

CONVERGENCE OF FINANCIAL AND MANAGEMENT ACCOUNTING IN THE CONTEXT OF COMPANIES' INTEGRATED REPORTING

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Abstract: *Integrated reporting, considered by specialists as the corporate reporting of the future, influences financial and management accounting and enriches the traditional information links between them. The objective of this paper is to prove that the information links and interactions traditionally existing between the financial and management accounting systems will be kept and enriched in a situation of the entities' integrated reporting. The existing relationships and interactions between the two accounting systems in the context of International Financial Reporting Standards (IFRSs) will be taken into account, as well as their development, triggered off by this new form of accountability.*

INTRODUCTION

“I think we have gone beyond financial reporting. If we look at corporate reporting, there are financial reports, sustainability reports, corporate governance reports, remuneration reports and a whole host of other regulatory reports. So there is a lot of information out there, but a lot of them do not tie up together. Thus, there is a need to put them together in a logical, comprehensive and structured way. Integrated reporting does that, but it also actually goes way beyond that. Integrated reporting compels corporations doing the reporting to look at their own business models, to better weigh the value of their capital, better measure the risk aspects of their businesses and to tie that in with what they are doing, what they plan to do, how they are going to do it and over a defined time-frame. It is a very ‘live’ form of reporting.”

Kevin Kwok
Council Member, Singapore Institute of Directors

In a situation of deepening economic uncertainty and complexity of the business environment corporate reporting meets the information needs of the stakeholders with increasing difficulty. In addition to the financial indicators such as profit, liquidity, earnings per share, etc., they need non-financial indicators allowing them to assess the entity's environmental footprint, the social and corporate responsibility, customer satisfaction and others. Integrated reporting is increasingly considered the reporting of the future, „a one-size-fits-all concept“ (ICPAS&IIRC, 2013, p. 5), as well as a shift of the traditional accounting paradigm (Ibid., 2013, p. 8). Despite its relatively short period in existence, its impetuous development over the past two decades drew the interest of various professional organisations (ACCA, 2014; IMA, 2016; IFAC 2015a,b; CGMA, 2014), international audit firms (see PWCa,b) and academics, who have contributed to the solution of topical issues in the area of integrated reporting through theoretic and empiric studies. Questions such as: "are there going to be attempts to converge the different reporting frameworks", "what will be the role of accountants and professional accounting bodies in an integrated reporting setting", "what would be the link between the integrated report and the statutory annual report", "how can high quality integrated report be recognised" and many others (Villiers, et al., 2014) have been raised. In order to resolve these issues focus on the information basis integrated reporting is required and, in this context, focus on its relation to financial and management reporting, the issues accounting and audit professionals are faced with, as well as the challenges to accounting education. The scope of financial and management accounting studies has expanded taking a new direction towards research of the links and interactions between them in an integrated reporting setting.

OBJECTIVES AND TASKS

The objective of this paper is to prove that the information links and interactions traditionally existing between the financial and management accounting systems will be kept and enriched in an entity integrated reporting setting. The specific requirements of this new form of reporting necessitate further development of the existing and creation of new communication links between the entity's information systems.

To achieve this objective the following tasks have to be solved:

- An overview of the areas of interaction traditionally existing between the financial and management accounting systems and study of their convergence resulting from the application of IFRSs.
- An outline of the directions of interaction between the two accounting systems for the provision of information for the preparation of the entity's integrated report.

Hypotheses of the authors:

1. The existing traditional information links and interactions between the financial and management accounting systems are developed and further enriched through the application of IFRS as a reporting basis.
2. The links traditionally existing between the financial and management accounting systems are kept and developed further in an integrated reporting setting due to the possibility for the generation of non-financial and future-oriented management information, as well as the importance of the historical financial information.

