



The pillars of internal control and risk management systems in relation to financial reporting: the perspective of the Polish and German capital markets

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Abstract

This article aims to identify, based on the reporting practices of companies listed on the Polish and German capital market, the pillars of internal control and risk management systems in relation to financial reporting.

The survey examined disclosures concerning the control systems over financial reporting included in consolidated annual reports drawn up in 2013 by WIG 30 and DAX companies. Eleven main categories of information were identified. They were presented within disclosures about control systems over financial reporting. The research results indicate that the examined companies presented largely similar information on the control systems over financial reporting. It seems, however, that in the case of the DAX companies, the practice of reporting in the area of disclosures about control over financial reporting has been developed to a greater extent, i.e., the repeatability of certain items is greater. The disclosures presented by the DAX companies are more transparent compared to the disclosures presented by the WIG 30 companies. The results of research on the transparency of disclosures of companies listed on the Polish and German capital markets are consistent with the dimensions of the national cultures presented in the literature.

Keywords: financial reporting, control over financial reporting, DAX, WIG 30.

Streszczenie

Filary systemów kontroli wewnętrznej i zarządzania ryzykiem w odniesieniu do sprawozdawczości finansowej – perspektywa polskiego i niemieckiego rynku kapitałowego

Celem artykułu jest identyfikacja, na podstawie praktyki sprawozdawczej spółek notowanych na polskim i niemieckim rynku kapitałowym, filarów systemów kontroli wewnętrznej oraz zarządzania ryzykiem w odniesieniu do procesu sprawozdawczości finansowej.

Badaniu zostały poddane ujawnienia dotyczące systemów kontroli nad sprawozdawczością finansową, zawarte w skonsolidowanych raportach rocznych sporządzonych w 2013 roku przez spółki należące do indeksów WIG 30 oraz DAX. Zidentyfikowano 11 głównych grup informacyjnych prezentowanych w ramach ujawnień na temat systemów kontroli nad sprawozdawczością finansową. Wyniki badania wskazują, że analizowane spółki prezentowały w dużej mierze podobne informacje na temat systemów kontroli nad sprawozdawczością finansową. Wydaje się jednak, że w przypadku spółek należących do indeksu DAX w większym stopniu wypracowana jest określona praktyka sprawozdawcza w obszarze ujawnień na temat kontroli nad sprawozdawczością finansową, tzn. jest większa powtarzalność określonych pozycji. Ujawnienia prezentowane przez spółki z indeksu DAX są w większym stopniu transparentne w porównaniu do ujawnień prezentowanych przez spółki z indeksu WIG 30. Uzyskane wyniki badań dotyczące transparentności ujawnień spółek polskich i niemieckich są zbieżne z wymiarami kultur narodowych prezentowanymi w literaturze.

Słowa kluczowe: sprawozdawczość finansowa, kontrola nad sprawozdawczością finansową, DAX, WIG 30.

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Introduction

Financial statements are a company's key tool to communicate with its environment. The information contained in their financial statements makes it possible to determine whether the board fulfils accountability requirements and effectively manages the entity. The accounting system is the information base to determine the share of stakeholders in the allocation of economic surplus (Jarugowa, Marcinkowski, 1989, p. 20; Gad, 2014, pp. 93–96). As noted by Farrar and Hannigan (1998, p. 11), the disclosures which the financial statements are at the heart of are the *sine qua non* of corporate accountability.

It seems indisputable that the credibility of the information presented by public companies in their financial statements is a key condition for the security of the capital market (Hoogervorst, 2014). Failure to observe the principle of a true and fair view when drawing up financial statements led to the financial scandals from the beginning of the 21st century which were widely commented on in the literature (Horn, 2012; Wang, 2012; Bauwhede, Willekens, 2008; Hoitash et al., 2009). The bankruptcies of Enron or WorldCom revealed the weakness of the system protecting the interests of capital providers. Due to the asymmetry of information accompanying capital markets, those providing capital and other stakeholders have limited access to information, incomparable with the access of managers or supervisory board members (boards of directors). The task of the corporate governance mechanisms is to alleviate problems arising from this asymmetry. The financial scandals of the early twenty-first century revealed that the corporate governance mechanisms do not always work properly. These scandals have also become an incentive to take global legislative actions to improve financial reporting and strengthen corporate governance. The regulations on financial reporting were also affected by the financial crisis which began at the end of the first decade of the twenty-first century. The countries of the Group of Twenty (G20) during summits on the financial crisis pointed out the necessary changes in the area of financial reporting, including in particular additional disclosures relating to financial instruments or detailed guidelines on the use of fair value (Shaw, Vassallo, 2012)¹.

In 2006, during the 17th World Congress of Accountants, it was clearly stated that an essential factor in building confidence in corporate reporting is to improve the quality of corporate governance (Schiller, 2006; after Hulicka, 2008). Following the financial scandals of the early twenty-first century, legislative measures were undertaken to strengthen corporate governance. Public companies were obliged to provide information on the characteristics of internal control and risk management systems in relation to the financial reporting (referred to in this paper as the systems of control over financial reporting). These disclosures are the subject of the analysis presented in this paper. Disclosures concerning systems of control over financial reporting are an important tool for

¹ During the summits in Pittsburgh (2009), Toronto (2010), Seoul (2010), and Cannes (2011), the G20 leaders confirmed their support for the development of a single set of global accounting standards (IFRS Foundation and the IASB, 2011).

the implementation of the accountability function. The scope of these disclosures is a kind of barometer of the company's transparency. Under these disclosures the management board indicates what the structure is and how the systems work, with the aim of ensuring the reliability of financial information. Detailed disclosures on control over financial reporting are a message to stakeholders that the company has undertaken systemic efforts to ensure the reliability of financial statements.

