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THE QUALITY OF FINANCIAL STATEMENTS DURING THE CRISIS PERIOD

Abstract: The aim of this paper is to investigate the quality of financial statements during the period of crisis. The crisis has a negative effect on the business performance of a company. It is necessary to measure and analyze various aspects of performance and take timely corrective actions in order to achieve business stability. Quality of financial statements can be expressed as one of the business performances. High-quality financial statements are created in an accurate, timely and reliable manner in accordance with all requirements of regulation. Professional accounting regulation determines a large number of obligatory disclosures which have a direct impact on the quality of financial statements. This paper will analyze the quality of financial statements from the aspect of disclosures according to the International Accounting Standard 2 – Inventory (IAS 2). Inventory represents significant assets for production and trade companies. Therefore, the quality of disclosures according to IAS 2 can be significant for adequate business decisions. The research is based on a sample of agricultural and manufacturing companies registered in the AP Vojvodina during the period 2020-2021. The research is based on a descriptive analysis of the quality of disclosures according to the IAS 2 and financial reporting quality index. The results indicate that 41% of the obligatory disclosures are presented in companies reports. Accounting policy for inventories and carrying amount according to inventory classification are identified as disclosures of high quality. On the other hand, disclosure of the write-down of inventories, recognized as an expense for the period is identified at the lower quality level. The research can be of interest for managers, owners, and creators of financial statements in order to improve the quality of financial reporting as a result of disruption during the period of crisis.

Keywords: financial statements, quality, inventory

1. INTRODUCTION

Financial reporting is the collection, processing, analysis and presentation of accounting information based on company's operations for the decision-making purposes on behalf of a large number of users. Observing the users of accounting information, it is important to mention the division of users into internal (company management, professional services in the company, etc.) and external users (potential investors, creditors, the state, etc.). Regardless of who the users of accounting information are, the purpose of use is the same and is reflected in the decision making process, which has to ensure the efficient allocation of limited resources. The main goal of general-purpose financial statements is to provide data on the financial position, business assets, effects of business changes and other transactions of the reporting entity (IASB, 2018). In order to ensure this goal, it is necessary that financial statements provide data on assets, liabilities, capital, income, expenses, profit or loss, contributions and distributions to owners, as well as cash flows (IASB, 2009).

It is known that many corporations operating in different countries around the world, regardless of the degree of local development of regulatory accounting regulations, prepare financial statements for external users, and the way of reporting may differ. With the development of global business, there has been an integration of local and international markets, as well as the exchange of goods, services and information between countries. Under such conditions, entities perform a myriad of different transactions that require unique accounting treatments. For this reason, there was a need for standardization of accounting regulations, in which international professional bodies contributed the most, which enabled greater transparency and comparability of information, as well as better understanding and trust by interested parties.

The regulatory basis of financial reporting represents a methodological framework of financial reporting for busimess entities and consists of a set of laws, regulations, standards and principles that regulate the way financial reports are prepared and presented. The regulatory framework of financial reporting can be grouped into three segments, or levels: professional accounting regulations, legislative and internal accounting regulations. The first level is the most comprehensive and represents the international element in the formation of accounting methodology, which includes professional regulatory bodies and committees that are authorized to define accounting standards. The two most important boards that belong to this level are the International Accounting Standards Board, IASB and the Financial Accounting Standards Board, FASB. The International Accounting Standards Board (IASB) has created the International Financial Reporting Standards, which include Standards and Interpretations, namely:

- International Financial Reporting Standards, abbreviated as IFRS,
- International Accounting Standards, abbreviated IAS,
- International Financial Reporting Interpretations Committee abbreviated as IFRIC, and
- Conceptual Framework for Financial Reporting.

Professional regulations through individual accounting standards define a set of mandatory disclosures of information in the company's financial reports. Publishing information in a complete and accurate manner ensures financial reporting of a high level of quality. Nowadays, accountants are faced with a big challenge, which is precisely reflected in the fact of how to adequately respond to the requirements of standards regarding the publication of information in financial reports. The professional regulation defines which information is of a binding nature in terms of publication, which is of a voluntary nature and finally which additionally affects the component of improving the quality of financial reporting of the company. On the other hand, the professional regulation does not define the way in which specific information should be published, which represents an additional challenge for accountants in terms of providing reasonable, complete and accurate information according to the requirements of the standard.

