

A SURVEY REGARDING THE QUALITY OF FINANCIAL STATEMENTS

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ABSTRACT: The paper aims at bringing arguments for the necessity of improvement of the financial statements of the companies. After highlighting the limitations of the information included in the financial statements and proposing some measures of qualitative improvement, there are analyzed the results of a survey, performed in the western area of Romania, that wanted to seize the needs and expectations of the users as far as concerns the accounting and financial information provided by the Romanian companies.

Keywords: financial statement, quality, users, information

JEL Codes : M21, M41

Introduction

Recently, the substance and contents of financial statements have been permanently improved, thus that right now the financial reports comprise also an image of the cash flows and a situation of the equity, next to the profit and loss account and the balance sheet. One can believe that these elements of the financial statements set represent a strictly quantitative approach, while the usefulness of information included in the financial statements must be quantified also from a qualitative point of view. The financial statements come from the interaction of three important parties: the companies whose activities are subject matter of accounting and financial information, accountant professionals, as well as the broad category of users of accounting and financial information.

By considering the three categories of actors concerned with the usefulness and accuracy of accounting and financial information, one can draw the conclusion that the vital part in improving and enhancing the substance of financial statements belongs to the accountants. However, at the same time, the published information bears the mark of expectations belonging to the accounting and financial information users, who envisage to determine certain indicators of the profitability, liquidity or solvability of the company.

So the question remains: is the current accounting and financial information meeting the demands of its users? The rest of the paper is structured as follows. Section 2 makes a brief presentation of the limitations of the financial statements and possible improvements. Section 3 analyses the results of a questionnaire, that wanted to seize the needs and expectations as regards the accounting and financial information provided by the companies in the western part of Romania. Section 4 concludes.

Limitations of the financial statements and possible improvements

Profitability of companies derives from analyzing the profit and loss account, where one can find also the estimate values corresponding to some past periods. The estimated values concern amortizations or provisions, which influence the accounting profit of the companies. Thus, the

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result emphasized in the profit and loss account can sometimes be grounded by using certain accounting options or by changing the accounting methods. In order to acquire additional information, users can analyze the notes attached to the financial statements but not all information can be found (the results are not indicated in the case when the accountant would have chosen a different accounting processing).

Users could acquire a relevant image on the profitability of the company if they could obtain comparisons to other companies, and not just comparisons concerning the economic entity subject to analysis, for various periods. As stated, the comparisons between companies can be irrelevant if they use different accounting policies, and the accounting information of various companies cannot be compared. As an example, in the case of expenses for amortization, the registered value depends of variables such as useful life, residual value and chosen amortization method. If one considers indicators such as liquidity or solvability, incongruities can occur in this case too. The liquidity degree of a company relies on its current assets and liabilities. Thus, by analyzing the financial statements, the users can set out the ratio between the current assets and liabilities and can notice whether the company under scrutiny has liquid moneys. However, difficulties appear when interpreting the current asset and liability concepts, in the meaning that the current elements are considered those registered in a 12-month period since the date of the balance sheet.

The limitations the users are bound to observe in connection to the information in the financial statements can be synthesized thus (Berheci, 2006):

- synthesis documents rely on estimates of various values, which indicates their subjective character;
- accounting and financial information refers to the past, while the decisions of accounting and financial information refers to the future;
- in most situations, the assessment basis of values from the financial statements is represented by the historical cost;
- important pieces of information cannot be included in the financial statements because they are not expressed in money (information that refer to the value of human capital);
- some pieces of information cannot be published by companies in the financial statements because they would generate competitive advantages;
- freely setting out the applied accounting principles and rules generates results followed by accountant professionals and not real information through the creative accounting;

However, despite the existence of limitations indicated above, one must admit that the financial statements are the bases of most of the economic decisions of the users. Due to this reason, certain manners of perfecting the content and quality of accounting and financial information must be used, in order to enhance its credibility. I believe opportune using forecasted accounting information too because the financial statements show the past, while the decisions of the users refer to the future. Thus, the forecasted information can be drafted as forecasted budgets or forecasted financial statements. Normalizing the supply of forecasted information is a manner of improving the accounting information offer that must rely, however, on the professionalism of issuers. In the case of forecasted information, a series of risks appear, such as affecting the confidentiality of information and generating some competitive advantages or lack of accuracy concerning the information that refers to the events that will take place in the future.

Right now, the users of accounting and financial information believe drafting the image of cash flows as being gradually more necessary. This aspect derives from the fact that the accounting result does not meet the information needs due to subjectivism involved when determining it. Thus, it is necessary to acquire an objective indicator such as that concerning the company's cash flow. At the same time, the financial reports might also comprise special information for employees, a so-called social balance sheet, as it is the case in other countries (e.g. France). The social balance sheet

includes, among others, information that indicates the education and experience of human resources, team relations and safety of work places. I believe useful for the users the provision of risks that a commercial company might face and, as consequence, presenting the measures for managing them.