The research results presented in the article complement the knowledge about the factors determining the reliability of financial reporting. The results seem to be thus a complement to research on the quality and scope of information presented in modern financial statements. The results also appear to be an important complement to research on the form and scope of non-financial reporting accompanying financial reporting. Taking into account the results of the literature review, it can be said that the scope of disclosures on control systems over financial reporting is a research gap.

This article aims to identify, based on the reporting practices of companies listed on the Polish and German capital markets, the pillars of the internal control and risk management systems in relation to the financial reporting.

To achieve the above main aim, the following specific objectives were formulated:

- 1) determine the scope of disclosures presented by the surveyed companies,
- 2) determine the elements of the systems of control over financial reporting most often presented by the surveyed companies,
- 3) determine the length and level of transparency of disclosures presented by the surveyed companies.

In this paper the pillars of control systems over financial reporting are understood as key elements of these systems, indicated by the majority of the surveyed companies.

The scope of the research did not include the operation of control systems over financial reporting in the practice of individual companies. The conclusions were formulated on the basis of disclosures about the control systems presented by the surveyed companies.

The survey examined disclosures concerning the control systems over financial reporting included in the consolidated annual reports drawn up in 2013 by the WIG 30² companies and the DAX³ companies.

The conclusions presented in the article were formulated based on literature studies, analysis of the Polish and German regulations, as well as analysis of disclosures in annual reports (textual analysis). The inductive method was used in the research process.

The article was designed according to the principle from general to specific. The first part of the article presents the regulations regarding disclosures about control over financial reporting. The second part concerns the use of corporate governance mechanisms

² The Polish Warsaw Stock Exchange Index, which comprises the 30 largest public companies.

³ DAX (*Deutscher Aktienindex*) is the most important German stock index. It consists of the 30 largest public companies.

within the framework of the control system over financial reporting. The next part provides an overview of empirical research on the issue of disclosures about corporate governance. The last part of the article presents the results of the author's own research on disclosures about control over financial reporting presented by the DAX and WIG 30 companies.

1. Disclosures about control systems over financial reporting in the annual report in light of Polish and German regulations

Public companies in Poland and Germany prepare their financial statements according to the same regulations, i.e., the International Financial Reporting Standards (IFRS). The IFRS do not provide guidelines as to the form and the information content of other, non-financial components of the annual report. There is, however, an international standard developed by the International Accounting Standards Board (IASB) *IFRS Practice Statement. Management Commentary. A Framework for Presentation*, related to the report of the management board, but it is not part of the IFRS. It is not absolutely mandatory either. It is of a good practices nature, which companies may use, but are not strictly required to. It appears that *IFRS Practice Statement. Management Commentary. A Framework for Presentation* is primarily a benchmark used by national legislators in designing guidelines for non-financial information which companies must present⁴. It should be emphasized that while presenting non-financial information, public companies both in Poland and Germany apply national regulations⁵.

In Poland, the contents of the report of the management board (Management Board's Report on the Activities) prepared by public companies is regulated by the Polish Accounting Act, the National Accounting Standard (KSR) no. 9 and the decree of the Minister of Finance dated 19 February 2009 on current and periodic information. In Germany, the guidelines on the scope of the management board's report stem from: the German Commercial Code and German Accounting Standards (GAS) no. 20 – *Group Management Report*.

Both Polish and German regulations take into account the guidelines for non-financial reporting (including the guidelines on disclosures on control over financial reporting) resulting from Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006⁶.

⁴ The National Accounting Standard no. 9 *Report on the Activities*, adopted in Poland in 2014, applied the guidelines from Management Commentary.

⁵ As indicated by the results of research, German legislation on non-financial information is more precise than the Polish (Eisenschmidt, Krasodomska, 2015, p. 98).

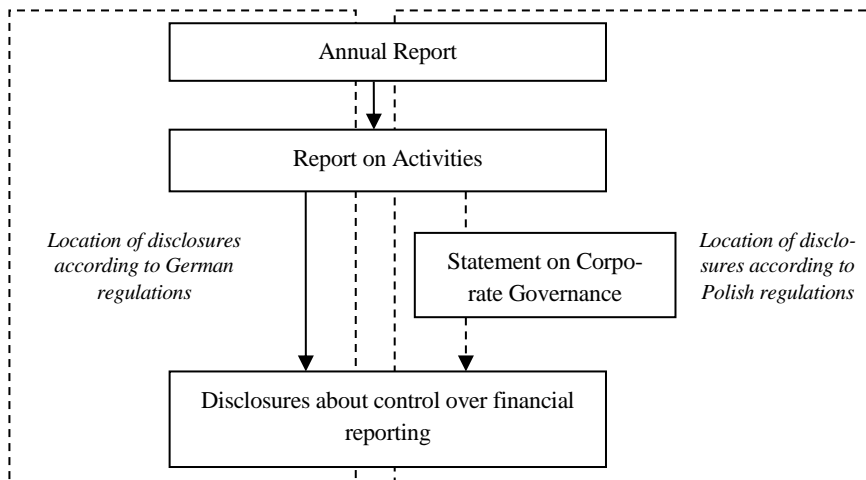
⁶ In accordance with paragraph 10 of Directive 2006/46/EC, the companies whose securities are allowed to trade on a regulated market and which are established in the community, are obliged to disclose an annual statement on corporate governance, being a specific and clearly identifiable section of the report on activities. This statement should provide shareholders with information about the actual practices in corporate governance applied by the company, including a description of the main features of all existing risk management systems and internal controls in relation to the financial reporting process.

In accordance with the provisions of the Polish regulation of the Minister of Finance dated 19 February 2009 on current and periodic information in reports on the activities of all issuers of securities, reports should include – which should constitute a separate part of the report – a statement on corporate governance, which includes, *inter alia*, information on the description of the main features of the issuer’s internal control and risk management systems in relation to the process of preparing financial statements and consolidated financial statements.