The paper will analyze the quality of financial reporting of companies registered on the territory of AP Vojvodina for the period 2020-2021. The quality analysis should indicate the extent to which companies comply with the requirements of professional regulations in terms of reporting, especially from the aspect of publishing information on stocks according to IAS 2 - Inventoris in a period of crisis. Furthermore, the results of the research will indicate critical areas and possible ways for improvement of quality of the company's financial reporting.

2. LITERATURE REVIEW

Professional accounting regulations are the first pillar in ensuring a high-quality financial reporting system. The specific advantages realized by the implementation of professional regulations, especially IAS/IFSI, are reflected in the following (IFRS, 2023):

- Ensuring transparency due to the improvement of international comparability and improvement of the quality of financial reporting.
- Implementation of standards strengthens management accountability by reducing the information gap between capital owners and people entrusted with capital management.
- Improving economic efficiency by helping investors identify opportunities and risks globally along with the improvement of capital and resource allocation.
- At the level of an individual company, the standardization of financial reporting provides a unique and reliable accounting language and reduces the costs of international financial reporting.

When talking about the quality of financial reporting, it is necessary to highlight the components that determine the quality of the financial reporting system. According to the Conceptual Framework (IASB, 2018), for financial information to be useful, it must be relevant and of a fairly manner in terms of what it represents. The usefulness of information in financial reports is further increased if it is comparable, verifiable, timely and understandable.

The question of the quality of financial statements is a subject of study for a large number of authors and professional accounting organizations. The quality of financial reports is studied from different aspects, which can, for example, include an assessment of the quality of the financial report as a whole or, for instance, assessment of the quality of the financial report at the level of the requirements of a particular standard of professional regulation.

The quality of financial reporting on property, plant and equipment in Serbia indicates that companies do not sufficiently meet the requirements of IAS 16 –Property, Plant and Equipment (Obradović, 2014). The authors emphasize low level of quality of financial reporting on property, highlighting in particular that there are companies that have not published even basic information on property, such as basis of measurement and used method of property depreciation.
Through descriptive analysis, research was conducted on the quality of financial reports of companies in Serbia from the aspect of reporting on related parties (Jakšić, 2010). The results of the research show significant deviations from the requirements of the International Accounting Standards, primarily with regard to the disclosure of the remuneration of key management personnel, as well as the terms and conditions under which transactions between related parties were carried out. Full disclosure of information in accordance with current regulations was made in 19% of the investigated financial reports.
Research on the relationship between company size and the quality of financial reporting was conducted by Glaum et al. (2013). The authors point out that the size of the company is a key factor that affects the level and quality of publishing information according to the requirements of professional regulations. The results of their research showed that larger companies allocate more funds for the needs of financial reporting and improvement of the quality of financial reporting in comparison to smaller companies.
The quality of financial reporting according to the requirements of IAS 41 - Agriculture was analyzed at the level of companies in Serbia for the period 2014-2016. Among other results, the authors emphasize the low level of quality, stating that on average only 29% of mandatory information is published at the company level according to the requirements of IAS 41. Also, it is noticeable that there are companies that do not publish any information according to the requirements of IAS 41 (Mirović et et al. 2019).
Research on the quality of reporting according to the requirements of IAS 16, at the level of hotel companies in Serbia and Croatia was conducted on the basis of financial reports from 2019. The research results indicate that the fair value model, as a method of subsequent recognition, is more common among hotel companies in Serbia, while in Croatia most hotel companies apply the historical cost method. In companies of both observed countries, the needed for improvement of the quality of financial reporting according to the requirements of IAS 16 is recognized, given that the companies do not fully meet the requirements of the specified standard (Milašinović et al., 2022).
Hladika et al. (2021) investigated the quality of reporting on the subsequent measurement of property, plant and equipment according to the requirements of professional regulation at the level of 500 large and medium-sized companies in Croatia. The research was conducted at the level of financial reports for the period 2014-2018. The author identified that there is 20% of companies that fulfill all disclosure requirements for revalued property, plant, and equipment, according to IAS 16 and fair value according to IFRS 13. Further, low level of financial reporting quality can be explained by the fact that there are 48% of companies that do not fulfill the requirements of the standards (IAS 16 and IFRS 13) and do not disclose any information on revaluation and fair value.

