

# CORPORATE RESPONSIBILITY AND INTERNAL REPORTING

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**Abstract:** Internal reporting in the companies (as opposed to external) is not standardized. It is entirely left to the knowledge and ingenuity of professional workers and managements of individual companies (business systems). Consequently, there are different efficiency and effectiveness of the internal reporting in different organizations. That indicates a need to formulate the principles of internal reporting, which requires a comprehensive treatment of information system for internal reporting purposes. In this paper the idea of a systemic and systematic approach to addressing areas of internal reporting is presented. It presents the starting point for the design of principles of internal reporting. Very important is the emphasis on corporate social responsibility, which needs to be addressed from operating, information and management point of view. The project is actual underway to create a Code of Principles of Internal Reporting.

**Keywords:** Social responsibility, information system, partial system, internal reporting, Code of Principles of Internal Reporting

## DRUŽBENA ODGOVORNOST IN NOTRANJE POROČANJE

**Povzetek:** Notranje poročanje za potrebe notranjih uporabnikov (za razliko od zunanjega) ni standardizirano, v celoti je prepuščeno znanju in iznajdljivosti strokovnih delavcev ter poslovodstev posameznih podjetij (poslovnih sistemov). Posledično je različna učinkovitost in uspešnost notranjega poročanja v različnih organizacijah. S tem je nakazana potreba po oblikovanju načel notranjega poročanja, kar pa zahteva celovito obravnavanje informacijskega sistema za notranje poročanje. V prispevku je podana zamisel systemskega in sistematičnega pristopa k obravnavanju področij notranjega poročanja, ki pomeni izhodišče za oblikovanje načel notranjega poročanja. Pri tem je pomemben poudarek na družbeni odgovornosti podjetij, ki jo je treba obravnavati z izvajalnega informacijskega in poslovnega vidika. V teku je projekt oblikovanja Kodeksa načel notranjega poročanja.

**Ključne besede:** Družbena odgovornost, informacijski sistem, delni sistem, notranje poročanje, Kodeks načel notranjega poročanja.

### 1. Introduction

Internal reporting (as opposed to external) is not standardized. It is entirely left to the knowledge and ingenuity of professional workers and managements of individual companies (business systems). Therefore, for example, accounting is often primarily focused on external reporting. This results in a different organization and efficiency of accountancy, and results also in different information systems of internal reporting (*ISIR*). This means the difference in the usefulness of *ISIR* for management, particularly in small and medium-sized enterprises. The information needs of these firms are often not sufficiently comprehensive identified; *ISIR* is not organized efficiently and does not offer the adequate level of information.

Therefore, management companies often understand accounting as a "necessary evil" rather than as an important part of internal reporting and also of the whole business process. This is (particularly in crisis situations) extremely important. The International Financial Reporting Standards (*IFRS*) are trying to solve the problem, but they are still aimed in particular at external reporting. However, they have a significant influence on the formation of the *ISIR*.

Such a situation has justified the need for a special Code of the principles of internal reporting, which should address this area from the relevant aspects.

## 2. Information system for internal reporting

*ISIR* presents an important part of the overall information system. The basic purposes of *ISIR* are information for decision making, measuring business performance and asset protection of the company. *ISIR* is a fundamental tool in the transition from the creditworthiness to the reliability of the business system (Knez-Riedl *et al.*, 1998), which is a prerequisite for its long-term existence and implementation of appropriate corporate social responsibility. *ISIR* consists of accounting for internal reporting, statistical information system for internal reporting (statistics) and operational information system for internal reporting purposes (other non-accounting data). *ISIR* comprises an important part of all four information functions of any information system: processing the data about the past (recording), processing the data about the future (forecasting), analyzing data, and controlling the information processes. Each of them is a special partial system that spans the entire business system (company). *ISIR* includes the information about the environment of the company and internal information as well.

Basic characteristics of internal reporting in relation to external reporting are as follows:

1. What is timely for external users, for internal users is too late.
2. What is sufficiently detailed for external users, lacks precision and detail for internal users.
3. What has sufficient explanation for external users, has not sufficient explanation for internal users.
4. What is often enough for external users, usually is not often enough for internal users.
5. For external users the information about the top level of organization is particularly important, for internal users lower levels are important as well.
6. Differences in the needs of internal users in large relative to small firms are significantly larger than the differences in the needs of external users, regardless larger or smaller companies.
7. Users of internal reporting can significantly affect the scope and content of reporting; for external users there are regulations and accounting standards.
8. External reporting is based mainly on standard accounting information, internal reporting depends on the needs of internal users, which set standards themselves and not only on accounting.
9. Due to the standardization, the external reporting has greater attention to formality comparing the content.
10. The internal reporting has more emphasis on non-financial information relative to external reporting.

