

## VOLUNTARY AND INVOLUNTARY IN THE ELABORATION OF THE EXPLANATORY NOTES ATTACHED TO FINANCIAL STATEMENTS

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**Abstract:** *In a continuous race for the development of the profit-generating activities the economic entities pursue the realization of revenue with the lower costs. At the end of each fiscal year the image of the economic entities' activity is analyzed and reported through financial statements. The accounting regulations foresee the components of financial statements that are required to be based on certain economic features or reporting framework. Since we very often find that the expression of "accounting information is confidential," the question arises: where is the border located between confidential and non-confidential? How much of the entity's financial data is reported through the annual financial statements, either involuntarily through the mandatory financial statements –or voluntary through the optional financial statements? In this work we analyzed the way of reporting the economic entities through the elaboration of the explanatory notes to the financial statements. In the research methodology we started from the study of the legal framework regarding their preparation, highlighting the mandatory or optional nature of their preparation, after which we selected the information presented frequently by the economic entities. The involuntary character is given by those directions regarding the minimum information that the accounting regulations foresee as necessary to be submitted. The voluntary character is given by the information which is presented by the economic entities without them being required by any accounting regulations, but they are considered to be important in the presentation of its image. In the end of the research we have identified the information that can be presented voluntary, but which can increase the confidence of the users of the accounting information in the economic entity to the extent of how this is willing to be transparent regarding the disclosure of the accounting information. We conclude that the information provided on a voluntary basis in the explanatory notes may be an important factor in enhancing the investor's confidence in an economic entity, but also of the other categories of users, in which this is willing to submit additional information in order to create better perceptions of the activity of the economic entity, as well as of its result and, last but not least, on other financial and non-financial elements used or held by the economic entity.*

**Keywords:** annual financial statements, involuntary, voluntary, confidential information, explanatory notes, accounting information,

**JEL classification:** M41

## **1. General Introduction**

The annual financial statements must provide accurate and useful information to the users with regard to the financial position - by the presentation of the Balance Sheet - financial performance - by the preparation of the profit and loss statement - changes to the financial position - by the statement of equity - cash flows - by cash flow statement, but also other additional and relevant information. (Berheci, 2010, p. 197)

Additional and relevant information are given in the explanatory notes of the financial statement. The main purpose of the explanatory notes is to inform with regard to the reporting framework, methods, principles and accounting policies that were taken as a basis for the preparation of the financial statements, as well as completion of certain information on the data submitted in the balance sheet and in the profit and loss statement. (Hristea, 2013, p.89)

The purpose of this article is to present the elaboration of the explanatory notes annexed to the financial statements by those economic entities which apply the accounting rules in accordance with the Directives of the European Communities by highlighting the *involuntary character* (via the mandatory synthesis statements) or *voluntary* (through the optional synthetis statements) of the information contained in them.

This article presents in the introduction the objective of this research starting, with the methodology of research, through the general ideas concerning the explanatory notes in the presentation of their use on the categories of accounting information most important: fixed assets, current assets, equity, debts, indicators of performance and additional information.

For all these categories we will highlight the information that need to be presented, the information that the economic entity wishes to submit and also our argumentation on the benefits that they may have to the users of accounting information by the fact that the economic entity is willing to ensure transparency by the disclosure of the information.

## **2. Methodology of Research**

To achieve the proposed objective we started using the method of descriptive research by studying the specialized literature - in particular legal aspects - and the opinions of some Romanian authors on the compilation of the explanatory notes annexed to the annual financial statements. As process of knowledge of the legal regulations the documentation has consisted in the study of regulatory acts, books and specialized magazines, which study the preparation of the financial statements of the economic entities.

Also, the research is based on the professional judgment in the identification of the information that can be presented on a voluntary basis, together with those presented involuntarily, as well as the extent to which the economic entity is willing to disclose the accounting information.

I have used at the same time the comparative methodology for highlighting the optional or mandatory character of the explanatory notes and the information provided by them.

### 3. Overview on the explanatory notes to the financial statements

For the economic entities in Romania which apply to the accounting regulations *in accordance* with the Directives of the European Communities, the assembly of accounting standards has its origin in the Public Finances Ministry Order No. 1752 of 17 November 2005, until then accounting rules being *harmonized* with European Directives. A historical retrospective on the accounting regulations it was presented in the article "European Accounting Regulation - History and Perspectives" (M.Farcas, L.Rus, 2014)

The optional or mandatory nature of the presentation of the explanatory notes has been covered in respect of the performance of two of the three criteria of size: total assets, total income and average number of employees. By highlighting the provisions of the Romanian laws in accordance with the Directives of the European Communities, in **Table 1**, it is presented the size of the characteristics which have limited the obligation to present the explanatory notes and if their presentation is or is not required.

