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THE MANAGEMENT'S REPORT IN THE LIGHT OF THE INTERNATIONAL AND NATIONAL REGULATIONS ON FINANCIAL REPORTING

Summary: The paper describes the significance of an important element of the economic entity's annual report, that is, the management's report. This is because the management's report constitutes a significant complementation and elaboration on the annual financial statements. In the paper the scope of management commentary is presented in light of the so-called practice statement of the International Accounting Standards Board. The requirements related to the annual report provided in the Fourth Council Directive are also quoted. The content of the report on entity's activities specified in the Polish Accounting Act isdiscussed against this background. The significance of the management's report as a source of the information on the activities and achievements of anenterprise in afinancial year as well as forecasts and plans for the future is also proved.

Keywords: financial reporting, management commentary, report on entity's activities

1. Introduction

The major part of the economic entity's annual report is financial statements, which include a balance sheet, profit and loss account, cash flow statement, statement of changes in equity and note to financial statements. These statements are a significant source of information on the entity's financial and asset position, achieved performance and cash flows. Based on financial statements alone, the activities and the economic position of an analyzed entity cannot be evaluated comprehensively and properly. In these statements merely the financial information on the past (the previous financial year) is provided in the retrospective approach.

In order to comprehend the financial position of an entity, one needs performance and cash flows in a given financial year as well as additional and more detailed information than the one presented in annual financial statements. This postulate is satisfied to a certain degree by the notes to financial statements, which include an introduction to financial statements as well as the notes and explanations to financial statements. Therefore, the regulations on financial accounting and reporting recommend the preparation of an additional complementary and explanatory report to annual financial statements by specified economic entities. This report is often colloquially referred to as "the management's report". The International Accounting Standards Board (IASB), in turn, uses the term "management commentary". In the Fourth Council Directive the term "annual report" is employed. In the Polish Accounting Act, in turn, the term "*roczne sprawozdanie z działalności*" ("the report on entity's activities") is adopted.

The major aim of this paper is to demonstrate the essence and scope of the management's report as a source of information for various stakeholders of an economic entity. The subject matter will be presented in the light of the international and national regulations on financial accounting and reporting. At the same time, the significance of the information provided in the management's report in evaluating enterprise economic achievements will be explained.

2. Management commentary in the light of the statement of the International Accounting Standards Board

The International Accounting Standards Board (IASB) issued the so-called IFRS Practice Statement *Management Commentary* in 2010. The practice statement was prepared with the assumption that management commentary is included in the scope of financial reporting since it corresponds to the definition of other forms of financial reporting included in the International Financial Reporting Standards (IFRS). At the same time, the practice statement specifies non-binding assumptions related to the manner of presenting management commentary and refers to the entities which prepare their financial statements in accordance with the International Financial Reporting Standards. Therefore, management commentary is included in the IASB Conceptual Framework for Financial Reporting. At the same time, the Practice Statement *Management Commentary* is not among the International Financial Reporting Standards. Therefore, the entities which apply IFRS are not obliged to comply with the practice statement.

The Practice Statement *Management Commentary* of the International Financial Reporting Standards [*International*… 2010, pp. B1929–1952] presents:

- the assumptions of a presentation,
- qualitative characteristics,
- elements of management commentary.

Pursuant to the practice statement, the primary purpose of management commentary is to provide users of financial statements with the integrated information that provides a context for related financial statements. This information presents the explanations of management on the objectives of an entity and its strategies for achieving those objectives. At the same time, this information refers not only to the past, but also to the prospects of entity development; it indicates both positive and negative circumstances and reveals the reasons for their occurrence and implications for the future.

Management commentary should be presented consistently with the following two fundamental principles in mind:

a) to provide management's view of entity performance, position and progress,

b) to supplement and complement information presented in financial statements.

Management commentary is a descriptive document, in which management interprets the financial position, financial performance and cash flows of an entity. Management commentary supplements and complements financial statements and explains the main trends and factors that affect the future performance, position and progress of an entity. This information should enable the users of financial statements to evaluate performance and management's activities in relation to the strategies and plans for the progress of an economic entity.