In a similar manner this issue was formulated in Germany. According to paragraph 315 section 2 no. 5 of the German Commercial Code (*Handelsgesetzbuch*), the board’s consolidated report (report on activities) should also include information on the basic characteristics of internal control and risk management systems in relation to the accounting process.

Both Polish and German regulations indicate that disclosures about the systems of control over financial reporting should be part of the management board’s report. In the case of public companies listed in Poland, these disclosures should be, in addition, part of a statement on the application of the principles of corporate governance, being a component of the management board’s report (Figure 1).

Figure 1. Disclosures about control over financial reporting in the annual report



Source: author’s own compilation.

It should be emphasized that neither the Polish nor German regulations provide guidance as to the scope of the disclosures about the control systems over financial reporting. There is no doubt, however, that the purpose of these disclosures is to indicate that the company has a system which is to ensure the reliability of financial reporting.

2. The integration of corporate governance mechanisms within the framework of control systems over financial reporting

The concept of control systems over financial reporting emerged as a result of the financial scandals that took place at the beginning of the 21st century in the United States. One of the key provisions of the Sarbanes-Oxley Act (SOX), which was a direct response to the financial scandals, meant that companies were obliged to publish information on the control over their accounting system (Clarke, 2004, p. 159)⁷.

Currently, control systems over financial reporting are a solution used in both Anglo-Saxon and German systems of corporate governance. It seems that the obligation of public companies to create formalized systems of control over financial reporting is an expression of the process described in the literature of diffusion of solutions between different systems of corporate governance (Jeżak, 2014, pp. 377–378). In Europe, until the 1990s the patterns of legal acts were drawn mainly from the German law. In the last two decades, due to the development of international capital markets and the globalization process, Anglo-Saxon patterns gained in importance (Opalski, 2010, pp. 43–44). The Anglo-Saxon system of corporate governance differs from the German system *inter alia* in concentration of ownership (dispersed – concentrated ownership) and shareholding structure (institutional – individual shareholders). In Anglo-Saxon countries, there is a one-tier model of corporate governance (the board of directors), while in the German there is a two-tier model (a management board and a supervisory board) (Jeżak, 2005, p. 25; Urbanek, 2005, pp. 47–48; Aluchna, 2007, p. 176; Jeżak, 2014, pp. 374–375). Moreover, in the German system of supervision, unlike in the Anglo-Saxon system, the internal supervision implemented by supervisory boards and capital providers is of fundamental importance (Piot, 2005, p. 22). The scope of information disclosed by companies is another criterion for classification into the Anglo-Saxon and the continental model. The continental model tends to reduce the scope of disclosures, and the Anglo-Saxon model tends to increase the scope of disclosures (Surdykowska, 1999, pp. 68–69; Krasodomska, 2010, pp. 121–122).

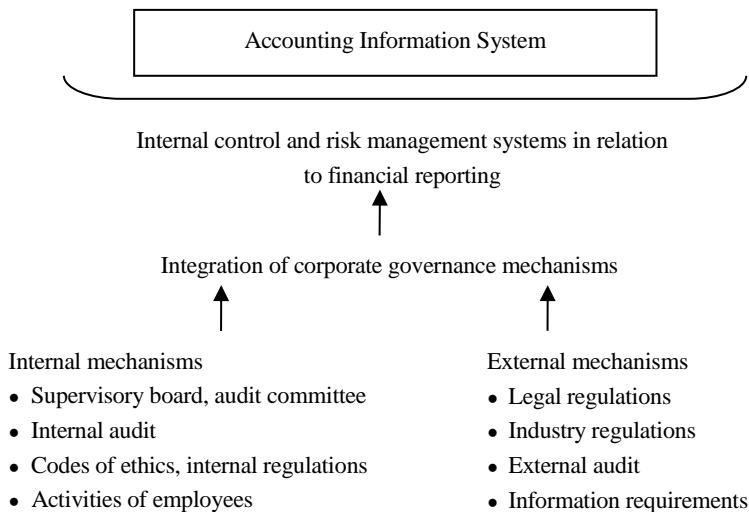
The system of corporate governance in Poland is similar to the German one, which is manifested, *inter alia* by a large concentration of ownership. Both the German and the Polish models have supervisory boards (a two-tier model of corporate governance). At the same time, as noted in the literature, the position of the supervisory board in Germany is stronger than that in Poland (Jeżak, 2014, p. 377). Both in Germany and in Poland, there are similar mechanisms of corporate governance, which Marcinkowska (2014, p. 50) classified into external and internal, depending on the location of the stimuli affecting the company.

⁷ It is mentioned in the literature that companies required to comply with the provisions of the SOX Act provided investors with much more timely information on the quality of the internal control system in comparison with the period prior to this law's enforcement (Hammersley et al., 2008, p. 164).

Control systems over financial reporting integrate selected internal and external mechanisms of corporate governance around the accounting information system (Figure 2). It should be noted that new mechanisms are not created within the framework of the control systems over financial reporting, instead, those which already exist are integrated into the area of the accounting system. Importantly, Enron and WorldCom applied mechanisms which are used by today's enterprises. However, they were uncoordinated, with the result that all simultaneously failed. It seems that the control systems over financial reporting make it possible to obtain a synergy effect leading to the strengthening of the credibility of financial statements.

The internal mechanisms of corporate governance which are of particular importance in terms of control systems over financial reporting include: the supervisory board, the audit committee (which includes members of the supervisory board), and the internal audit. In turn, the external mechanisms of corporate governance, significant in terms of control systems over financial reporting, include: regulations on financial reporting, regulations on reporting in the area of corporate governance, and the external audit.

Figure 2. Integration of corporate governance mechanisms within the control systems over financial reporting



Source: author's own compilation.