3. METHODOLOGY

The main goal of this paper is to investigate the quality of financial reporting of companies registered in the territory of the AP Vojvodina, particularly from the aspect of fulfilling the requirements regarding the publication of information on inventories according to IAS 2 - Inventories. Inventories represent the company's current assets, whose lifespan is less than 12 months. The basic forms of inventories are inventories of material, unfinished production, finished products, goods, etc. Inventories are of a high importance for the regular implementation of business activities, because they ensure a smooth running of the business processes. On the other hand, quantities of inventory larger than necessary can create expenses for the company due to their depreciation over time (Bragg, 2010). In most agricultural and manufacturing companies, inventories represent a significant category in total assets. Adequate inventory reporting can therefore have a decisive impact on the quality of a company's financial reporting (Hulya, 2020).
The quality of inventory disclosure according to the requirements of professional regulation is viewed from two aspects. The first aspect includes a descriptive analysis of financial reporting on inventory of each individual request at the level of enterprises in the Autonomous Province of Vojvodina. IAS 2 defines a range of mandatory and voluntary reporting on inventories in paragraph 36 (IASB, 2005). The reporting of inventories according to the requirements of IAS 2 was observed based on the existence of:

- accounting policy for inventories,
- carrying amount, generally classified as merchandise, supplies, materials, work in progress, and finished goods,
- the book value of inventory is carried at fair value reduced by the costs of sales,
- cost of inventories is recognized as an expense (cost of goods sold),
- amount of any write-down of inventories is recognized as an expense for the period,
- other information such as carrying amount of inventories pledged as security for liabilities, amount of any reversal of a write-down to NRV and the circumstances that led to such a write-down.

The second aspect of the analysis includes the evaluation of the quality of disclosure at the level of IAS 2 - Inventories according to the quality index of financial reporting. When calculating the quality index of financial reporting, other information regarding individual standards will not be taken into account, since this information cannot be verified from the aspect of existence or non-existence only based on an insight into the financial statements.
The quality index of financial reporting is calculated according to the following formula (Goncalves et al., 2014).

$$In\partial exFI = \sum \frac{di}{m}$$

Symbol translation:
IndexFI – financial reporting quality index,
di = 0 or 1,
di = 1 if the requirements are disclosed,
di= 0 if the requirements are not disclosed,
m = maximum number of requests that can be disclosed.

The research in this paper was conducted on the basis of a sample of 216 observations of companies registered in AP Vojvodina for the period from 2020-2021. For the purpose of this research, the sample was formed on the basis of financial reports of companies from the sector registered on the territory of AP Vojvodina, which are publicly available on the website of the Agency for Business Registers (The Serbian Business Registers Agency, 2023).

4. RESULTS AND DISCUSSION

Following are the results of the conducted research on the quality of inventory reporting according to IAS 2. IAS 2, paragraph 25, requires that inventory output values are calculated according to FIFO (first-in-first-out) or according to the weighted average cost method, whereby the same method should be used to calculate the output of stocks of similar nature and similar purpose. Adopted policies and accounting methods should be presented in the financial statements. From the total number of observed companies for the period of 2020-2021, 87.04% reports on accounting policies and the method for calculating the inventory output. On the other hand, 12.96% of companies that have the stated the value of inventory in their financial statements do not display the specified mandatory information (table 1).

Table 1. Disclosure of accounting policy for inventories

Accounting policy for inventories	2020-2021
Average cost	85.19%
FIFO	1.85%
No information	12.96%
Total	**100.00%**

Source: Authors` calculation

Table 2 presents the results of the research on the quality of reporting using the book value for inventories according to the classification of inventories included in the notes to the financial statements. It is noticeable that 70.37% of companies publish more detailed information about the types of inventories in the notes to the financial statements.

Table 21. Disclosure of carrying amount, generally classified as merchandise, supplies, materials, work in progress, and finished goods.

Carrying amount for inventories	2020-2021
Yes	70.37%
No	29.63%
Total	**100.00%**

Source: Authors` calculation

IAS 2 establishes the possibility of recording inventory at fair value reduced by sales costs, and thus creates the obligation to report on these inventories. At the level of companies in AP Vojvodina, 9.26% of companies report on the fair value of inventory reduced by sales costs. Looking further at the requirements of IAS 2, the standard dictates that the book value of sold inventories is recognized as an expense of the period in which the income associated with them is recognized. In regards to that, the amount of expended supplies has to be disclosed in the financial statements. Observing the fulfillment of the aforementioned request for the period 2020-2021, 45.37% of companies reported on the previously mentioned information in their financial statements (table 3).

Table 3.2 Disclosure of cost of inventories recognized as expense

Disclosure of cost of inventories recognized as expense	2020-2021
Yes	46.30%
No	53.70%
Total	**100.00%**

Source: Authors` calculation

Regarding the fulfillment of the requirements for reporting on inventory write-offs, it is noticeable that 40.74% of companies present the previously mentioned information in their financial reports (Table 4). This result should be carefully analyzed, because the write-off reporting is related to the existence of the inventory write-off, and not only to the mere existence of the inventory as an asset of the company.

