over the private sector. Given the more recent events in the Romanian national accounting reform, OMFP 1802/2014 seeks to shy away from the EU IVth directive, and be more compliant with the IFRS, but offers little resolution in as far as compliance with IAS 1. The new legislative act does, however, align to the IAS 1 regulations regarding the definition of liabilities, and categorizes them in current and noncurrent. Also, similar to IAS 1, the legislation rules on the issue of extraordinary income or expense, as no longer being an integrated part of the income statement. Although not directly linked to the subject at hand, it is worth mentioning that another convergence merit of OMFP 1802/2014 is the compliance to IAS41 “Agriculture”, through the adoption of similar definitions of biological assets.

Going back on the idea that IFRS and US GAAP seem to be far more similar than the Romanian legislation and IFRS, certain inconsistencies need to be pointed out. While certain underlying principles are indeed similar, inconsistencies do exist when examining how differently the two describe or classify statement elements that bear the same label [7]. The 2004 joint venture between IASB and FASB have sought to harmonize certain divergent points between the two systems, among which we mention the following: the recognition test for certain statement elements (where under IFRS some elements ar considered assets, FASB rules them as expenses), a joint fashion in the way the two systems govern the many liberties in statement form and presentation, jointly recognizing prior divergent income and expenses, finding a common ground on the ordinary/extraordinary expense issue, etc. While the professional environment of the US gave the initiative a positive reception, the project has come to a stalemate. The only ground breaking decision as of today, is the postulation of two new common principles with regards to statement presentation: the principle of disaggregation (*def.* presenting the cash flow in a more transparent way, while the relationship between assets, liabilities and changes in the two are more faithfully represented in financial statements) and the principle of cohesion (*def.* presenting accounting information in such a manner that the relationship between its elements are more clear)[12]. As of 2010, a FASB bulletin communicates that the joint boards of the two institutions lack the necessary time and resource to evaluate the gathered data. Therefore, there are no notable changes on the issue in *table 1,* since 2009 up to date.

CONCLUSIONS

The current situation clearly indicates that the FASB-IFRS-OMFP norms present financial statements in a divergent fashion, especially on two major issues. While the prescribed or imposed format is quite similar from one standard to the other, the manner in which certain elements are defined and recognized, as well as a number of underlying accounting principles represent the core of the problem. Directly, a great deal of confusion may arise from evaluating the accounting information contained within the balance sheet and income statement, as one user may not completely understand or appreciate the way in which information is transmited in statements aligned to a different system than the one he/she is accustomed. *Table 1* points out a number of differences such as various types of liabilities, minimum or maximum requirements for information volume, rules for ordering information, professional judgment liberties, etc. In addition to all these factors that have an influence over the rendering of information aiding the business decision making process, the present paper leaves room for future research on the topic of statement presentation impact on factors with indirect influence. As previously mentioned, accounting information directly addresses a number of concerns that decision makers might have regarding a given economic entity, however its value is limited in the absence of proper interpretation techniques. The result of applying these techniques, displays information that further explains, indirectly, the causes behind a certain economic event. Since the decision making process evaluates causes in order to be able to decide upon e certain type of effect, the FASB-IFRS-OMFP differences that influence the statement analysis comparability factor are equally detrimental to the process itself. The expectation is that the lack of convergence will mostly influence the financial ratio analysis process. The cause for this is due to the mathematical based nature of this type of analysis, which establishes a linear relationship between figures that, in this case, are not equally defined across the principles that make up the three present systems. For pertinent results on this issue, it is our intention to further our research, based on a more quantitative methodology.

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