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THE INFLUENCE OF SELECTED ACCOUNTING FACTORS ON FINANCING A BUSINESS ON THE CAPITAL MARKET

Abstract: The financial sector of the economy has undergone turbulent times of late, a situation that continues as a result of the so-called debt crisis within the European currency union. Expert opinion has made efforts to respond to the effects brought about by this situation in many areas of the financial market. This article looks at capital market regulation within the European Union, focusing on International Financial Reporting Standards (IFRS). These standards should make it possible to harmonise the financial reporting of quoted companies and thus limit asymmetry of information when reducing the market risk, and in doing so, increasing trust in the capital market.

Keywords: international accounting standards, capital market, financing a business.

1. Introduction

The capital market is where investors, meaning those who buy securities and trade in them, and dealers or issuers, who by contrast issue securities with the aim of obtaining finance, come together to do business. Both sides are limited in this by the influences of the environment in which they move, such as political, legal and financial aspects, accounting regulations and customs and so on. This area is therefore closely connected to the economics of businesses and their management, given that businesses first and foremost enter the capital market to finance their investment plans and other objectives (for example, operating plans, social plans etc.). There is a certain degree of stability[1] in this sector, which is desirable for a business, among

[1] A certain degree of stability is understood to be such a state in which legislative rules are defined for the market by the state and other possible rules by self-regulating institutions (from the perspective of international accounting, for example The International Accounting Standards Board, abbreviated as the IASB). The environment continues in its dynamic change, however, meaning that no investor and no organisations in financial deficit should lose a sense of caution and consideration, even in the light of the existence of various rules and regulations. By contrast, both sides must remember that a certain asymmetry of information between the potential creditor and investor will always exist. The system of accounting regulation is therefore significant; of that there is no doubt. However it is merely one of many instruments to grind down this asymmetry.

others from the perspective of its suppliers, clients or customers who also move around the capital market. By contrast, instability has a negative effect on the economic possibilities of individual organisations. The aim of the article is therefore to examine a limited part of the functioning of businesses on the capital market from the accounting perspective, in which these organisations, mainly by issuing shares and bonds, are able to obtain the resources they need to develop and ensure the day-to-day running of the business. The IFRS might also be considered limiting, and therefore what are practically regulatory, factors in entering the capital market of the EU and thus accessing sources of financing through the instruments in this area.

The primary task of the paper is to define the possibilities a business has in terms of obtaining financial resources on the European Union capital market. For business organisations to be able to enter such a market, they must comply with certain measures and directives. Another aim of the article, therefore, is to define and analyse the relevant regulatory instruments, concentrating on accounting, and the instruments required for the effective management of the finances of a business.

2. International Financial Reporting Standards

In a modern, global society in which barriers are being broken down between states leading to better and greater economic cooperation, it would appear more than practical to harmonise such an important information tool in managing a business as accounting. The harmonisation of accounting means reducing the differences between individual systems, and is proceeding in a number of areas. This article focuses specifically on the global level, meaning the IFRS, and its ties to the capital market, where businesses can, in the form of share and bond issues, obtain the funds they need to further develop or ensure their day-to-day running.

If a business wants to place its financial resources on the capital market, it must adhere to certain procedures and requirements. One such requirement is to compile financial statements in line with International Financial Reporting Standards (IFRS). For this reason we can say that the IFRS can also be considered as a limiting factor in entering the EU capital market. Here we are referring to, for example, IAS 39, IAS 32, IFRS 7, IFRS 9 and IFRS 13, which deal with the issue of capital markets and the conditions for showing the relevant transactions in accounting. Individual standards are regularly updated to take on board the latest theoretical and practical knowledge.

Since 1988 the International Accounting Standards Committee has been charged with the task of dealing with the recognition, measurement and presentation of financial instruments. Three standards were successively adopted: IAS 32 Financial instruments: presentation; IAS 39 Financial instruments: recognition and measurement; and IFRS 7 Financial instruments: disclosures. These standards proved to be insufficient and were therefore supplemented or broadened or new standards developed. Among the newly-developed standards are IFRS 9: Financial instruments and IFRS 13: Fair value measurement.