As stated by Tweedie (2004, p. 4), a robust infrastructure of financial reporting must be built on four pillars: (1) consistent, comprehensive accounting regulations based on clear principles, (2) effective cooperation between the management board and the supervisory board, and internal controls *inter alia* in the area of the implementation of accounting regulation, (3) an external audit, which assures stakeholders that the entity

reliably presented its achievements and financial situation in the financial statements, (4) law enforcement mechanisms which ensure that the rules resulting from accounting regulations and external audits are observed.

As part of the control systems over financial reporting, individual internal and external mechanisms of corporate governance „overlap”. The supervisory board monitors the selection process of the auditor and the individual stages of auditing. Importantly, the supervisory board uses the results of the auditor’s work, for whom, in turn, the internal audit can be a valuable source of information.

3. Disclosures on corporate governance as a subject of research – literature studies

Disclosures on control over financial reporting, as part of the disclosures in the area of corporate governance, are a tool to monitor management actions. They help to alleviate the problem of agency (Jensen, Meckling, 1976). It is worth noting that the disclosures about control systems over financial reporting alleviate the agency problem when investors perceive this information as relevant and reliable (Deumes, Knechel, 2008, p. 41).

Research on disclosures on internal control and risk management systems took on a new meaning after the entry into force of the Sarbanes-Oxley Act. Due to the implementation of the provisions of this Act, more attention began to be paid to internal control and risk management systems in relation to financial reporting. Earlier analyses concerned much wider approach. In particular disclosures on internal control and risk management relevant to stakeholders were examined (Solomon, Cooper, 1990; Hermanson, 2000). Many studies undertook, among others, the problem of the impact of the new regulations resulting from the Sarbanes-Oxley Act on financial and non-financial disclosures in the United States (Coates, 2007; Hoitash et al., 2009; Wang, 2012).

The European legislative response to the Sarbanes-Oxley Act involved a *Modern Regulatory Framework for Company Law in Europe*, a report presented on 4 November 2002, prepared under the direction of Jaap Winter. Suggestions formulated in Winter’s report were reflected in the Action Plan on *Modernising Company Law and Enhancing Corporate Governance in the European Union*, developed in May 2003. Provisions of the Action Plan were taken into account, among others, in Directive 2006/46/EC of the European Parliament and of the Council of 14 June 2006 and thus became part of EU law.

The introduction of new regulations in Europe on disclosures concerning corporate governance intensified studies in this area. These studies sought to establish, *inter alia*, whether there is a relationship between debt and disclosures in the area of corporate governance, or whether the companies in non-common-law countries, compared to companies in a common-law countries disclose more information on corporate governance (Bauwhede, Willekens, 2008). Attempts were also made to determine whether the scope of disclosures about corporate governance depends on the size of the supervisory board or the number of its meetings (Russo et al., 2015).

From the perspective of this article, particularly important is the measurement of the scope of disclosures in the area of corporate governance, and in particular the measurement of the scope of disclosures about control systems over financial reporting. The studies mentioned above related primarily to general disclosures in the area of corporate governance.

The studies carried out by Bauwhede and Willekens (2008, p. 106) to measure the scope of disclosures in the area of corporate governance used the Deminor Rating of disclosure on corporate governance, which consists of the following items:

1. Disclosure on corporate governance
 - a) disclosure on general information:
 - availability and language of documents,
 - accounting standards,
 - compliance with a Code of Best Practice,
 - auditors' mandates,
 - political and charitable information,
 - environmental information,
 - b) information on the Company's capital and shareholder structure,
 - c) information on the Company Board,
 - composition and functioning of the Board,
 - remuneration of the Board,
 - d) information on the Company's committees,
 - e) information on stock options,
 - f) disclosure on Corporate Governance: summary.

The studies on the scope of disclosures in the area of corporate governance conducted by Deumes and Knechel (2008, p. 48) and Russo et al. (2015, p. 382) used the Internal Control Disclosure Index, which consists of the following items:

1. Elements reported by the supervisory board:
 - Item 1. The supervisory board discussed (elements of) the internal control systems in at least one meeting;
2. Elements reported by the management board:
 - Item 2. The purpose of the internal control system;
 - Item 3. Management's responsibilities of internal control;
 - Item 4. A statement about the effectiveness of internal control;
 - Item 5. The role of the internal auditor;
 - Item 6. Activities to manage risk.

It should be noted that the above mentioned disclosure indexes take into account various issues related to corporate governance. These indexes do not directly refer to disclosures about control systems over financial reporting.

From the point of view of empirical research on disclosures about control systems over financial reporting it seems particularly important to create a corresponding index.

Disclosure about the control systems over financial reporting are of a specific nature. These are non-financial disclosures although they concern the functioning of the information system of accounting, in particular, financial accounting. Thus, it seems that, given their nature, they can be somewhere between the notes to the financial statements and the management board's report.

4. Disclosure on the control systems over financial reporting in WIG 30 and DAX companies: a comparative analysis

The aim of the empirical study was to identify the major components (pillars) of the control systems over financial reporting. The research group comprised WIG 30 and the DAX companies⁸. The two indexes include the 30 largest public companies listed in Poland (Warsaw Stock Exchange) and Germany (Frankfurt Stock Exchange). The DAX companies were chosen for the study due to the fact that the German economy is the largest among EU economies. In turn, the WIG 30 index was chosen due to the fact that Poland's economy is the strongest among the economies of the new EU members. Germany and Poland can be a kind of benchmark for other EU countries. Both in Poland and in Germany there is a two-tier model of corporate governance. It is assumed that companies in the WIG 30 and DAX indexes are a kind of „litmus test” of the two stock exchanges in the area of reporting practice, among others. It was therefore concluded that the reporting of companies in both these indexes is the correct plane for comparative studies.

The study used the following research methods: literature studies, analysis of the Polish and German regulations, textual analyzes. The conclusions were formulated using the inductive method. One company from the WIG 30 index was excluded from the survey as it did not present information on the systems of control over financial reporting.