Management commentary ought to possess the qualitative characteristics specified in the Conceptual Framework for Financial Reporting prepared by the International Accounting Standards Board. These characteristics are supposed to ensure the usefulness of the information presented in management commentary when making a decision concerning an entity by specified users. In the IASB Conceptual Framework two types of these characteristics are distinguished due to their importance: fundamental qualitative characteristics and enhancing qualitative characteristics [*International*… 2010, pp. A36–41].

The fundamental qualitative characteristics, which shall ensure the relevance of the information presented in the management's report, are useful and faithful representations. Information is considered useful if it may cause the change of the decisions made by users on its basis. Information is decision-useful if it is forward-looking or confirmatory or both. Information is forward-looking if it may be employed by users to project future performance. Information is confirmatory if it provides knowledge on the previous evaluations, thus confirming or changing them.

A specific aspect of the usefulness of the information presented in management commentary is its significance. Information is significant if its omission or distortion could influence the decisions made byusers based on the information related to an evaluated economic entity. The significance of information depends on the type or size of the items presented in management commentary of a given entity. However, IASB did not establish the quantitative thresholds for the significance of an item because, according to the Board, this depends on a particular situation.

If the information provided in management commentary is to be useful, it should represent relevant economic phenomena, which are characterized in a descriptive and numerical form, in a faithful manner. Faithful representation is achieved if information is complete, neutral and free from errors.Complete presentation is expressed with disclosing the information necessary for the user to understand the characterized phenomenon. Neutral presentation consists in proving impartiality when selecting the presented information and the manner of proving it. If information is free from error, there are no errors and omissions in the description of phenomena and the procedures of preparing the presented information are well-chosen and applied.

The enhancing qualitative characteristics of the information provided in management commentary are comparability, verifiability, timeliness and understandability. These characteristics contribute to increasing the level of relevance of the information which is useful and faithfully presented. Therefore, it is advisable that the enhancing qualitative characteristics be achieved in management commentary to the largest possible extent. Moreover, they may help select the manner of presenting a phenomenon if the solutions under consideration are regarded as equally useful and faithfully represented.

The International Accounting Standards Board specified the scope of the information that should be presented in management commentary. This information is related to five elements to the assessment of the needs of the primary users of management commentary: investors, lenders and other creditors. They are listed in Table 1.

Table 1. Elements of management commentary

Elements	User needs
Nature of the business	The knowledge of the business in which an entity is engaged and the external environment in which it operates
Objectives and strategies	To assess the strategies adopted by an entity and the likelihood that those strategies will be successful in meeting management's stated objectives
Resources, risks and relationships	A basis for determining the resources available to an entity as well as obligations to transfer resources to others; the ability of an entity to generate long-term, sustainable net inflows of resources; and the risks to which those resource-generating activities are exposed, both in the short and the long term
Results and prospects	The ability to understand whether an entity has delivered results in line with expectations and, implicitly, how well management has understood the entity's market, executed its strategy and managed entity's resources, risks and relationships
Performance measures and indicators	The ability to focus on the critical performance measures and indicators that management uses to assess and manage entity's performance against stated objectives and strategies

Source: *International*… [2010, p. B1951]

The individual elements of management commentary listed in Table 1 include the needs of the primary users of this report: investors, lenders and other creditors. This information may be also useful to other stakeholders of an entity. At the same time, the extent of and elaboration on the disclosure depend also on the specificity of reporting entity's activities and the significance of the presented information to particular users.

3. Annual report in the light of the Fourth Council Directive

In the European Union member states, the requirements concerning the preparation of reports are stipulated in the Fourth Council Directive of 1978 on the annual accounts of certain types of companies. This Directive specifies the companies which are obliged to prepare this account and determines the minimum scope of the information to be presented. The Directive 2003/51/EC (the so-called Accounts Modernization Directive) contributed a significant increase in the scope of the information disclosed in the report. Further amendments related to the content of this report were introduced by the Directive 2006/46/EC [Krasodomska 2011]. This manifests the dynamic nature of this element of the annual report and its significance in evaluating the achievements of an economic entity.