Table 4.3 Disclosure of amount of any write-down of inventories recognized as an expense in the period

Write-down of inventories	2020-2021
Yes	40.74%
No	59.26%
Total	**100.00%**

Source: Authors` calculation

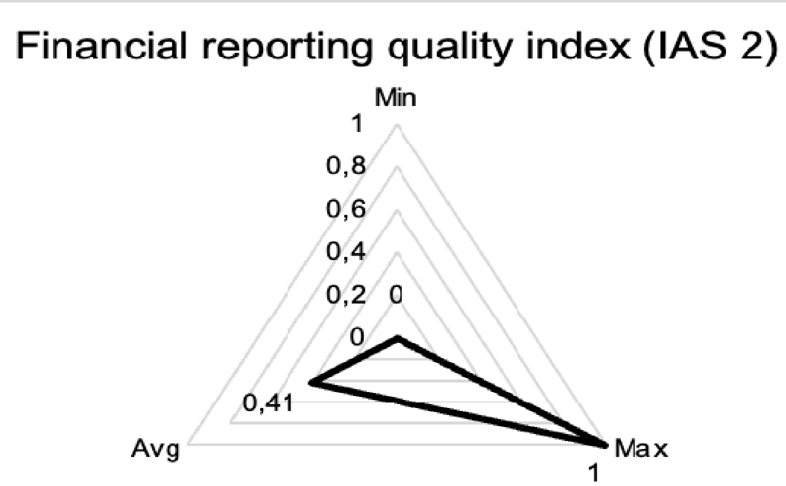
The following table presents the quality of reporting on other information related to inventory. The only additional information is about inventory pledged as a guarantee, which was shown by 10.19% of companies in AP Vojvodina. It should be noted that no companies have been identified that disclosed information regarding the cancellation of write-offs. Also. companies that disclosed information regarding events that did not happen were not identified, which may be of interest to business decision makers.

Table 5. Disclosure of other information according to IAS 2

Other information about inventory	2020-2021
Reversal of write-off	0%
Carrying amount of inventories pledged as security for liabilities	11.11%
Transaction that was not realized in previous period	0%

Source: Authors` calculation

Observing the quality index of financial reporting according to IAS 2, it can be seen that the average value of the index is 0.41, which means that on average companies publish 41% of the observed information (Picture 1). It should be noted that there are companies that fully publish all the required information according to the requirements of IAS 2. The quality of financial reporting on inventories at these companies is assessed at an extremely high level. On the other hand, there is a smaller number of companies that do not publish any required information in accordance with the requirements of IAS 2.



Picture 1: Financial reporting quality index according to IAS 2
Source: Authors` illustration

5. CONSLUSIONS

The quality of financial reporting on stocks of companies in AP Vojvodina according to IAS 2 is at a relatively acceptable level, given that almost all companies show accounting policies and methods of calculating inventory output, as well as information on the book value of inventory according to their classification. Reporting on the amount of inventory recognized as an expense during the period stands out as a critical area of financial reporting on inventories at companies in AP Vojvodina. Given that inventories have a shelf life of up to 12 months, companies must report on transactions that cause the expenditure of inventory during the accounting period. The results indicate that almost every other company in AP Vojvodina presents information on the expenditure recognized during the period regarding the inventory position.

Regarding the reporting of fair value, existence of write-offs, inventory provided as guarantees, research results must be taken with a grain of salt, considering that these reports are only related to the existence of the mentioned business events. Also. it is notable that companies do not provide additional information about transactions and events of those that did not occur, which could provide more complete information for business decision-making purposes. So, for example, even if there are no inventories that have been provided as a guarantee, the company can report this in its financial statements. In this way, complete and relevant information for business decision-making is provided and doubts among the users of financial statements are removed as to whether there are inventors provided as a guarantee without the company reporting this in their reports.

The results of this research indicate a stable level of quality reporting on inventories during the crisis period; 2020-2021. The existence of a relatively short research period can be highlighted as a limitation of the mentioned research. Future research should continue on the period of the crisis that was observed and conduct a trend analysis regarding the quality of financial reporting for the period during and after the crisis. The research results are primarily of interest to company management and accountants, who based on the identified critical areas can make decisions for the improvement of the quality of financial reporting. Also, the research results are of interest to external users in order to provide complete and relevant data for business decision-making.

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