The survey examined disclosures in the consolidated management board reports prepared in 2013 by the WIG 30 and DAX companies. All examined companies declared

⁸ The list of companies included in both indices was determined on 31.12.2013. Companies from the DAX index: ADIDAS AG, ALLIANZ SE, BASF SE, BAYER AG, BEIERSDORF STK, BMW STK, COMMERZBANK, CONTINENTAL STK, DAIMLER AG, DEUTSCHE BANK STK N, DEUTSCHE BOERSE STK N AG, DEUTSCHE POST STK N, DEUTSCHE TELEKOM, E.ON SE, FRESENIUS MEDI STK, FRESENIUS SE, HEILDELBERG CEMENT AG, HENKEL AG & CO. KGAAH – VORZUGSAKTIE, INFINEON TECG STK N, K+S STK, LANXESS, LINDE STK, LUFTHANSA STK, MERCK KGAA STK, MUNCHNER RUCKVERSICHERUNG, RWE STK, SAP STK, SIMENS STK, THYSSENKRUPP STK, VOLKSWAGEN PR.

Companies from the WIG 30 index: ALIOR, ASSECO, BORYSZEW, BZ WBK, CCC, CITY HANDLOWY, CYFROWY POLSAT, ENEA, EUROCASH, GRUPA AZOTY, GTC, ING BANK ŚLĄSKI, JSW, KERNEL, KGHM, LOTOS, LPP, LUBELSKI WĘGIEL BOGDANKA, mBANK, NETIA, ORANGE, ORLEN, PGE, PGNIG, PKO BP, PKO SA, PZU, SYNTHOS, TAURON, TVN.

in their disclosures the fact that they had formalized control systems over financial reporting.

Almost all (96.7%) DAX companies provided disclosures about the systems of control over financial reporting as part of the report of the management board. One company in this index presented disclosures about the control system over financial reporting within the explanatory report of the executive board. Almost 90% of the WIG 30 companies submitted disclosures on the control system over financial reporting in a statement on the application of the principles of corporate governance, which was part of the report the management board. Two companies in the WIG 30 presented disclosures about control systems in a statement on the application of corporate governance which was not part of the report of the management board. One of the companies from the WIG 30 presented disclosures about the control systems in the report of the management board outside a statement on the application of the principles of corporate governance.

The research process for the analysis of narrative disclosures involved „the semi-objective approach” proposed by Beattie et al. (2004, p. 208). Under this approach, the analysis of disclosures is made using disclosure index studies (a partial form of content analysis where the items to be studied are specified *ex ante*). A simple binary coding scheme is used. As noted by Beattie et al. (2004, p. 210), since it is difficult to assess the quality of disclosures directly, it is assumed that the number of disclosures on specified issues translates into the quality of disclosures.

The current study determined (using a zero-one system) whether the company presents specific information. A detailed list of disclosures was also updated on a regular basis.

Inference based on the conducted survey entails specific restrictions. The lack of information about the selected area of the control systems over financial reporting does not always mean that it does not work in the company. A company may merely not disclose information on this subject. The fact that disclosures were presented at different levels of detail caused some problems. Certain companies described in detail certain issues, while other companies only signal particular issues.

The research process identified the items of detailed disclosures concerning control over financial reporting presented by the surveyed companies. In the next stage the detailed items of disclosures were grouped and 11 major areas of information presented by the examined companies within disclosures about the systems of control over financial reporting were identified. The main groups of information include:

- 1) the main principles of the control systems over financial reporting,
- 2) IT tools,
- 3) regulations,
- 4) external audit,
- 5) internal audit,
- 6) organization of the accounting system,
- 7) data security and protection,

- 8) the process of preparing financial statements,
- 9) the supervisory board (audit committee),
- 10) managerial accounting,
- 11) risk.

The identified main information groups can constitute a basis to create the disclosure index⁹.

Within individual main information groups, the article presents detailed disclosures presented by at least 10% of the WIG30 or DAX companies. While determining the level of transparency of disclosures about control over financial reporting, all detailed disclosures presented by the surveyed companies were taken into account.

The first category of disclosures (the information area) refers to the main principles of the control system over financial reporting. In particular, the DAX companies presented information within this category of disclosures. As many as 80% of companies from this index listed the benefits associated with the operations of systems (mainly the increase in the reliability of financial reporting), whereas the same information was presented by only 34.5% of the WIG 30 companies.

Many more DAX companies, compared to WIG 30 companies, indicated that one of the key tasks of control systems over financial reporting is to ensure the compliance of accounting with regulations such as IFRS and German GAAP.

More than 43% of the DAX companies and almost 14% of the WIG 30 companies affirmed that they regularly evaluate the quality of control systems over financial reporting. Nearly one-third of the DAX companies stated that for the construction of their control systems they used the COSO model, while none of the WIG 30 companies disclosed such information (Table 1).

Table 1. Disclosure category: the main principles of the internal control and risk management systems (in percentage)

No.	Detailed items	WIG 30	DAX
1.	The benefits associated with the operation of control systems	34.5	80.0
2.	The control system ensures conformity of the entity's accounting with the regulations (IFRS / German GAAP / Accounting Act)	10.3	73.3
3.	Regular (annually/quarterly) assessments of the quality of control systems*	13.8	43.3
4.	Components of control systems	41.4	36.7
5.	The units responsible for the operation of control systems	34.5	40.0
6.	The use of the COSO model for the construction and development of control systems	0.0	33.3

⁹ Similar main information groups have been identified in previous research conducted by the author (Gad, 2015a, 2015b).

