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## Adaptation of Balance Theories to the Assessment of Sustainable Economic Development of Business Units

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**Abstract:**

*The article deals with the category of sustainable development and its application to business units' activities. The essential ideological basis of the article is the need to combine business interests in profit increment, aimed at increasing stability, through extensive use of balance sheet instruments as well.*

*Financial stability still occupies a vital place, despite a growing priority of environmental and social components of sustainable business development. Its analysis requires the use of static and dynamic balance theories. Their practical application calls for an adequate perception of a current financial and economic situation in a specific place and time period. From this perspective, the authors consider it necessary to use a variety of different balance techniques, depending on specific goals, faced by users of accounting information flows.*

*The researchers make a conclusion about the essential priority of business units functioning longer, even at the expense of short-term achievements of a high level of profitability. In this regard, frequent revaluation of assets should be considered ineffective. This makes it objectively necessary to use both static and dynamic balance theories.*

**Keywords:** Business units, sustainable development, balance theories, accounting principles

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## **1. Introduction**

The article is devoted to defining the essential requirements for development and growth of business units operating under the need to adapt to the requirements of sustainable development and, first of all, to the financial component of this process. Financial stability assessment should be based on an adequate system of accounting and analytical tools and, above all, on balance theories.

The objective is to study and rationalize the most objective and reliable approaches to assessing financial stability of business units, both in terms of cash flow dynamics and from the point of view of preservation and increase of their assets and investment potential.

To achieve the goals and find a solution to the stated problem, in the first place, the study analyzes the interests of accounting information users in relation to the requirements of sustainable development, and, secondly, shows the features of receptivity of credentials, depending on various theoretical concepts and forms of business operation. Thirdly, it demonstrates the perspectives and problems of the use of dynamic and static balance theories from the point of view of stability.

## **2. Theoretical, Informational and Empirical, and Methodological Grounds of the Research**

Modern economic development is characterized by a large group of controversial moments covering both economic issues and strategic ones, comprising conditions and adjoin spheres of management (Havlíček *et al.*, 2013; Thalassinos *et al.*, 2012; Liapis *et al.*, 2013; Thalassinos and Liapis, 2014; Ivanova *et al.*, 2017; Denisova *et al.*, 2017; Hapsoro and Suryanto, 2017). One of such issues is adaptation of economic growth to the sustainable development requirements. In itself, the problem is not new. It has been actively discussed for the past few decades, serving for many countries, including Russia, as a "beacon" of socio-economic development.

Despite the fact that there is no common understanding of the sustainable development category, it is based on a maximum harmonization of economic, environmental and social development, which caters to the present needs without doing harm (or, at least, minimizing it) for future generations. This approach differs significantly from the neoclassical economic views, as it does not prioritize the maximum growth of material consumption and focuses on long-term growth.

In other words, business objectives of business units should be much broader than creation and increase of profits or capital by their owners; they should be guided by the interests of a much greater range of partners, including government institutions, NGOs, trade unions, individuals, potential investors and so on. This approach creates more "comfortable" conditions for functioning business units by ensuring the growing confidence of the society and creating the so-called relationships capital.

It should be noted that each partner group has its priority interests. State institutions (including the taxation authorities) are objectively interested in maintaining and multiplying sources of revenue and maintaining longer terms of business unit sustainability on the market under the policy of economic and social stability. Moreover, the degree of satisfaction of diverse interests (economic, social and environmental) of specified groups of users forms a long-term business unit sustainability, which largely determines the perspective value of companies. In this respect, current financial accounting should be critically assessed from the standpoint of meeting users' needs.

It is known that in different countries financial information is more or less explicitly orientated to specific groups of users, due to essential historical and evolutionary, economic and national characteristics. It is believed that the most harmonious combination of interests of public institutions, entrepreneurs and employees is observed in Germany. A radical predominance of private business interests over its other types is characteristic of the Anglo-American accounting model. In Russia, a number of continental accounting model countries, Japan and the Nordic countries, the priority is given to public institutions, while in some Islamic States social institutions prevail. In theory, it can be assumed that the most adequate co-existence of different interests should be ensured by the state, and, in this respect, an accounting system, focused on national interests, possesses a greater stability.