**Table 1.** Categories of reporting entities

Table 1.1			
Characteristics of the size	OMPF 1752/ 2005	OMPF 3055/ 2009	OMPF 1802/ 2014
Total Assets : 0-350 000eur Total Income: 0-700 000eur The average number of employees: 0-10	Yes	Yes	No
Total Assets 350.001 - EUR 3.650.000 Total Income: 700.001-7.300,000 EUR Average number employees 11-50			Yes
Total Assets 3.650.001 - EUR 4,000,000 Total Income: 7.300.001 - EUR 8.000.000 Average number employees 11-50	Yes	Yes	Yes
Total assets over EUR 4,000,000 Total Income: over EUR 8.000.000 The average number of employees: over 50			Yes
Source: own processing after legal regulation referred to			

By analysing the data submitted we could see that only starting from 2015 there is no longer the obligation of presenting the explanatory notes annexed to the financial statements for all economic entities. The elimination of mandatory character on the presentation of the explanatory notes by micro entities justifies the question: *why to submit information which there are not required?*

It must also be mentioned that the OMPF 1752/2005 presents the models of presenting the explanatory notes and their numbering, leaving at the choice of the economic entities to voluntarily provide additional information in the "explanatory note 10. Other information".

Ompf 3055/2009 rules the general provisions regarding the explanatory notes listing the information that must be submitted *systematically* and *clearly*.

Starting with 2015, the accounting regulation - OMPF 1802/2014 - mention only the information that must be mandatory submitted by the economic entities without presenting the model or a list of explanatory notes. This causes the voluntary nature of the transmission to the users of the financial and accounting information regarding the economic entity.

#### **4. The submission of the explanatory notes**

In the following, without claiming to cover the entire range of information, we will present a number of aspects which can be offered voluntarily or involuntarily in the explanatory notes of the annual financial statements, showing the differences in their approach to compliance with European Directives - by OMPF 1752/2005 - up to now - by OMPF 1802/2014. We will also argue the usefulness of the presentation of the additional information on a voluntary basis.

The information regarding the fixed assets have been offered by presenting the "Explanatory Note 1 Fixed Assets" where such information has been recorded with regard to the gross amount, the amount of the depreciation and the value of the adjustments for the depreciation of fixed assets, detailed down to the level of fixed asset.

Today, the information concerning the fixed assets are offered:

Involuntarily: *For each time:* the purchase price, the increases or decreases in the value in the course of the financial year, the value at the end of the financial year

If they have been revalued, information relating to the revaluation

The adjustments in value recorded in the course of the year

The capitalized elements

Voluntarily: The usage time remaining

The place of use of the fixed assets

Any major repairs have been carried out in the course of the financial year or to be taken in the following financial year.

#### **Arguments concerning the usefulness of the voluntary information:**

- A description of the fixed assets, the costs generated by them in the future - sooner or later - will be able to influence the decisions of the users of the accounting information through the knowledge of the operating status of the fixed assets, as well as the degree of high tech of the economic entity, the extent to which it carries out its activities with efficient assets, the need for investment in upgraded equipment, etc.

Regarding the current assets, the explanatory notes presented as a model in the accounting regulations in the year 2005, it have been legislated the provision of the information about receivables - with details on the types and deadlines - for stocks and cash, requiring only the presentation of policies and accounting methods.

As of now, the information on the current assets are illustrated:

Involuntarily: Accounting policies on stocks, receivables and cash

Terms and specific conditions relating to financial investments which may affect the cash flows

Statement of receivables taken through an assignment contract

The value of the loans granted to the members of the leadership of the economic entity, indicating the conditions under which they were granted, the reimbursement and the rate of interest

Voluntarily: Elements that have changed or will change the destination of the stocks in fixed assets or the investments in stocks  
 The cause of possible adjustments in the of the stocks  
 Statement of receivables detailed on types of receivables, in RON and foreign currency, at the time of settlement  
 Information relating to the foreign bank accounts  
 The result of the inventory of stocks on the types of inventories and highlighting the causes of any plus or minus differences

Arguments concerning the usefulness of the voluntary information:

- A description of the circumstances which may cause the transformation of the fixed assets in stocks or of the stocks in fixed assets may offer clues regarding the activity of the economic entity, the changes in managerial policies, etc
- A detailed statement of receivables can facilitate the process of making decisions in the efficient manner if there are known information regarding cash flow, but also if they are likely to be affected by the exchange rate differences, etc.
- Submission of the inventory results can provide information on stringency and discipline in the management of goods received in the administration by the employees of the economic entity

The information with regard to the capital and reserves were and remain of major importance for the users of accounting information, in particular for investors. This information is displayed:

Involuntarily: The changes in the capital and reserves in the course of the financial year  
 The number and the nominal value of the shares subscribed on the categories of actions  
 The movements of the reserve from the revaluation with an explanation of the fiscal treatment

Voluntarily: The details of the information relating to the establishment of the reserves  
 The periodicity of the operations of the revaluation and also the method used for their recognition in the accounts  
 The number and the nominal value of the shares on the categories of shareholders

Arguments concerning the usefulness of the voluntary information:

- The establishment of reserves, as the destination of the margin profit, could influence the decisions of the users of the accounting information when there are rules concerning the periodicity of establishing the statutory reserves or other reserves
- Knowledge of the information on the reserve from the revaluation - frequency and the method of recording in the accounts - lead to a better perception on the equity of the economic entity but also on the value of fixed assets held by it.