Pursuant to the provisions of the Fourth Council Directive and the directives which modify it, the annual report should include at least the reliable assessment of company's development and results as well as its position, together with the description of the most significant types of risk and uncertainty that is involved in company's activities. The presented assessment ought to be a result of a complete and well-balanced analysis of company's development and results as well as its position. In order to comprehend these issues better, not only financial indicators but also crucial non-financial indicators which describe the results of given activities, including those related to the environmental protection and employee matters, need to be indicated to the necessary degree.

In accordance with the provisions of the Directives of the European Parliament and of the Council, the company's report should present particularly the information on:

- any important events that have occurred since the end of a financial year,
- the company's likely future development,
- activities in the field of research and development,
- acquisitions of own shares,
- existing branches of a company,
- risk management purposes and policy in a company and the degree of company's exposure to various types of risk,
- application of the principles of corporate governance.

The regulations on the report included in the Directives of the European Parliament and of the Council are reflected in the provisions of the Accounting Act, which refer to the entity's report. The purpose of these Directives with respect to reporting of companies is to uniform the solutions employed in the member states. Only certain detailed issues may be regulated separately by the individual states on a discretionary basis. Moreover, the Directives of the European Parliament and of the Council relieve the member states from the obligation to indicate the non-financial information in the reports of small companies.

The developed new Directive of the European Parliament and of the Councilon accounting provides for relieving economic micro-entities from the obligation to prepare the report. The planned limits for considering an entity a micro-entity are as follows:

- balance sheet total up to EUR 300,000;

– net turnover up to EUR 750,000;
– average number of employees during the financial yearup to 10.

In order to consider an economic entity a small one, it is necessary to satisfy two of the three listed criteria.

4. The report on entity's activities in the light of the Polish Accounting Act

In Poland joint stock companies, limited liability companies, limited joint stock partnerships, mutual insurance societies, mutual reinsurance companies, co-operatives and state-owned enterprises are obliged to prepare the report on entity's activities. Pursuant to Article 49, Point 1 of the Accounting Act, the entity's manager prepares the report on entity's activities together with annual financial statements for this entity [Ustawa… 2000].

This obligation refers to both the entities which are obliged to subject annual financial statements to the examination by a certified auditor and those which are not. The report on entity's activities should be made available to partners, shareholders or members (in the case of co-operatives) prior to its approval.

The scope of the information provided in the report on entity's activities is specified in general terms in the Accounting Act. Pursuant to Article 49, Point 1 of the Act, the relevant information on the asset and financial position of an entity, including the evaluation of the achieved results and the indication of risk factors as well as the description of the threats for entity's activities, has to be provided in this report.

The report on entity's activities should particularly include the following information groups:

1) events that significantly affect entity's activities which occurred in a financial year and upon its end, until the date of approving financial statements;

2) entity's likely future development;

3) the most important achievements in the field of research and development;

4) current and expected financial position of an entity.

The provisions of the Accounting Act do not specify in detail what information ought to be disclosed in the report on entity's activities. They only specify the issues the information on which may not be omitted in this report. Hence, in the report on entity's activities also other information than the mentioned groups may be included if it is relevant for the complete and clear image of the activities and position of an economic entity. Additionally, the following information needs to be disclosed in detail in the report on entity's activities:

a) branches (establishments) owned by an entity,

b) acquisitions of own shares,

c) risk to which an entity is exposed due to the financial instruments held and the purposes and methods assumed for financial risk management,

d) application of the principles of corporate governance in relation to specific entities.

Unless it is not relevant for evaluating the position of an entity, the report on entity's activities should also include the following:

a) financial and non-financial indicators, including:

– information on environmental issues,
– information on employment;

b) additional explanations regarding the amounts provided in financial statements.

The approach to reporting adopted in the Accounting Act responds to the information needs of stakeholders in different degrees. The remark relates especially to those investors who have specific information needs. On the basis of information presented in company reports, investors take decisions on purchasing, retaining or selling their investments. The main aim of disclosing information by companies is to protect the interests of investors.