2.1. IAS 32 – Financial instruments: Presentation

IAS 32 is one of the oldest standards to determine the accounting of financial instruments and its presentation. The primary aim of IAS 32 is to determine the principles for presenting financial instruments – in particular financial assets, liabilities and equity instruments. The standard is divided into three areas that set out a definition of financial instruments: the boundary between liabilities and equity and the conditions of offsetting financial assets and financial liabilities [11].

2.1.1. Definition of financial instruments

The first area of the standard defines a financial instrument as a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity [11].

This part of the standard also clearly defines:

A financial asset is any asset that is:

- cash;
- an equity instrument of another entity;
- a contractual right
  - to receive cash or another financial asset from another entity, or,
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity, or;
- a contract that will or may be settled in the entity's own equity instruments and is
  - a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments, or,
  - a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments [11; 17].

However, the standard also sets out that an entity's own equity instruments do not include:

- puttable instruments that are classified as equity instruments;
- instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments;
- instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

Financial liability is any liability that is:

- a contractual obligation
  - to deliver cash or another financial asset to another entity; or,
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity, or;

- a contract that will or may be settled in the entity's own equity instruments and is
  - a non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments, or;
  - a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments [11; 17].

An **equity instrument** is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. **Fair value** is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties under normal conditions [11].

2.1.2. The boundary between liability and equity

The second area of the standard explains the relatively extensive boundary between liability and equity. This is characterised by the following areas:

a) **General liabilities** describe the obligation of an issuer of a financial instrument. It again defines an equity instrument and the conditions that should be met, as well as what an entity's own equity instruments do not include. For more information – [11];

b) **The non-existence of a contractual obligation to deliver cash or another financial asset** principally characterises criteria for differentiating a financial obligation from an equity instrument;

c) **Settlement in the entity's own equity instruments;**

d) **Puttable instruments** – This part first explains this instrument, before going on to name the characteristics for the proper classification of an equity instrument;

e) **Instruments or component parts of instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation.** This part of the standard explains when the relevant contractual obligation arises and defines the characteristics which an equity instrument must comprise to be classified as an equity instrument in this area;

f) **The reclassification of puttable instruments and instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation;**

g) **Contingent settlement provisions** determine when a liability may be settled and, by contrast, the exceptions when the financial liability of the issuer cannot be considered a financial liability;

h) **Settlement options** present illustrations of possible settlement methods;

i) **Compound financial instruments** determine the presentation options for determining a compound instrument and subsequent split;

j) **Treasury shares;**

k) **Interest, dividends, losses and gains** to concern financial instruments. This part of the standard explains the way of proper recognition [11].

2.1.3. The conditions of offsetting financial assets and financial liabilities

The final part of the standard deals with the rules for the offsetting of financial assets and financial liabilities. This section, however, is continually being developed and improved.

The above allows us to criticise IAS 32 from two different perspectives. The first is its complex application and the second the none-too-precise differentiation of the terms and capital and liability, which could lead to conflict between the conceptual framework and IAS 32 in areas such as derivatives with settlement in the entity's own shares, for example [11].

IAS 32 is supplemented by the principles laid down in IAS 39 and IFRS 7. Certain interpretations therefore apply to the standard.

- SIC 12 – Consolidation – Special Purpose Entities;
- IFRIC 2 – Members' Shares in Co-Operative Entities and Similar Instruments;
- IFRIC 11 – Group and Treasury Share Transactions;
- IFRIC 12 – Service Concession Arrangements;

etc. [1, p. 109].

IAS 32 also names the types of financial instruments to which the standard does not apply. These are as follows:

- Interests in subsidiaries, associates and joint ventures that are accounted for under IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* or IAS 31 *Interests in Joint Ventures*.
- Employers' rights and obligations under employee benefit plans, dealt with under IAS 19 *Employee Benefits.*
- Insurance contracts as regulated in IFRS 4 *Insurance Contracts.*
- Financial instruments that are regulated within the scope of IFRS 4 and whose content is based on the precautionary principle.
- Financial instruments, contracts and obligations under share-based payment transactions in accordance with IFRS 2 *Share-based Payment* [2].