From the foregoing it follows in particular:

- An important part of information for external users is also interesting to internal users; the information system for external users thus partially overlaps with the information system for internal reporting purposes;
- Part of information for internal users of the company may also be given to other users, if the company wants to increase its reputation and trust in the environment or in certain interest groups;
- With further development of social responsibility of companies we can expect even greater overlap of both systems;
- Nevertheless, the differences between internal and external reporting content and purpose are so great that they have a significant impact not only on the content and manner of the information provided, but also on the organization of an information system within the company.

Figure 1: Systemic approach to the treatment of *ISIR*

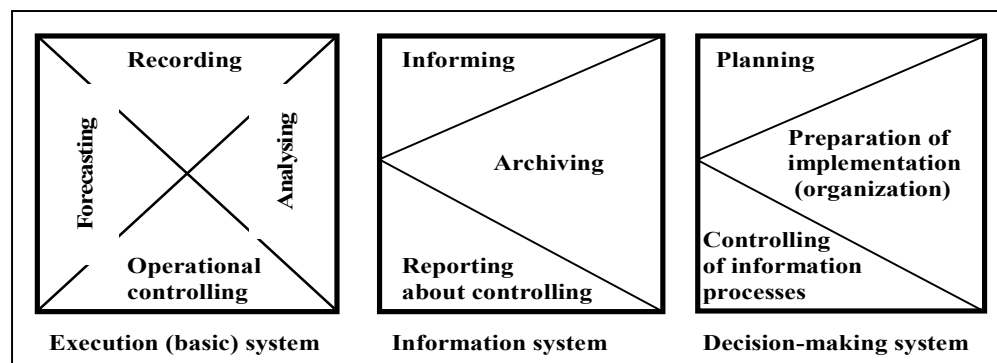


Figure 1 shows systemic approach to the treatment of *ISIR* through three partial systems:

- *execution* partial system comprising execution of four information functions:
  - recording,
  - forecasting,
  - analyzing,
  - controlling,
- *information* partial system comprising:
  - informing,
  - archiving of data and information,
  - reporting of controlling,
- *decision-making* (managing) partial system, which comprises three basic managerial functions:
  - planning for the *ISIR* ,
  - preparation and implementation of the *ISIR*,
  - controlling information processes.

*ISIR* can therefore be studied from the executive, information and management point of view.

*Recording* covers several processes, such as data collection, compilation, entering the appropriate records, and bookkeeping. *Forecasting* processes are such as the collection and compilation of data, predicting business flows, possibilities of doing business and other circumstances. *Analyzing* comprises the steps of the process, such as the collection and processing of data, identifying the differences and causes of deviations, making analytical reports and proposals. *Controlling* process comprises the steps, such as monitoring of the execution of information processes and producing of relevant reports and proposals. In order to carry out the tasks of *ISIR* effectively it is necessary to define the responsibilities of individuals, who are in charge for particular information processes.

*Informing* is the last stage in the process of information transmission. Its tasks are presenting, explaining and clarifying information. It is communication between designers and users of information, because it is feedback on the proper understanding from the users that is essential. In the frame of informing, there should be continuous tasks:

- studying users' needs and to make suggestions for the design of new or different (better) information;
- training users to better understand the information conveyed and inspiring the awareness of the need for new information.

In the context of the above two indents it is important to consider the aspect of corporate social responsibility.

*Archiving* has the task of functional and secure storage of data, information and documentation. In addition, it has to enable more:

- tracking of dedicated information,
- determining the quality of information,
- efficiency in the use of data and information.

The task of *reporting about controlling* is informing about the findings and the effectiveness of internal controls, inspections and audits that have been carried out in the framework of an information system. This reduces the level of risk in the business.

*Planning* for the *ISIR* comprises deciding on its operations in the future. It is the job of leader or coordinator of internal reporting system in the company. Planning is based on the forecasted information needs of specific types of information users in the company, while taking into account the capacity of an information system also. Particularly important is planning financial statements which require timely preparation of data. This is also important in the case of outsourcing of accounting services. Within the plan of operation *ISIR* it is useful to define in particular:

1. The development and operation of *ISIR*:
  - the scope of services of recording (e.g., number of entries and the financial statements);
  - the extent and nature of estimates and forecasting;
  - the extent and type of analysis (e.g. the number and scope of financial reporting and analysis);
  - the volume and type of control (e.g. the number and kinds of supervisory information).
2. *ISIR* organization, including in particular:
  - the plan of information and communication technology and other equipment, facilities and archives;
  - needed number of employees by education and structure;
  - the plan of changes in the organizational regulations and instructions;
  - the plan of the organization of controls.