INTEGRATION OF FINANCIAL AND MANAGEMENT ACCOUNTING SYSTEMS AS A RESULT OF THE CONVERGENCE PROCESS WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS

There are numerous publications on the similarities and differences between the financial and management accounting systems. According to Lambert (2007, p. 265) academic research focuses excessively on the differences but „...at the conceptual level there is a tremendous amount of overlap between the two”. We support the opinion that the two accounting systems share a common theoretical fundamentals. They produce information regarding the same economic phenomena and processes, taking place during a specific reporting period, but they are recorded from a different, specific perspective, while both accounting systems use all elements of the accounting method. (Stancheva-Todorova, 2014, p. 190)

Strengthening of the integration between the two reporting systems is noted during the past few decades, even in continental Europe countries, and particularly in the German-speaking counties, traditionally applying “the

dual” design model (Weissenberg and Angelkort, 2011). One of the reasons pointed out is that company reporting has shifted towards the investors, which has made them a key stakeholder group (Krahnert and Schmidt, 2004). A key advantage of the integration of the two systems is the optimisation of the costs for the preparation of the management accounting information. Furthermore, easily obtained reconciliation between management and financial performance measures is ensured.

Constant exchange of information between the financial and management accounting systems occurs in the course of the current accounting for the entity's business transactions (fig. 1). The main objective is to create accounting indicators for expenses, cost calculation and pricing. Using the specific management accounting tool set it is possible to study the company's costs through the application of various classification criteria, which facilitates their efficient management. For example, their grouping depending on the fluctuations in the volume of the business facilitates the cost-volume-profit analysis. Treating them as relevant and irrelevant, on the other hand, allows assessment of different management solution options. The information regarding the opportunity costs created in the management accounting process is extremely important. The two accounting subsystems share cost classifications as manufacturing and non-manufacturing costs, product costs and period costs, which is the basis of the interaction considered. The reliable definition of the period costs is important for the proper measurement of the entity's financial performance.

Another traditional area of interaction is related to cost calculation. The use of different approaches in management accounting allows the management to look at the entity's operations and performance from different perspectives and to assess the profitability of production. The cost indicators are used currently by the financial accounting system and periodically during the preparation of the financial statements. It has to be pointed out that the approaches to the classification of expenses and definition of cost are regulated due to the financial reporting regulatory frameworks existing in each country.

The information regarding sales prices created in the management accounting system can also be considered a crossing point. It determines the financial indicators as to sales revenue, return on capital invested and entity's profits. The latter are presented mandatory in the entity's financial statements due to their extreme importance to the external users.

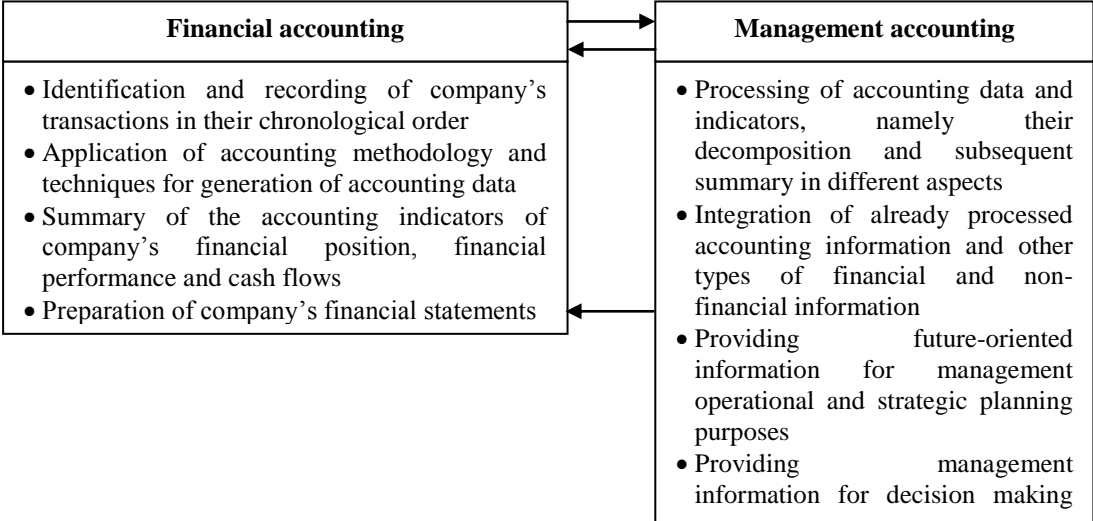
Another, more modern form of interaction is along the line of the Balanced Scorecard, being a management tool for performance measurement and control (Kaplan and Norton, 1996). It integrates financial and non-financial

indicators, which allows assessment of the different aspects of the operations of the entities, including social and environmental aspects.