No.	Detailed items	WIG 30	DAX
7.	Caveat: the effectiveness of control systems may be limited by discretionary decisions, crime, defective parts of control systems and other events	0.0	20.0
8.	An indication that the control systems are integrated with the financial reporting system	0.0	20.0
9.	Principles of the operation of control systems	10.3	0.0

* One company in the WIG 30 index indicated that the management board periodically has the company evaluated by an external body in terms of the functioning of the internal control system and the risk of abuse.

Source: author's own compilation.

The WIG 30 and DAX companies drew attention to the importance of IT tools in terms of the functioning of the control systems over financial reporting. In most cases, the companies indicated only that IT tools are part of control systems (Table 2).

Table 2. Disclosure category: IT tools (in percentage)

No.	Detailed items	WIG 30	DAX
1.	Information on the use of IT tools for the purposes of control systems (e.g. SAP)	51.7	76.7

Source: author's own compilation.

Given the disclosures about the control systems over financial reporting, it seems that regulations are important for the functioning of these systems. This concerns both statutory regulations and internal regulations. In the category of disclosures concerning regulations, the share of companies presenting specific detailed disclosures was similar for both indexes, but in terms of uniform accounting manuals and guidelines used in the capital group the scope of disclosed information was significantly different. This information was presented by more than 76% of the DAX companies, while, except for one company, it was not presented by any of the WIG 30 companies (Table 3).

Table 3. Disclosure category: regulations (in percentage)

No.	Detailed items	WIG 30	DAX
1.	Uniform accounting manuals and guidelines used in the capital group	3.4	76.7
2.	Information on sources of financial reporting regulations (Polish Accounting Act/ International Accounting Standards / German Generally Accepted Accounting Principles /stock exchange regulations)	44.8	56.7
3.	Information about the specific internal regulations relating to the process of preparing financial statements (procedures for incurring obligations, regulations, inventory manuals, lists of duties, material liability norms, codes of ethics, and rules)	44.8	30.0

Table 3. Disclosure category: regulations (in percentage) (*cont.*)

No.	Detailed items	WIG 30	DAX
4.	Information on tracking changes in regulations relating to financial statements and interim reports	31.0	43.3
5.	Uniform accounting policy for the whole group	34.5	10.0

Source: author's own compilation.

The analysis shows that within disclosures about the control systems over financial reporting of the WIG 30, companies presented more information about the external audit than the DAX companies. Almost 76% of the WIG 30 companies indicated that their financial statements have been audited. The same information was presented by only 26.7% of the DAX companies. Importantly, over 48% of the WIG 30 companies presented information on the process of the selection of an auditor, while none of the DAX companies presented this information (Table 4).

Table 4. Disclosure category: external audit (in percentage)

No.	Detailed items	WIG 30	DAX
1.	Information on the audit of financial statements or review by the auditor	75.9	26.7
2.	The process of selecting an auditor	48.3	0.0
3.	Review of the adequacy and effectiveness of the control systems carried out by the auditor	6.9	16.7
4.	The conclusions of the external audit are submitted to the supervisory board (audit committee)	13.8	3.3

Source: author's own compilation.

Most companies in both indexes indicated that an internal audit which is involved in risk identification is part of the control systems over financial reporting. In the case of 23.3% of the DAX companies and 6.9% of the WIG 30 companies, the internal audit assesses the control systems over financial reporting (Table 5).

Almost 14% of the WIG 30 companies stated that the internal audit works on the basis of the annual audit plans.

Table 5. Disclosure category: internal audit (in percentage)

No.	Detailed items	WIG 30	DAX
1.	The functioning of the internal audit is involved in risk identification (institutional internal control carried out by the internal auditor)	65.5	60.0
2.	The internal audit performs an independent assessment of the adequacy, accuracy, and efficiency of the control systems over financial reporting	6.9	23.3

No.	Detailed items	WIG 30	DAX
3.	Internal audit annual plans (programs) (in conformity with the International Standards for the Professional Practice of Internal Auditing)	13.8	0.0

Source: author's own compilation.

Many more of the DAX companies, compared with the WIG 30 companies, revealed information about the organization of the accounting system. Over 50% of the DAX companies indicated the application of the four-eye principle and the dual-control principle within the accounting system (Table 6), whereas only 6.9% of the WIG 30 companies provided information on the separation of the functions within the accounting system.

Half of the DAX companies stated in their disclosures that they use the knowledge of independent experts in relation to selected areas of accounting, while none of the WIG 30 companies disclosed such information.

Table 6. Disclosure category: organization of the accounting system (in percentage)

No.	Detailed items	WIG 30	DAX
1.	The principle of the separation of functions within the accounting system (administration, implementation, execution, and authorization) (the four-eye principle)	6.9	56.7
2.	The principle of dual control within the accounting system (the dual-control principle)	0.0	53.3
3.	The use of independent experts specializing in areas such as post-employment benefits, share-based payment obligations, purchase price allocations in the context of asset acquisitions and business combinations	0.0	50.0
4.	Regular training for staff dealing with financial reporting	0.0	20.0
5.	Identification of the department for control of individual financial statements before the consolidation process	6.9	10.0
6.	Accounting is carried out in subsidiaries. The parent company performs selected actions such as: business combinations, estimation of post-employment benefits or share-based payment obligations	0.0	10.0

Source: author's own compilation.

The majority (56.7%) of the DAX companies presented the information about control of access to financial data in their disclosures about the control systems over financial reporting. This information was presented by 31% of the WIG 30 companies (Table 7).

Table 7. Disclosure category: data security and protection (in percentage)

No.	Detailed items	WIG 30	DAX
1.	Control of access to financial data	31.0	56.7
2.	Information on the security and protection of financial reporting data	24.1	13.3

Source: author's own compilation.

As part of the disclosures about the control systems over financial reporting, companies in both indexes presented information on the process of preparing financial statements. The majority (55.2%) of the WIG 30 companies revealed the units responsible for the preparation of financial statements, while in the case of the DAX companies only 26.7% presented this information.