However, in practice it is not so, because the state not always can be the public institution that is impartial and exercise its functions without giving preference to one or another group. And in this regard the experience of Russia is very revealing. The Russian state has traditionally exploited the services of information and accounting systems, solving the problem of maximizing the state's influence on the society and enforcing tax obligations, regardless, in some cases, of social and economic requirements. But in practice the business community has successfully overcome the excessive care of state institutions, using of a variety of corrupt practices, tax evasion (legal and illegal), or setting up tax havens.

Under these conditions business initially starts searching for and then practically implements the most high-yielding economic projects. Such projects are generally selective and concentrated in the most profitable sectors of economy (trade, construction, some services), or in the commodity sector, where integration of financial and industrial capital, as well as control over the sales markets, reaches its maximum. An inherent element of such business activities is minimizing expenses, including standing ones, for example, costs, related to social and environmental aspects of management (Nikolova *et al.*, 2017; Anikina *et al.*, 2016).

This reduction of expenses can only be possible at certain stages of business processes and individual products existence, namely at the stage of stability. But periods of stability cannot be mothballed and are usually followed by periods of change. Business units have to take care of increasing their efficiency, especially, in

operating matters, and at the same time constantly monitor the environment in order to develop preventive actions to expected changes. Moreover, one of the most important areas of modern analytics is collection and processing of information about the status of business processes and the use of certain factors to optimize the latter.

It is believed that long-term stability leads to narrowing of market niches for a particular company and, as a consequence, to a fall in the volume of sales and business value. And the larger a company is, the more difficult it is for it to initiate reorganization proceedings. This situation objectively arises from the essential premises of the neoliberal economic model, which was based on the priority of consumption and increasing competition for a potential buyer. A product, introduced to a particular market, cannot maintain the same consumer properties even within a medium-term time frame, as consumer qualities of goods get outdated quickly. To adapt to new customer demands, manufacturers are forced to upgrade their products continuously, almost certainly affecting technological aspects of production.

With these changes, it is difficult to talk of maintaining stability of the reproduction process in a broad sense of the word, although it directly influences financial stability. And here it is necessary to choose the most appropriate analytical assessment options for this category. Marginal analysis, for example, is appropriate only in forecasting. The real financial situation related to estimating profits cannot be determined (paradoxically) only on the basis of financial statements reports.

The reason is that a statement of financial results shows an accrued income and expenses, i.e the factors for which there are real cash savings, as well as those which presuppose money transfers in the future. This gap often leads to an economic shock for businesses, since the profit potential is not transformed into a situation where funds actually become available. Reporting a financial position and profit will not allow obtaining information about specific sources of cash income and basic directions of their use, while studying a company's liquidity and solvency requires receiving information on income and cash payments (or their equivalents) during a given reporting period. This information is to be accumulated with the help of a cash flow statement.

According to IFRS 7 "Cash flow statement", cash recourses include not only cash which is on hand, banking accounts and demand deposits, but also so called cash equivalents, consisting of short-term highly liquid investments that can be easily transformed into a certain amount of cash and are characterized by an insignificant risk of changes in value. They are vital for companies not so much for their investment income, but for providing short-term liabilities. However, an exhaustive description of the cash equivalents list does not exist, and IFRS allows business entities to determine the above list by themselves, but without attaching a company's sharing commitments to it. It remains possible to attribute bank overdrafts to it when they are integral elements of money management.

In particular, profits and interests, both received and paid, can be classified as part of an operating activities cash flow, since they are included in the concept of profit (loss) during the reporting period, although the interest paid and dividends can be also presented as part of a financial cash flow, as they are connected with external funding. That causes major theoretical and methodological complications.

### **3. Results**

To solve the existing theoretical and methodological difficulties in assessing sustainable development and its financial component, accounting institutions use a variety of transformations and interpretations of accounting data from methods of deliberate "embellishing" of a financial situation up to obtaining extremely conservative characteristics based on real dynamics of a cash flow and funds at the disposal of an economic entity. In our opinion, business owners have the most objective accounting information. They regularly carry out comparative analyses of the invested capital effectiveness, combined with alternative methods from the points of view of both accounting and economic profit. The latter objectively pushes owners to most accurate calculation of expenses and costs of production.

However, even in these conditions, we cannot ensure the absolute reliability of accounting, as D. Zappa (1982) formed a well-known postulate that, from the standpoint of accounting, a company's income is estimated more precisely than the costs. This arises from the fact that profit, as a rule, is well documented (especially sales income), while the amount of expenses depends on a variety of subjective factors associated with the choice of accounting policies, administrative influence on accounting, level of an accountant's professional skills.