Additional requirements concerning the provision of information in the report on entity's activities need to be fulfilled by specific quoted joint-stock companies, that is, the issuers of securities. Such companies are obliged to prepare the report on issuer's activities. The requirements related to this report are stipulated in the relevant Regulation of the Minister of Finance of the Republic of Poland.

The issuers of securities are obliged to disclose, together with the information provided for in the Accounting Act for the report on entity's activities, the following informationin the report on issuer's activities [Rozporządzenie… 2009]:

1) the discussion of the basic economic and financial data disclosed in anannual financial statement, in particular, the description of the factors and events which have a significant impact on issuer's activities and earned profit or incurred loss in a financial year as well as the description of issuer's development prospects at least in the following financial year;

2) the description of significant risk factors and threats with the determination of the degree of issuer's exposure thereto;

3) the declaration on employing corporate governance, which constitutes a separate part of the report on activities;

4) the indication of the proceedings pending before court, a competent body for arbitration proceedings or a public administration body.

Moreover, specific requirements with respect to disclosing information by the issuers of securities which conduct particular types of activities are stipulated.

The information that should be additionally disclosed by the issuers that conduct manufacturing, construction, commercial or service activities is particularly related to:

– basic products, goods or services;
– sales market and sources of supply;
– concluded agreements relevant for issuer's activities;

- issuer's organizational relationships or capital ties with other entities and major domestic and foreign investments;
- concluded and terminated loan and borrowing agreements as well as granted borrowings;
- differences between the financial performance indicated in an annual report and the previously published forecasts;
- manners of managing financial resources;
- factors and unusual events affecting the performance for a financial year;
- factors significant for enterprise's development and prospects of activity;
- changes in the fundamental principles of enterprise management;
- remunerations, bonuses and benefits of the persons managing and supervising the issuer.

Specific requirements related to disclosing information in the report on issuer's activities are stipulated for banks, insurance companies, investment funds, local government units.

5. Significance of the management's report as a source of information on enterprise's activities and achievements

The primary purpose of the management's report (the report on entity's activities) is to present the management's viewpoint on entity's activities and position in a financial year and the plans for the future to owners and other stakeholders. The objective of this report is also to provide complementary information to this presented in an annual financial statements, which facilitates the evaluation of the behaviour of its various items. Therefore, the information capacity of the management's report is extremely high in terms of the scope and nature of the information provided therein compared to annual financial statements.

The information presented in the report on entity's activities has a particular significance when evaluating the actions undertaken by entity's management with respect to managing the asset resources entrusted thereto. Moreover, the role of this report as a source of information on management's forecasts as to the future development of an economic entity increases. This information is employed by various users, e.g., investors, creditors and contracting parties, when making strategic decisions.

Preparing the report on entity's activities by its manager is also a manifestation of fulfilling the going concern principle. The obligation to assess entity's capability to continue activities rests with a manager. When assessing if the going concern assumption is reasonable, all the available information on the foreseeable future ought to be taken into consideration.

The report on entity's activities should not repeat the information indicated in an annual financial statements. It should present the interpretation and analysis of this information. The report on entity's activities is supposed to elaborate on the information disclosed in financial statements. Moreover, complementary and explanatory information needs to be provided therein. It is important that all the information that is relevant for the evaluation of an asset and financial position, achieved results and cash flowsis disclosed in these statements. This obviously refers to detailed and complementary information, with the exception of the information included in a balance sheet, profit and loss account, cash flow statement and a note to financial statements.

The report on entity's activities may not be restricted to presenting historical data, referring to the events and situations from the previous financial year. What is characteristic for this report is presenting also the information on future plans, prospective positions and development prospects of an entity. Moreover, the information on risk factors and potential threats to entity's activities should be disclosed therein.

The data provided in the report on tentity's activities should present the activities and position of an economic entity from different time perspectives. Thus, the data for the current and the previous financial year need to be presented. The basic economic indicators should be shown from a multi-year perspective, for 3–5 financial years. This is important for detecting long-term development tendencies of enterprise's activities. Hence, the report on entity's activities has both the retrospective and prospective dimension.