The disclosures of the DAX companies contained information which was not presented by the WIG 30 companies. This information concerned the use of shared service centres in the process of preparing financial statements as well as automated and non-automated controls as part of the process of preparing financial statements (Table 8).

Table 8. Disclosure category: the process of preparing financial statements (in percentage)

No.	Detailed items	WIG 30	DAX
1.	Indication of the units responsible for drawing up financial statements and oversight of the process	55.2	26.7
2.	The use of shared service centres which support local units in the preparation of financial statements	0.0	46.7
3.	Automated and non-automated reconciliations, controls	0.0	46.7
4.	Stages in the process of preparing financial statements	27.6	30.0
5.	Uniform rules and procedures for the consolidation of the financial data ensured by standardized reports	6.9	26.7
6.	Consultations with other departments (controlling, taxes, IT) during the preparation of financial statements	0.0	13.3
7.	An indication that the process of preparing financial statements is formalized	6.9	10.0

Source: author's own compilation.

One of the elements of the control systems over financial reporting is the activity of the supervisory board and the audit committee selected from this group. Over 40% of the WIG 30 companies mentioned the list of tasks of the audit committee associated with the operation of control systems. These were mostly tasks transferred directly from article 86, paragraph 7 of the Polish Act on Auditors. The list of the audit committee's tasks relating to control systems over financial reporting was presented by only 10% of the DAX companies.

20% of the DAX companies presented general information that the audit committee monitors the effectiveness of control systems over financial reporting. What is important is that 33.3% of companies in this index indicated that the supervisory board and audit committee receive regular reports on the effectiveness of the control over financial reporting (Table 9).

Table 9. Disclosure category: the supervisory board (audit committee) (in percentage)

No.	Detailed items	WIG 30	DAX
1.	A detailed list of the audit committee's tasks related to the operation of control systems (e.g. monitoring the financial reporting process and the independence of the auditor, recommending the supervisory board accept or reject financial statements)	41.4	10.0
2.	The supervisory board and the audit committee receive regular reports on the effectiveness of control systems	0.0	33.3
3.	The audit committee monitors the effectiveness of control systems	0.0	20.0
4.	Information related to the implementation by the supervisory board of the obligations under Article. 4a of the Polish Accounting Act*	13.8	0.0
5.	Following the completion of the audit, the financial statements are submitted to the supervisory board (audit committee)	13.8	0.0
6.	The supervisory board (audit committee) supervises the financial reporting process	10.3	6.7
7.	The financial statements are subject to analysis carried out by the supervisory board (audit committee) during regular meetings	0.0	10.0

* According to article 4a of the Polish Accounting Act, the supervisory board is obliged to ensure that the financial statements and reports on activities comply with the provisions of this act.

Source: author's own compilation.

Among the disclosures about the control systems over financial reporting, companies in both indexes presented information on managerial accounting. Over 27% of the WIG 30 companies and over 23% of the DAX companies stated that budgetary control is part of the control systems over financial reporting. Companies in both indexes indicated that within the control systems over financial reporting they use management reports (Table 10).

It should be noted that the share of companies presenting information about managerial accounting and the scope of this information was similar in companies in both indexes.

Table 10. Disclosure category: managerial accounting (in percentage)

No.	Detailed items	WIG 30	DAX
1.	The budgetary control system (including compliance with the strategic plan) as part of the control system over financial reporting	27.6	23.3
2.	Information on the use (also for the preparation of financial statements) of periodic reports with management information on key financial and operational indicators of business segments	17.2	10.0
3.	Information on the periodic review of the financial results, implementation of the strategy and operational plans (including economic and financial plans)	10.3	3.3

Source: author's own compilation.

Companies in both indexes presented information on the risks in their disclosures about the control systems over financial reporting. Over 20% of companies in both indexes provided information on the risk management process. The WIG 30 companies presented their disclosures about types of risks related to the operation of the entity (not directly related to financial reporting). The DAX companies disclosed that they used the risk and control matrix in their control systems (Table 11).

Table 11. Disclosure category: risk (in percentage)

No.	Detailed items	WIG 30	DAX
1.	The risk management process	24.1	23.3
2.	Types of risks associated with the preparation of financial statements	10.3	10.0
3.	Risks associated with the operation of the entity	10.3	0.0
4.	Risk and control matrix	0.0	10.0

Source: author's own compilation.

In summary, the results of the survey indicate that the investigated companies presented fairly similar information on the control systems over financial reporting.

Taking into consideration the frequency of presenting selected information, it seems that in terms of the functioning of the control systems over financial reporting, the following are of fundamental importance:

- in the case of the DAX companies: IT tools, internal and external regulations, internal audits, the organization of the accounting system, and data protection,
- in the case of the WIG 30 companies: IT tools, the process of preparing financial statements, external audits, and internal audits.

It should be noted that in the practice of public companies listed in Germany, the disclosures on control over financial reporting are a fragment of a wider report on internal control and risk management.

The survey results indicate that in the case of the DAX companies, the reporting practice in the area of disclosures about control over financial reporting is more developed, i.e. the repeatability of certain items is greater. Analysis of the frequency of disclosures indicates that in the case of the DAX companies as many as 10 of the same detailed items were presented by the majority of the surveyed companies in this index, while in the case of the WIG 30 companies, only 4 such items were presented by most of the companies in this index.

The number of disclosed detailed items could be a benchmark of transparency of the company in the area of control over financial reporting. Depending on the number of detailed items (the maximum number is 25, while the minimum is 3) disclosed by individual companies one can distinguish companies with a very high, high, low and very low transparency.

Importantly, the number of the DAX companies whose disclosures about control over financial reporting may be regarded as transparent to a very large extent is greater compared to the WIG 30 companies. None of the DAX companies was classified as a company with very little transparency of disclosures about control over financial reporting while as many as 20.7% of the WIG 30 companies were classified as such (Table 12).