The information on the liabilities of the entity economic, shown in the balance sheet on the two categories of maturity – payable in less than one year and over a year - have been detailed in the explanatory note 5 "Receivables and Liabilities" on the types of liabilities, being presented separately from those which will mature in five years.

In these days the information on the liabilities are given:

Involuntarily: The value of the liabilities and financial commitments not included in the balance sheet

The commitments in respect of the affiliated entities or associated

The liabilities of the economic entity payable in more than five years

Securities submitted by the economic entity

Voluntarily: Statements of liabilities detailed on types of payables, both in RON and foreign currency by the due dates

The description of the liabilities to the suppliers that are the providers also for the economic entities in the competition

Arguments concerning the usefulness of the voluntary information:

- A detailed statement of the liabilities can facilitate the process of making decisions in the efficient manner if there are known the information on the cash flows, but also whether such payments may be affected by the exchange rate differences, etc.
- In the conditions of competition, to know the suppliers of the competitors could influence decisions on acquisitions, but also can avoid situations with negative impact for economic entity and its users of accounting information

The main indicators of economic and financial performance have been presented in the explanatory note 9 being given the examples of the indicators of liquidity, risk indicators, the indicators of management and profitability. Today, these indicators are calculate:

Involuntarily: The economic and financial analysis by the calculation of the key indicators of performance - financial and nonfinancial – presented in the report of the managers and not disclosed in the explanatory notes annexed to the financial statements

Voluntarily: The Economic and Financial Analysis by comparing the level of performance of the indicators for a period up to five years  
The calculation of the indicators based on cash flows  
The compared analysis of the indicators calculated based on the profit and loss account with those calculated based on the situation of the cash flow statement

Arguments concerning the usefulness of the voluntary information:

- The comparative analysis on a period of up to five years provides useful information on the image of the economic entity
- Avoid the situations in which the profit - established as the difference between the revenue and expenditure account - to represent a deficit
- The calculation of some indicators based on the cash flow provides information about the surplus or the deficit of cash, but also about its use compared with the profit or loss of the year and its distribution.

For the presentation of additional information has been ruled the Explanatory Note 10 "Other information" which requires to give information about the affiliated entities, the basis of conversion into national currency of the elements in foreign currency, the tax on profit, total income, bills of exchange before maturity, etc.

At present, the presentation of the supplementary information is provided:

Involuntarily: The income presents the criteria that can provide information useful for the decision factors: on working points, geographical areas, business segments  
The average number of the employees that have participated in the activity in the course of the financial year, detailed by category  
The affiliated entities and the preparation of the consolidated financial statements  
The administrative management and the supervision of the entity and the amount of their wages  
The nature of the relationship and transactions conducted with the affiliated entities

Voluntarily: The situation of the outstanding payments detailed on the types of liabilities, in RON and in foreign currency  
The details of the income and expenses on the types of activities  
The influence of the tax on income or on the result in the determination of the net result  
The causes that have led to a loss and ways of reducing the costs



#### Arguments concerning the usefulness of the voluntary information:

- A detailed statement of unpaid liabilities can facilitate the process of making decisions regarding the due date negotiated with the clients or taking loans to pay them.
- The fiscal influence on the determination of the result can facilitate the correct forecasting of the net result, of the capacity of the implementation of the investments and even the effort of rewarding the investors through the distribution of dividends.

#### Conclusions

The annual financial statements, as summary documents of the economic entity, present the position and the performance of the economic entity through the components provided by the accounting regulations. The requirement of presenting all the components depends on the characteristics of the size referred to above.

If the *Financial Statement* shows information regarding the financial position and the *Profit and Loss Statement* shows information regarding the financial performance, the *Explanatory Notes* are designed to provide additional and detailed information regarding the activity of the economic entity.

By analyzing the method of presentation of the explanatory notes we found that the minimum information required by the accounting regulations as being necessary to be presented by the economic entity determines the involuntary nature of the explanatory notes. *The voluntary nature* of the explanatory notes is given by the extent to which the economic entity is willing to divulge accounting information which it considered as being important in the correct presentation of his image.

Arguing the usefulness of the voluntary information we concluded that the information offered on a voluntary basis in the explanatory notes could be an important factor in increasing the confidence of the investors in the economic entity, but also of the other categories of users.

An economic entity willing to submit supplementary information will transmit a better perception on its activity, its position and its performance, but also on other financial and non-financial elements used or held by the economic entity.

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