Table 1. Historical development of IAS 32

Published	Changes (amendment)		Effect
1995		Disclosure and presentation as IAS 32	1.1.1996
	12/1998	IAS 32 revised by IAS 39	1.1.2001
	17.12.2003	Review of IAS 32	1.1.2005
	8/2005	Part replacement by IFRS 7	1.1.2006
	14.2.2008	Financial instruments and puttable instruments and obligations arising on liquidation – added from IFRS 7	1.1.2009
	10/2009	Classification of rights issues and share purchase by current shareholders denominated in foreign currencies	1.1.2010
	16.12.2011	The rules of offsetting financial assets and financial liabilities	1.1.2014
	17.5.2012	The tax effect of equity distributions	1.1.2013

Source: compiled by author based on: [2].

The standard was published in 1995, entering into effect on 1.1.1996. However, it has been amended and updated on several occasions, as described in Table 1.

The main characteristics of IAS 32 can be summarised as follows. For an accounting entity to be able to account according to IAS 32, it must first classify its financial instruments according to the definitions in IAS 32. It must then consider the boundaries between liabilities and equity and the rules for offsetting financial assets and financial liabilities. What is more, it must keep up with the latest amendments to IAS 32. Since IAS 32 only deals with the presentation and not the measurement of financial instruments, an accounting entity must also follow another standard – IAS 39.

2.2. IAS 39 – Financial instruments: recognition and measurement

IAS 39 follows on from/supplements IAS 32. The standard regulates principles for the classification and measurement of all types of financial instruments and specifies which financial instruments it does not apply to i.e. in the case of being specified in other standards; for example IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates*, IAS 31 *Interests in Joint Ventures*; IAS 19 *Employee Benefits*, IFRS 4 *Insurance Contracts*; IFRS 2 *Share-based Payment*; IAS 32 [1].

The standard determines [10]:

a) **Four categories of financial instruments.** These categories are:

- Financial assets or financial liability at fair value through profit or loss can be considered financial assets or financial liabilities if meeting one of the two conditions which the standard lays down [10, p. 206].
- Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity, with a list of those to which this definition does not apply.
- Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The standard also indicates those not covered by this application.
- Available-for-sale financial assets are the non-derivative financial assets that are not classified under one of the three categories which the standard lays down [10].

b) **Derecognition of financial assets and financial liabilities:**

- Derecognition of financial assets. The standard explains what exactly derecognition is and the essential steps to be taken for possible derecognition.
- All transfers involving the recognition of repo transactions.
- Regular way purchases or sales. The standard first explains purchases and sales and then explains the way of recognition. It also deals with the issue of trade date accounting and the principle of settlement date accounting.
- Derecognition of financial liabilities [10].

c) **The measurement of financial assets and financial liabilities:**

- The initial measurement of financial assets and liabilities, which should initially be measured at fair value, including transaction costs.
- The revaluation of financial assets, when the entity should again measure a financial asset at fair value, in that no adjustment should be made for transaction costs, with exceptions again determined.
- The revaluation of financial liabilities, when all financial liabilities are measured using the accrued value using the effective interest rate method, with further exceptions.
- Questions to concern measurement at fair value explain how to determine fair value and what applies to quoted market prices.
- Reclassification determines when an entity may and may not reclassify a financial instrument.
- Gain and loss. The standard specifies the recognition of gain and loss.
- Impairment of financial assets. The standard deals with the impairment of financial assets in two stages. It also describes a loss event as objective evidence of impairment and explains possible recognition [10].

d) **Embedded derivatives.**

Defines a derivative and an embedded derivative.

e) **Hedge accounting.**

Explains and defines hedge accounting, hedge instrument, hedge item, hedging relationship, fair value hedge, cash flow hedge, expected operations hedge and hedge of a net investment [10; 17].

The standard was published in 1998, entering into effect on 1.1.2001, and was the result of changes to a number of previous standards. It was itself subsequently amended and updated on a number of occasions, as described in Table 2.

Table 2. Historical development of IAS 39

Published	Changes (amendment)		Effect
12/1998			1.1.2001
	17.12.2003	Publication of new IAS 39 and IAS 32	1.1.2005
	31.3.2004	Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk	1.1.2005
	12/2004	for transition and initial recognition of financial assets and financial liabilities	1.1.2005
	4/2005	for cash flow hedges of forecast intragroup transactions	1.1.2006
	6/2005	for fair value option	1.1.2006
	8/2005	for financial guarantee contracts	1.1.2006
	13.10.2008	for reclassifications of assets and liabilities	
	16.10.2008	Amendment of amendment from 13.10.2008	
	11/2009	IFRS 9, which replaces certain parts of IAS 39	1.1.2013
	10/2010	Another part of IFRS 9, which replaces certain other parts	1.1.2013

Source: compiled by author based on: [3].