Table 12. The level of transparency of disclosures about control over financial reporting in the WIG 30 and DAX companies

Level of transparency	Number of detailed disclosures	The share of the WIG 30 companies (in percentage)	The share of the DAX companies (in percentage)
Very high transparency	20–25	10.3	26.7
High transparency	14–19	31.0	30.0
Low transparency	7–13	37.9	43.3
Very low transparency	0–6	20.7	0.0

Source: author's own compilation.

Differences in the level of transparency of companies in both indexes may result from cultural differences. Dimensions of national cultures were the subject of research conducted by Hofstede and Hofstede. Poland belongs to the group of countries with a high uncertainty avoidance index, while Germany belongs to the group of countries with an average uncertainty avoidance index (Hofstede, Hofstede, 2007, p. 182). Uncertainty avoidance is defined as „the level of threat perceived by members of the given cultural in the face of new, unknown or uncertain situation” (Hofstede, Hofstede, 2007, p. 181). It should be noted that, according to the classification developed by Hofstede and Hofstede, the Anglo-Saxon countries belong to the group of countries with a low uncertainty avoidance index. In countries with a low level of uncertainty avoidance

index there is a higher level of innovation, while in countries with a high uncertainty avoidance index there is higher accuracy of executing activities and a strong need for their formalization. In countries with a high uncertainty avoidance index there is a need to cover everything in the provisions of law (Hofstede, Hofstede, 2007, p. 357). It seems that the level of uncertainty avoidance index is reflected in the disclosures presented by companies, the scope of which is not precisely defined in the provisions of law or good practices. Entities operating in a country with a high uncertainty avoidance index (e.g. Poland) will choose not to present detailed, non-compulsory disclosures. For countries with an average uncertainty avoidance index (Germany), the propensity to present optional disclosures will be higher. A higher level of transparency of disclosures presented by the DAX companies may also result from the national characteristics of Germans, namely from the need to organize activities (Hofstede, Hofstede, 2007, p. 290)¹⁰.

The study also determined the length (measured by the number of words) of the disclosures about control over financial reporting presented by the surveyed companies. The results show that these disclosures were longer in the DAX companies, averaging 713 words, while in the WIG 30 companies the disclosures were, on average, 562 words long.

The minimum length of the disclosures presented by the DAX companies was 329 words and the maximum 1934 words. In the case of the WIG 30 companies, the minimum disclosure was only 90 words long, while the maximum was 1130 words long.

The findings indicate that there is a weak, positive correlation between the length of disclosures and equity in the case of the WIG 30 companies and a moderate positive correlation between the length of the disclosures and total assets in the case of the DAX companies (Table 13).

Table 13. The Pearson correlation coefficient – the disclosures of the WIG 30 and DAX companies

Items	Revenues from sales	Total assets	Equity
Length of disclosures (measured by the number of words) in the WIG 30 companies	0.367	0.284	0.433
Length of disclosures (measured by the number of words) in the DAX companies	-0.227	0.589	0.023

Source: author's own compilation.

It seems that larger companies (with more equity or assets) disclose more information about control systems over financial reporting. This may be due to the fact that the structures of these entities are more developed compared to companies with lower levels of equity or assets.

¹⁰ A higher level of transparency of the DAX companies, compared with the WIG 30 companies, was also confirmed in studies on the presentation of information in the statement of comprehensive income (Gad, 2015c).

Conclusions

The obligation of entities to disclose information on the control systems over financial reporting is a manifestation of concern over the reliability of financial reporting. This is another activity aimed at increasing the safety of the capital market. It also seems that the obligation to disclose information on the control systems over financial reporting may encourage companies lacking such systems to create them. It should be noted that the functioning of control systems over financial reporting is related to the use of mechanisms of corporate governance already operating in the companies. The role of the control systems over financial reporting is to coordinate these mechanisms around the accounting system.

The regulations do not provide guidance as to the content of disclosures about the control systems over financial reporting. It seems that the disclosures presented by companies include information which a few years ago was regarded as internal and intended only for management. Disclosures about control systems are an example of the transfer of inside information into external reporting (financial and non-financial). Management boards of individual companies define the scope and structure of the disclosures. It seems, therefore, that it can be assumed that the scope of these disclosures is an expression of the company's transparency.

Given that there is no catalogue of information on the control systems over financial reporting which companies must obligatorily disclose, the studies on reporting practice in this area seem particularly important. It also seems important to disseminate the results of these studies. The conclusions of the research (especially international comparative research) help establish a reporting model.

It also appears that the control systems over financial reporting are similarly understood among companies listed on the Polish and German capital market. The results of the study indicate that the WIG 30 and the DAX companies presented the same main categories of information within the disclosures about the control systems over financial reporting.

It should additionally be noted that the WIG 30 and the DAX companies spread accents within the disclosures in a slightly different way. Companies in both indexes also presented different detailed items within specific information areas (categories of disclosures).

The DAX companies presented more information pertaining directly to the information system of accounting while the WIG 30 companies presented a great deal of general information, not related to the accounting system. Moreover, the WIG 30 companies, to a greater extent than the DAX companies, presented information which did not bring any value. For example, almost 76% of the WIG 30 companies indicated that their financial statements were audited by a certified auditor, while the financial statements of all entities listed on the Warsaw Stock Exchange are audited.

The reporting practice of the DAX companies in the area of control systems over financial reporting appears to be ahead of the reporting practice of the WIG 30 companies.

Taking into account the number of detailed items presented in disclosures about the control systems over financial reporting it can be concluded that the disclosures of the DAX companies are more transparent than the disclosures of the WIG 30 companies.

The set of disclosures developed as part of the research process may provide a basis to construct an index of disclosures about the system of control over financial reporting.

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