A certain influence is exerted by a range of balance generalizations, as the owner (management) gives the priority to a dynamic balance interpretation, which allows calculating the financial results and the effectiveness of a full-time company more or less accurately. The latter implies impossibility of re-assessment, as the assets consist of a strictly defined capital, whereas re-assessment implies deducing costs, which in fact did not occur. It distorts the sources, financial results and funds. The assets of dynamic balance consist of invested capital only, rather than the assets which can be sold. Within a dynamic balance, incomes understood as payments already received or to be received during a particular reporting period are defined more clearly, unlike increasing or decreasing in accounts payable, and even authorized capital is demonstrated in the form and size of actually incoming cash.

However, despite the fact that the dynamic balance allows to reveal actual financial results more clearly to the owner, which can be seen from the role played by the "Gains and losses" account in achieving sustainable development, some more attractive features can be revealed within a static balance approach. Here more attention is paid to the process of reservation, study of profitability in relation to the entire invested capital, regardless of the fact whether it is private or called up from

outside, a clear comparison of business performance assessment at current prices, absence of the "goodwill" notion (this is not the property which can be sold).

At the same time, when we consider successful and long-term functioning of a business unit as an important criterion for sustainability, we are confronted with a paradoxical situation. It is known that a free market competition environment encourages a continuous (and in some cases intensified) process of formation and elimination of certain companies. Suffice it to say that out of ten established business units only one to three survive until the next financial year. In fact, it violates one of the fundamental principles of accounting - the principle of continuity or ongoing concern. This principle is typical for the dynamic accounting interpretation, although some of its elements are used in the static balance theory.

The static approach is rigidly linked with creditors' needs, when the property and debts of a company must be evaluated separately in order to identify and meet external financing requirements. In other words, it determines the ability of an economic entity to fulfill its obligations.

At the same time, the dynamic balance theory considers the principle of an operating enterprise to be the main point of a particular accounting model. With this approach, you can assess the financial performance more accurately and minimize the attempts to reevaluate significant objects. The longer a company functions, the less useful it is to reevaluate the assets because, when it is liquidated, the assets are assessed according to the actual situation on the market. If a company is sold, the entire accounting component remains the same, since only the owner changes.

And in this respect it is interesting to note that the development of contemporary international accounting and IFRS in particular clearly points out the priority of fair value assessment of an economic entity. However, this contradicts the dynamic theory of accounting, although there is still no precise legal definition of a fair value assessment.

The legal interpretation in the majority of Western countries, first of all in the US, points at non-equivalence of fair market value. Fair value is considered to be mainly a legal category, and adding the term "market" to it refers to appearance of an estimation criterion. Fair market value is largely adapted to the notion of market in its open and active interpretation. In terms of individual differences the attention is drawn to the criteria of voluntariness, absence of pressure, awareness, applicability to shareholdings within the framework of fair market value, rather than to market value as such.

However, the final interpretation of the concept of fair value remains the prerogative of local courts. In general, analyzing the static and dynamic balance theories in terms of stability it is impossible to give a clear advantage to any of them. The general trend of global business development is characterized by the desire for a

long-term operation of its individual units, even at the expense of gaining profit. This contradicts both concepts, as the dynamic concept is focused on the most assessment of financial results, and the static one is not rigidly linked with the principle of continuity, which has a definite impact on the system of assessment criteria for a company's investment attractiveness. The latter is based on details of financial and economic activities of business units, focused primarily on external users and being a combination of quantitative and qualitative characteristics giving verification to economic expediency of investments.

#### **4. Conclusions and recommendations**

The authors of the study came to a conclusion about an urgent need of comprehending sustainability as a complex category, which must harmoniously combine its social, environmental, financial and economic components, the latter being still dominant.

The importance of running a business should be clear to various stakeholder groups and public institutions. Nonetheless, business units should take care of increasing their financial and economic efficiency with the priority shift to more long-term operations on the market. In these circumstances, we need to strengthen accounting and analytical support of the financial component of sustainable development, which should be based on a system of assessment criteria reflecting the most coherent definition of a financial result and an ability to meet external financing requirements at the same time. This is why we need a dialectical understanding of specific features and capabilities of balance theories, their use being based on a high level of professional accounting judgment.

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