We can therefore say in conclusion that an accounting entity could quite easily misinterpret the standard, leading to discrepancies in accounting, which would obviously result in an incorrect presentation. In order to prevent these risks as best as possible, a further standard was published to regulate financial instruments – IFRS 7.

2.3. IFRS 7 – Financial instruments: disclosures

The standard was compiled in line with the need for a risk management concept to deal with the risks arising from the disclosure of financial instruments. Users of financial statements need to know the risks to which the relevant accounting entity is exposed and how to manage these [9].

The standard sets out:

a) **Definitions of risks**, such as credit risk, market risk and liquidity risk.

b) **Disclosure of the significance of financial instruments for an entity's financial position and performance** – the entity should disclose information which allows users of its financial statements to evaluate the significance of financial instruments for its financial position and performance. This principally involves the disclosure of:

- a statement of financial position;
- a statement of comprehensive income.

c) **The nature and extent of risks arising from financial instruments.** Where the entity must disclose the qualitative and quantitative information specified in more detail in the standard for each type of risk [9; 14].

Two interpretations apply to this standard – IFRIC 12 *Service Concession Arrangements* and IFRIC 17 *Distributions of Non-cash Assets to Owners*.

The standard names the types of financial instruments to which it does not apply:

- Interests in subsidiaries, associates and joint ventures that are accounted for under IAS 27, IAS 28 and IAS 31.
- The rights and obligations of the employer arising from employee benefit plans, as dealt with under IAS 19.
- Insurance contracts matching the definition in accordance with IFRS 4.
- Financial instruments, contracts and liabilities from share-based transactions in accordance with IFRS 2.
- The entity's own equity instruments defined in accordance with IAS 32 [1].

The standard was published in 2005, entering into effect on 1.1.2007. However, it has been amended and updated on several occasions, as described in Table 3.

All accounting entities are exposed to various types of risk and this leads to various presentations of financial statements and notes to them. In spite of the fact that IFRS 7 defines a number of these risks, individual financial statements and the notes to them need not necessarily be comparable between businesses. By contrast, the concept of IFRS 7 can be so demanding as to lead to even greater misrepresentation.

Table 3. Historical development of IFRS 7

Published	Changes (amendment)		Effect
18.8.2005		IFRS 7 – Financial instruments	1.1.2007
	14.2.2008	IFRS supplements IAS 32	1.1.2009
	10/2008	Relation to disclosures of information about liquidity risk	1.1.2009
	13.10.2008	Disclosures about the reclassification of financial assets	1.6.2008
	5.3.2009	Disclosures of information about fair value and liquidity risk	1.1.2009
	6.5.2010	Annual improvements to IFRSs 2010	1.1.2011
	7.10.2010	Enhancing disclosures of information about transfers of financial assets	1.6.2011
	16.12.2011	The rules of offsetting financial assets and financial liabilities	1.1.2013

Source: compiled by author based on: [4].

As already indicated, standards are not always complete and sufficient. This has led to the need for a new requirement: to make the area of financial instruments more precise using two further standards – IFRS 9 and IFRS 13.

2.4. IFRS 9 – Financial instruments

A new standard that was published in 2009, but that only entered into effect on 1.1.2013, IFRS 9 primarily supplements IAS 39.

The standard sets out:

a) **The classification of financial assets and financial liabilities.** The standard classifies two primary categories of financial assets (whereas IAS 39 sets out four categories) and two categories of financial liabilities.

b) **Fair value option.** Taken mainly from IAS 39, where there is a difference for financial assets. Here there is only one option case (there are three in IAS 39).

c) **Dealing with embedded derivatives.** It is first explained how an embedded derivative comes into being (an embedded derivative is a component of a hybrid contract that also includes a non-derivative host). The standard goes on to specify what comes under IFRS 7 and how to deal with other cases.