In addition to the above-mentioned areas of interaction exchange of information occurs in the management decision process related to the acquisition of assets, the measurement of the different ways of resources utilisation and their derecognition. These decisions may have direct impact on the amounts reported in the entity's financial statements.

We can conclude that despite the relative separation between the financial and management accounting systems, there has always been information interaction between them. A visible trend for increased integration between the two is observed during the past few decades. In our opinion IFRSs and their development are currently the factor exerting the strongest influence to that effect. The constant changes in the accounting regulations internationally are the result of the need to address the dynamic development of the globalised world economy and the new information needs of financial information users.

Fig. 1. Traditional areas of interaction between financial and management accounting



Source: Stancheva and Ankova, 2011, p. 186.

The quality of companies' financial reporting is in the focus of regulators in an attempt to support capital markets and confine financial fraud. This is also the key factor determining the development directions of IFRSs, and one of their effects is the strengthening of the information exchange between the two accounting systems (see table 1).

Table 1

Areas of convergence	Financial accounting	Management accounting
Exposure to financial risks	<i>IFRS 7 Financial Instruments: Disclosure</i> – the nature and extent of financial instruments-related risks (credit, foreign currency, interest rate, liquidity, price risks) that the entity is exposed to and how the entity manages these risks are subject to disclosure	Provides: - Future-oriented information on the effects of the changes in certain economic parameters on the amounts reported in the entity's financial statements; - Information regarding the strategy adopted by the entity's management to minimise the adverse effects of the risks
Key management judgements, accounting estimates and assumptions of high uncertainty	<i>IAS 1 Presentation of Financial Statements</i> – the accounting estimates and judgements used by the entity's management, which impact the amounts of assets, liabilities, income and expenses, the disclosure of contingent assets and liabilities as at the date of the financial statements (impairment of assets, actuarial calculations, deferred tax assets, provisions set aside in relation to lawsuits, fair values, normal production capacity, etc.) are subject to disclosure	Provides management information, including for the accounting estimates used in the preparation of the financial statements.
Definition of cash generating units	<i>IAS 36 Impairment of Assets</i> – need to define cash generating units in relation to the estimation of and accounting for impairment losses	- Provides information necessary to determine the smallest identifiable groups of assets generating cash flows from their continuing use that are largely independent from the cash flows generated by other assets or groups of assets. The distinction is based on assessment depending on their current management, operation and reporting within the entity - Provides information concerning the impairment of tangible and intangible assets, affected by pollution incidents, physical damage or non-compliance with environmental rules
Provisioning	<i>IAS 37 Provisions, Contingent Liabilities and Contingent Assets</i> – requires recognition of a liability (provision) as a result of a legal or constructive obligation of the entity associated with environmental protection and clean-up, and in certain cases requires recognition only of a contingent liability	Provides information for future cash flows, related to environmental protection and clean-up by the entity, taking into account the technology and complexity of the process
Definition of operating segments	<i>IFRS 8 Operating Segments</i> – requires the entity to disclose information allowing financial	- Provides information for the definition of the entity's operating segments based on the nature of the

	statement users to assess the nature and financial performance of its business operations and the economic environment	risks and the various rates of return - Provides the necessary analytical accounting organisation by facilitating the extraction of the information regarding assets, liabilities, income and expenses as a cross-section of the operating segments - Allows reflection of the effect of the management strategy applied on the future development of the entity's business
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Source: Yonkova, 2012; Filipova, 2012

A characteristic feature of the modern corporate reporting is the increasing volume of non-financial information subject to disclosure. According to Robert Elliott „...\"financial accounting\" ... limits the reporting entity's accountability to financial information, and third-wave (companies in the information era, author's note) entities have external accountabilities that go beyond financial information“ (Elliott, 1992, p. 74). There is an increasing need for disclosure of the risks and management judgements and assumptions as part of the information, provided by the internal management reporting. A contemporary trend, which is observed in the development of financial accounting, is the strive towards presentation in the financial statements of information serving the purpose of forecasting certain aspects of the entity's future operations and assessment of the risks it is exposed to (Moolman at al., 2016). This emerges as one of the areas of convergence between the two accounting systems considered.