3. *ISIR* impact on the planned financial statements, including:
  - estimate of investments;
  - estimate of work and education costs, and other operating costs *ISIR*.

*ISIR* plan should cover all processes, without regarding different organizational units.

*Preparation of implementation* provides an effective matching the information needs through an appropriate organization of individual information processes. In this context, it is necessary to ensure the operation of all capacities of *ISIR*, including personnel. Here is the important role of leadership by personal example of management and its focus on the company's social responsibility.

*Controlling* of information processes is primarily the task of the head of *ISIR*-coordinator. Probably often this is the head of accounting. Controlling process must be exercised at all points of information process in the company. From this perspective, the role of the head of accounting is important especially regarding:

- planning accounting processes (the draft endorses the management of the company);
- responsibility on organizing accounting processes;
- responsibility on accounting control system;
- coordinating accounting processes that take place outside the accounting department, which must be arranged with the relevant organizational documents.

In terms of partial systems, the head of accounting in the above areas has two types of tasks:

- managerial responsibilities as the head of the accounting department, which is as an organizational unit;
- professional and operational coordination tasks, as an expert authority in the field of accounting.

### 3. Development aspect of *ISIR*

The development of *ISIR* is based on the following starting points:

- the globalization, the integration of business entities and the increasing competition result in management's need for ever more detailed, new and reliable information for decision-making, measuring business performance and risk management;
- arising awareness of corporate social responsibility and changing centers of power in society in general (lobbies, trade unions, international corporations, bank capital) require additional and new information as an integral part of professional base for decision-making;
- information and communication technology (*ICT*) is developing rapidly, thereby enabling further development of information systems in both the improvement of existing (current development) as well as in creating new information (strategic development);
- the efficiency of the information system in terms of information costs in relation to their usefulness is becoming increasingly important.

The development of *ISIR* changes its structure as well, especially regarding the types and characteristics of input data, namely:

- new types of data are emerging, which *ICT* is able to process as well;
- accounting information system deals with more and more non-accounting data, particularly in small and medium-sized enterprises. This results in changing the head of accounting to the head of *ISIR*. In larger companies they apply different solutions in respect of responsibility for *ISIR*, depending on the specific capacities and information needs;
- the number of non-traditional accounting models is increasing (e.g. economic value added, activity based costing, balanced scorecard);
- new "species" *ISIR* are emerging (particularly in the accounting area), which are the expression of a variety of special emphasis on *ISIR*, according to the specifics of the newly required information (e.g., different types of ecological accountings, strategic accounting, responsibility accounting, research accounting, open-book accounting, value chain accounting), especially to mention socially responsible accounting.

### 4. Areas of internal reporting

For a comprehensive treatment of *ISIR* as an addition to the systemic approach, there is necessary to systematically identify areas of internal reporting. This we can do with the help of three dimensions, which are shown in Figure 2:

- areas of basic business tasks (purchasing, production, sales, finance, human resources, investment technical scope and outcomes at the societal level);

- levels of reporting or the type of users (governance, management, employees),
- the types of information depending on the orientation period (budget or forecast and statement of account for the past).