d) **Initial and subsequent recognition.**

e) **Reclassification.** An explanation of when and how the standard allows the reclassification of a financial asset. (A financial liability cannot be reclassified.)

f) **Investment in equity instruments.** The standard explains the values in which equity instruments may be accounted and the area of unquoted equity investments and contracts.

g) **Dealing with gains and losses:** on financial assets or financial liabilities designated as at fair value are recognised in comprehensive income. The standard also determines the exceptions to which it does not apply.

h) **Dealing with securitisation tranches.** The standard first explains what securitisation tranches are and then specifies the rules and method of recognition.

i) **The effect of the standard.** This standard is effective for the accounting period beginning 1.1.2013 or thereafter. Previous application is permissible [8; 13; 16].

This standard is primarily designed to supplement and offer additional explanation of certain items from IAS 39, as shown in Table 4.

Table 4. Historical development of IFRS 9

Published	Changes (amendment)		Effect
12.11.2009		Part replacement of IAS 39	1.1.2013
	28.10.2010	Further part replacement of IAS 39	1.1.2013
		Revised effective date	1.1.2015

Source: compiled by author based on: [5].

IFRS 9 principally supplements IAS 39. It is possible that an accounting entity will not register the recency of the standard and will classify its financial instruments in the wrong place, again leading to a misrepresentation of the accounting facts.

2.5. IFRS 13 – Fair value measurement

IFRS newly defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The standard tries to improve consistency and comparability in fair value measurement and related disclosed data through a fair value hierarchy [7; 12; 15].

The standard:

a) defines fair value;

b) sets out a framework for measuring fair value;

c) requires disclosures about fair value measurements [12; 15].

IFRS 13 was originally published in May 2011 and applies to accounting periods beginning after 1 January 2013, which is evident from Table 5.

Table 5. The development of IFRS 13

Published	Changes (amendment)		Effect
12.5.2011		Fair value measurement – IFRS 2013	1.1.2013

Source: compiled by author based on: [6].

3. Conclusion

This article is a theoretical introduction to further, more in-depth research. Selected accounting entities will be contacted and a questionnaire will be used to check whether businesses enter the capital market with the aim of obtaining the resources required for development and the day-to-day running of the business and the role played by the accounting factor in these efforts. The aim of the article is to show the complexity and ambiguity of an interpretation of individual standards and their impaired practical application. This is demonstrated by the standards themselves; for example, a discussion paper entitled “Reducing complexity in reporting financial instruments” was published for IAS 32 in 2008. Individual standards are under continual development in response to new needs. These new needs are dealt with in the form of amendments and changes to standards. For the accounting entity, however, it is not easy to continually follow all the changes and apply them. It is also expensive, from the perspective of training staff, for example. If an accounting entity wanted to do business on the capital market, it would actually have to keep two sets of books: one at the national level in line with the requirements of the relevant state and the second international in line with IFRS/IAS. This means further additional costs for the business in terms of compiling two sets of accounting statements, switching to International Accounting Standards and so on. This all leads to an unwillingness among accounting entities to enter such a market, preferring instead to use means such as long-term bank loans to finance their operations without the added cost of ensuring the required accounting.

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WPŁYW WYBRANYCH CZYNNIKÓW KSIĘGOWYCH NA FINANSOWANIE PRZEDSIĘBIORSTWA NA RYNKU KAPITAŁOWYM

Streszczenie: Sektor finansowy gospodarki znajdował się, i z powodu tzw. długiego kryzysu w Europejskiej Unii Walutowej, znajduje się od kilku lat w bardzo burzliwym okresie. Do sytuacji będących przyczyną takiego stanu rzeczy starają się odnosić eksperci z wielu dziedzin rynku finansowego. W niniejszym artykule opisano regulacje rynku kapitałowego funkcjonujące w ramach Unii Europejskiej, przy szczególnym uwzględnieniu Międzynarodowych Standardów Sprawozdawczości Finansowej. Standardy te powinny umożliwić unifikację sprawozdań finansowych spółek notowanych na giełdzie, ograniczając w ten sposób asymetrię informacyjną w celu zmniejszania ryzyka rynkowego, a tym samym podniesienia zaufania do rynku kapitałowego.

Słowa kluczowe: międzynarodowe standardy rachunkowości, rynek kapitałowy, finansowanie przedsiębiorstw.