Financial accounting is more and more noticeably looking at the entity as an active economic subject interacting with the market, thus being exposed to different market risks. The increasing use of fair values in the measurement of certain assets and liabilities is also indicative as to the dependency of the reporting entity on the market changes and their impact on the organisation's financial performance. The focus on the entity's economics is typical for the management accounting as well (Stancheva-Todorova, 2014; Filipova, 2012).

Another interaction between the accounting systems reviewed is also observed with respect to the frequency of presentation of financial statements covering periods shorter than one year, especially valid for public interest entities. This allows financial information to be used in a more operational manner – a characteristic feature of management accounting.

A new area of convergence is detected along the lines of integrated reporting. Its development reaffirms the integration trend between the financial and management accounting systems, which are turning into a major information base of the integrated report.

INTEGRATION OF FINANCIAL AND MANAGEMENT ACCOUNTING SYSTEMS AS A RESULT OF INTEGRATED REPORTING

The coming of integrated reporting is not an accidental phenomenon. It is a process rooted in the changes of the information needs of a broad range of stakeholders, related to companies' environmental, social and governance issues and could be dated back to the mid 50's of XX century. These evolution changes of corporate reporting are gradually transitioning into a new form of integrated reporting. Table 2 presents the main phases of this evolution.

Table 2

Phase	Period	Characteristic features
Phase 1: Emergence of social and environmental information	1960-1990	<ul style="list-style-type: none"> • Advertisements and annual-report sections (environmental-oriented) • No link to corporate performance • Few isolated corporate efforts • Start of quality and environmental management systems • French Bilan Social Law (1979) • Toxic Releases Inventory (1987) expanded by the Pollution Prevention Act of 1990
Phase 2: Sustainability reporting initiation phase	1990-2000	<ul style="list-style-type: none"> • First stakeholders report produced by Ben & Jerry's Homemade Inc. (recommended by the social auditor) • Global Reporting Initiative (GRI); Corporate Impact Reporting; AccountAbility's AA1000 Framework (learning through stakeholder engagement) • Still dominated by environmental reports
Phase 3: Sustainability reporting going mainstream	2000-Present	<ul style="list-style-type: none"> • Third-party certification of the reports • Increase in nonfinancial reports produced during this period (45% of Global Fortune Top 250 in 2002) • Sustainability reports • GRI's Sustainability Reporting Guidelines G2 (2002) and G3 (2006)
Phase 4: Reporting on material issues	Present and Future	<ul style="list-style-type: none"> • Integrated Reporting • The Sustainability Accounting Standards Board (SASB) • GRI's G4 Sustainability Reporting Guidelines
Phase 5: Convergence of corporate reporting frameworks	2014-Present	<ul style="list-style-type: none"> • Corporate Reporting Dialogue Initiative (June 2014) • The Corporate Reporting Landscape Map

Source: IMA - ACCA, 2016, p. 11 (<http://corporatereportingdialogue.com/landscape-map/>).

Gradually entities started including limited disclosures of some environmental issues in their corporate reports, which expanded over time. Some social issues in regard of company's activity effects on employees and society also emerge. The objective is that companies present information

concerning their policies focused on the management of the interactions between the organisation, the society and the environment (Unerman, 2000). Recently such disclosures have been referred to as sustainability disclosures but the term has become subject to criticism, as it does not reflect the essence of sustainability reporting. (Milne at al., 2009). These disclosures become more structured over time, which is facilitated by the development of guidelines supporting and encouraging voluntary disclosures. These early lengthy sustainability reports failed “to focus on the sustainability impacts that are of most significance to the stakeholders or are directly relevant to the business” (Deloitte, 2014, p. 3). Despite the deficiencies this approach to partial disclosures has been used by the end of the past century. The focus remains on the historical financial information of the company rather showing its short-term performance than its potential for value creation in the long run (Ibid., p. 2).