The provisions on accounting do not impose the form and structure of the report on entity's activities. Thus, when preparing this report, the content-over-form principle needs to be followed. The report on entity's activities is primarily descriptive. In this description,the compilations of numbers, which characterize the activities and position of an economic entity by means of measures and indicators, are employed. The presented numerical data may be illustrated with diagrams, which demonstrate the presented issues in the graphical manner.

Moreover, the conciseness of the report on entity's activities is important: it should not include too detailed data, which are insignificant for the assessment of the activities and position of an economic entity. This is because an excessive amount of detailed data obscures the picture of entity's activities, hinders making synthetic assessments and right economic decisions. At the same time, the costs incurred for preparing the management's report need to be balanced with the benefits coming from the use of the information presented therein by various users.

The regulations concerning company reporting do not have a normative character in relation to particular issues or positions in the report. They rather tend to be "good practices" in reporting. With such an approach, the Board has a degree of freedom in the scope and form of information disclosure. The report will then present the Board's perspective on company's activities.

6. Conclusion

Obligatory financial reporting is oriented on providing information to external users that make specific decisions concerning an entity on this basis. Economic decisions taken by entity's stakeholders refer to the future and regard the economic plans and expected results of activities. Therefore, as part of the annual report, not only the information enabling the preparation of forecasts, but also the information that is prospective in nature that presents the forecasts of specific events and results of the activities, needs to be disclosed. This postulate is complied with by the management's report (the report on entity's activities), which becomes increasingly a more significant element of the annual report. This is because the management's report comprises a broad scope of information related to the achievements of an economic entity in various areas of business activity. This is diverse information: historical and prognostic, financial and non-financial, short- and long-time horizons. It is important that disclosed information enables specific stakeholder to determine the degree of achieving the strategic objectives of an enterprise.

The comparative analysis of three approaches to reporting presented in the article demonstrates a convergence in the aim of reporting. Moreover, none of the regulations enforce any kind of reporting form or limitations in information character. The differences between approaches relate primarily to the scope and degree of the information disclosed. The list of information items that need to be disclosed in a report in accordance with the Accounting Act is much shorter than in the international standards and EU directives. However, it is not a closed list and companies can also disclose other information beside the items listed in the Act.

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Rozporządzenie Ministra Finansów z dn. 19 lutego 2009 r. w sprawie informacji bieżących i okresowych przekazywanych przez emitentów papierów wartościowych oraz warunków uznawania za równoważne informacji wymaganych przepisami prawa państwa niebędącego państwem członkowskim, *Dziennik Ustaw* nr 33, poz. 259.

Ustawa z dnia 9 stycznia 2000 r. o zmianie ustawy o rachunkowości, *Dziennik Ustaw* z 2000 r. nr 131, poz. 1186.

RAPORT ZARZĄDU W ŚWIETLE MIĘDZYNARODOWYCH I KRAJOWYCH REGULACJI SPRAWOZDAWCZOŚCI FINANSOWEJ

Streszczenie: Artykuł ukazuje znaczenie ważnego elementu rocznego raportu jednostki gospodarczej, jakim jest raport zarządu. Raport zarządu stanowi bowiem istotne uzupełnienie i uszczegółowienie rocznego sprawozdania finansowego. W artykule ukazano zakres komentarza zarządu w świetle tzw. praktycznego stanowiska Rady Międzynarodowych Standardów Rachunkowości. Przytoczono także wymogi dotyczące rocznego sprawozdania z działalności wynikające z Czwartej Dyrektywy Rady Unii Europejskiej. Na tym tle omówiono zawartość sprawozdania z działalności jednostki określoną w polskiej ustawie o rachunkowości. Ukazano także znaczenie raportu zarządu jako źródła informacji na temat działalności i dokonań przedsiębiorstwa w roku obrotowym oraz przewidywań i zamierzeń w przyszłości.

Słowa kluczowe: sprawozdawczość finansowa, komentarz zarządu, sprawozdanie z działalności jednostki.