Figure 2: Three dimensions of internal reporting

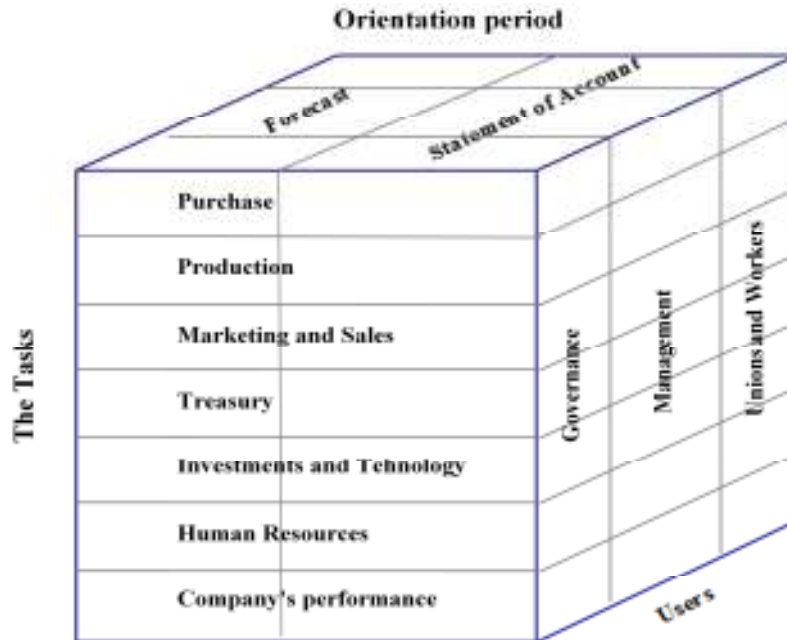


Figure 2 shows the 42 areas (7 x 3 x 2) of internal reporting. Each of them is defined by three dimensions. In this way a comprehensive approach is ensured covering the relevant areas of internal reporting. These 42 "drawers" provide a systematic critical approach to assessment of the status and quality of internal reporting of a particular company. As such it is a starting point for improving internal financial reporting from information point of view.

We can analyze further (and it is needed) each of the drawers, especially in view of detailed tasks defined in a particular field. Figure 2 is merely a synthetic and a comprehensive assessment of the business system as a whole. For example, the drawer Company's performance can be broken down into:

- efficiency,
- performance,
- solvency,
- organizational culture,
- sustainable development,
- social responsibility.

Each of the drawers needs to be addressed systemically, that is from the perspective of the three partial systems, which were presented in Figure 1. For example, the area of corporate social responsibility should be considered through executive, information and management points of view.

## 5. The concept of The Code of Principles of Internal Reporting

Figures 1 and 2 are the basis for the development of a comprehensive model of *ISIR*. With the creation of the Code of principles of internal reporting (*CPIR*) we could partially compensate for the lack of standards in this area. Slovenian Association of Economists, Association of Accountants, Treasurers and Auditors of Slovenia and the Institute of management accounting in the College of Accounting Ljubljana have established the project of making the Code principles of internal reporting (*CPIR*). *CPIR* should have particular purposes as follows:

- contribution to the establishment of professional standards for the organization of *ISIR* in organizations;
- help and support to professionals in organizations at their work;
- contribution to facilitate the understanding of the role and mission of internal reporting (especially accounting) in relation to the particular business functions and organizational units;

- help and support to top management and other managers and executives on the (re)organization of *ISIR* and the achievement of its mission in the company;
- contribution to facilitate the understanding of the role and mission of accounting professionals and workers in the organization;
- contribution to the development of criteria for internal audit in connection with the internal reporting;
- support for proper transmission of theoretical achievements into practice;
- one of starting points for training young accountants;
- professional guidelines for the preparation of general norms and organizational instructions from internal reporting point of view;
- contribution to the improvement and unification of terminology in the context of management accounting and internal reporting;
- contribution to improving the quality of external reporting;
- support to the further development of internal reporting.

Contents of *CPIR* will consist of the following sections:

- 1 General part:
  - Introduction;
  - The definitions of basic terms.
- 2 The central part:
  - General principles of internal reporting;
  - Principles of internal reporting in specific areas and types of users.
- 3 Special part:
  - Principles of internal reporting for different industries.

With the aim of creating a professional basis for making *CPIR* in the last three years three conferences were held; the general sponsor was the Slovenian Chamber of Commerce.

Themes of the first conference in 2011 were defined according to the Figure 1, so that the content covered all the areas in the figure. Based on the papers from the conference a draft of 11 chapters of the general principles of internal reporting, has already been made. It is currently in the public debate (Draft *CPIR*, 2013). These chapters constitute the general principles of internal reporting in the central part of *CPIR*.

Themes of the second conference in 2012 have been identified in Figure 2, so that the content covered all areas of internal reporting, which are shown in the figure. They are intended to be the basis for another section of the central part of *CPIR*. The draft of these chapters is in preparation.

Themes of the third conference in 2013 were aimed at addressing the specificities of internal reporting in certain industries and present the basis for the creation of a special part of *CPIR*.

## 6. Conclusions

Internal reporting within companies is an extremely broad area of expertise; however, it requires a comprehensive approach. Therefore, it needs a systemic and systematic approach, which also promotes the continuous development of internal reporting. In this trends the social responsibility is an extremely important element of internal reporting, which significantly contributes to the sustainable development of enterprises and improving the standard of living of the people. Accordingly, it is important to design and develop the principles of internal reporting to assist in establishing an appropriate *ISIR* in companies and other organizations.

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