The end of the XX century and the early XXI century has seen an upsurge of the initiatives related to more structured environmental, social and governance company’s reporting. The criticism against the traditional corporate reporting has deepened in the increasing globalisation of the world economy, growing policy activity around the world in response to financial, governance and other crises, heightened expectations of corporate transparency and accountability, actual and prospective resource scarcity, population growth and environmental concerns (GRI, 2011). Allen White, vice president and senior fellow at the Tellus Institute, believes that there is a quiet renaissance in corporate reporting and it is transforming its purpose, content and readership. Accountability failures in cases such as Enron, WorldCom, etc. speeded up this process bringing into the list yet again the failures of the traditional financial reporting (White, 2005).

In 2007 the first guideline “Connected Reporting Framework” was published by The Prince of Wales’s Accounting for Sustainability Project. The objective was to provide guidelines as to how companies may present in an integrated manner their performance and corporate strategy and management (IMA - ACCA, 2016). The International Integrated Reporting Committee (later International Integrated Reporting Council - IIRC) was established in 2010. Its mission is to establish integrated reporting and thinking within mainstream business practice as the norm in the public and private sectors¹.

The overview presented above provides the basis for the conclusion that there are historically predetermined links between the integrated reporting and financial and management accounting systems, while the former can be

¹ For more details, visit <http://integratedreporting.org/the-iirc-2/>

considered evolutionary development of the traditional corporate reporting. The possibility to generate non-financial and future-oriented management information, as well as the importance of the historical financial information presuppose the preservation of the traditional links between the two accounting systems in an integrated reporting environment.

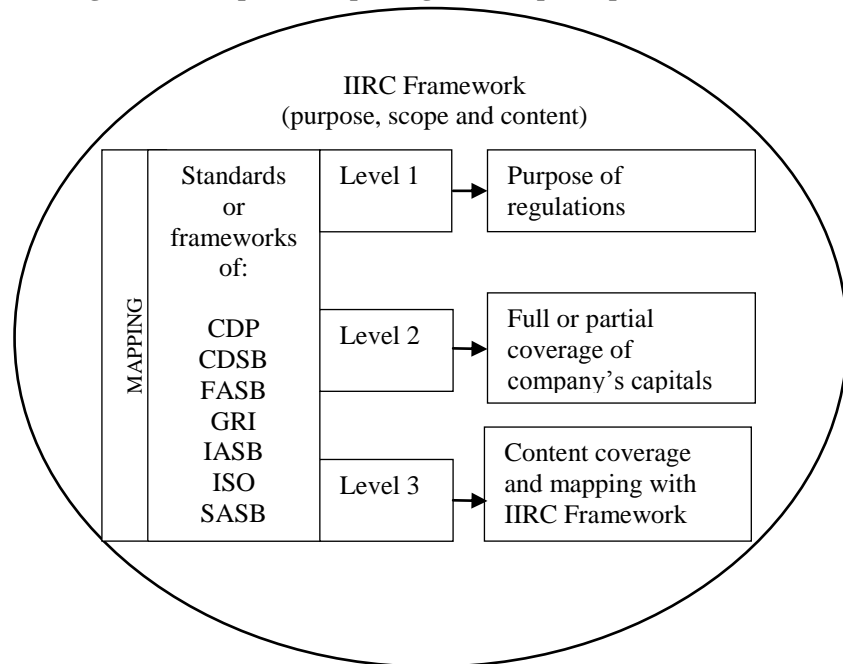
In June 2014 the IIRC has initiated The Corporate Reporting Dialogue (CRD). Its objective is to respond to market calls for greater coherence, consistency and comparability between corporate reporting frameworks, standards and related requirements². Organisations exerting significant influence on the financial and sustainability reporting are involved in it - Carbon Disclosure Project (CDP), Climate Disclosure Standards Board (CDSB), Financial Accounting Standards Board (FASB), GRI, International Accounting Standards Board (IASB), IIRC, International Organization for Standardization (ISO), and The Sustainability Accounting Standards Board (SASB). The objective is to find a solution to a problem broadly discussed over the past years, namely:

- The existence of host of guidelines, both mandatory and recommended, addressing companies' financial, environmental, social and governance reporting;
- Provision of high quality financial and non-financial information for the entity's integrated reporting;
- Ensuring efficient communication between the different information systems of the entity.

In its search for solutions the Corporate Reporting Dialogue has developed and published The Corporate Reporting Landscape Map. Its objective is to assist the users to find their way among the numerous regulations and to contribute to the high quality of the published information. The structure of this document is shown in fig. 2. There is a three-level comparison, where the first level compares the objectives of the standards and reporting frameworks reviewed to the <IR> Framework. The second level provides an analysis of the extent to which the capitals defined in the <IR> Framework - financial, manufactured, human, social and relationship, natural – are covered. It is shown that manufactured and intellectual capitals are not covered by any of the above-mentioned regulations, unlike natural capital, which is presented in 5 of the 7 papers compared. Financial capital is covered only by the IFRSs. It is evident that no comprehensive presentation has been achieved by the standards and reporting frameworks under review with respect to any of the eight elements that should be presented in the integrated report. (GRD, 2014)

² <http://corporatereportingdialogue.com/>

Fig. 2. The Corporate Reporting Landscape Map



Source: GRD (<http://corporatereportingdialogue.com/landscape-map/>)

There is practical possibility for the financial and management information systems to secure information concerning each of the mentioned elements of the integrated report, the basis for which is the efficient communication between different information systems of the entity. The design of key performance indicators and monetized metrics is required in order to provide information as to how the organisation creates value and how its different capitals are being used. The development of such financial and non-financial metrics is within the expertise of accountants. For example, based on their knowledge regarding the accounting for the company's capital, they can identify its value-added and non-value-added activities, relevant to its business model. The risk and opportunities-related information produced by the accounting systems could facilitate the analysis of the external environment and its impact on the company's ability to create value in the future (IMA - ACCA, 2016). Such information system integration requires communication between the different employees of the company, revision of their functions and proper direction of the information and communication flows between them, as well as with the environment.

The use of information from the accounting systems in the preparation of the integrated report contributes to the solution of the issue related to the quality of the latter. A characteristic feature of the accounting systems is the existence of control mechanisms, especially those concerning the information produced for external users. The mandatory financial audit is a guarantee for

the transparency and quality of the information published in the entity's financial statements. Despite the lack of institutional tools the quality of the management accounting information may also be guaranteed through internal audits, separation of duties, assignment of specific control functions, etc.

CONCLUSION

The development of the integrated reporting over the past two decades has resulted in effective practical solutions, the adoption of uniform indicators as to the effects of the utilisation of the capitals, as well as common criteria, which corporate reporting has to meet in order to achieve the sustainable development objectives. On the other hand, companies are facing a serious issue related to the existence of host of regulations concerning the same matters, requiring presentation of information from different sources. This requires more efforts, administrative costs, as well as lack of clarity as to what should be subject to disclosure, who needs this information and how should it be communicated. The users are also having difficulties as according to them corporate reports contain a large volume of immaterial information, which prevents them from grasping the essence of companies' performance.

The development of the integrated reporting has also given rise to the need for reassessment of the role of the accountants. Accountants are currently experts in the preparation and presentation of financial information, but they also have knowledge of multiple accounting tools, as well as well-developed analytical and judgement skills. Therefore, they might not only be involved in, but they could play a key role in multidisciplinary teams in the preparation of the integrated reports. This requires broadening of their knowledge of the non-financial information. The issue concerning the accounting education in an integrated reporting environment by the companies is broader and requires more focus on research initiatives in this area. Integrated thinking is a new concept requiring specific knowledge and skills. Another important aspect is the need to promote the integrated reporting concept as early as tertiary education level, thus provoking reconsideration of the education curricula and syllabi.

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