In a recent study, Armstrong et al. (2009) analyzed the mechanisms that can be used to reach a transparent informational environment of the company that would lead to an efficient corporate governance of the company. Among these, I mention here the need for the company to draft regular reports in connection to the economic and financial situation, also by presenting negative accounting and financial information (conservative accounting), the need to employ an external auditor, well-experienced in this area, that would check the activity of the managers, encouraging the participation in the company's management team of some external managers with high professional training or attracting representatives of institutional investors or company creditors for monitoring the activity unfolded by the company's internal managers.

Of course, the matter of efficiency of these measures of diminishing informational dissymmetry can be raised too considering that the financial information that becomes public might endanger the company, at the same time with other user categories, such as direct rivals accessing the information. Some authors suggest that, as regards certain financial or economic aspects of the company, the accounting and financial information is preferable to reach some external managers of the company that monitor the activity developed by the internal managers, through some private information means (internal reports, presentations, notes, etc.). On the contrary, Armstrong et al. (2009) argues that it is less probable for the external managers of the company to rely only on the information provided and "filtered" by internal managers in order to achieve their monitoring and consultancy activity. Representation conflicts will continue to appear between managers and shareholders when the managers have reasons to use actions that are detrimental to the shareholders' interests. In such cases, Armstrong et al. (2009) showed the inefficiency of private information documents, arguing that if managers are interested in hiding something (a non-profitable project, exaggerated costs, low performance, and various problems of the accounting statements), it is very likely that the information presented to the external managers not to indicate the real situation of the company. Thus, they would use the "filtration" of information presented to the external managers. As regards this, it is preferable for the accounting and financial information to be made public, by some regular reports, which are certainly more credible than the private information documents, being subject to the legislation in this area and to the report drafted by an auditor. Moreover, being transparent, other parties can analyze the accounting and financial information, including the mass media, a thing that would lead to increasing the actual monitoring of the company by uncovering the possible abnormalities. Other author have focused on the quality of the financial and accounting information (Armstrong et al., 2010, Barth et al. (2001,2006), Cole et al. (2007), Daske and Gebhardt (2006), Lee et al. (2002)).

Needs of financial information users. Analysis of an investigation

Data and methodology used

The study we made considered the analysis of responses given by a broad range of users to a questionnaire structured on several questions that wanted to seize their needs and expectations as regards the accounting – financial information provided by the companies. For being able to achieve this goal and for differentiating their answers, I believed necessary to divide the respondents into relatively homogenous user groups by using a stratified sample. This was made by dividing the identified respondents group in the next sub-categories: creditors (analysts of loans from banks, bank managers); financial analysts (accountant experts, auditors); owners of companies or managers.

The respondents represented the organizations using accounting and financial information or individual users, according to the data presented below (Table no. 1). The questionnaire was given to 200 respondents from the western area of Romania.

Table no. 1

Structure of questionnaire respondents

	CREDITORS	FINANCIAL ANALYSTS	MANAGERS / OWNERS	Total
<i>Identified respondents</i>	97	92	65	254
<i>Actual participation</i>	80	60	60	200
<i>Participation rate</i>	82%	65%	92%	79%

Source: realized by the authors

The respondents were asked, within the applied questionnaire, to identify the user category to which they belong. Responses given were considered for analyzing the results of the questionnaire. Three user categories actually participated in the questionnaire, as indicated by the figure presented below (Figure no. 1).

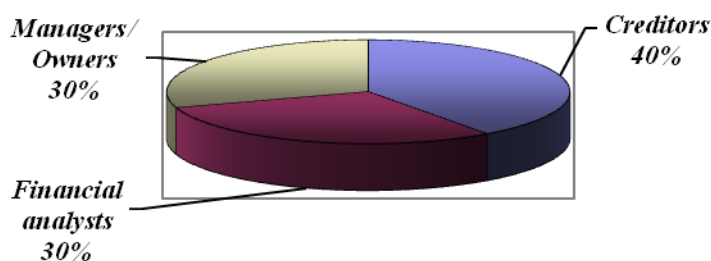


Fig. no.1. Structure of questionnaire respondents

Source: realized by the authors

Creditors represented 40 % of the respondents; as consequence, their standpoint had a greater influence as regards the results of the study. Next to them, the accountant experts and auditors categorized as financial analysts held a smaller percentage, 30. The same percentage, 30, belonged to the *financial managers of companies and owners*, seen as potential investors and users of accounting – financial information.

Individual analysis of responses to the questionnaire

The first question was asking the users to name a type of accounting and financial information considered by them as the most useful. They had to choose between: financial statements; declarations made by the company’s management; other sources (respondents were asked to indicate up to 3 additional information sources; the news of mass media, economic polls, and information appeared on the market were supplied as examples).

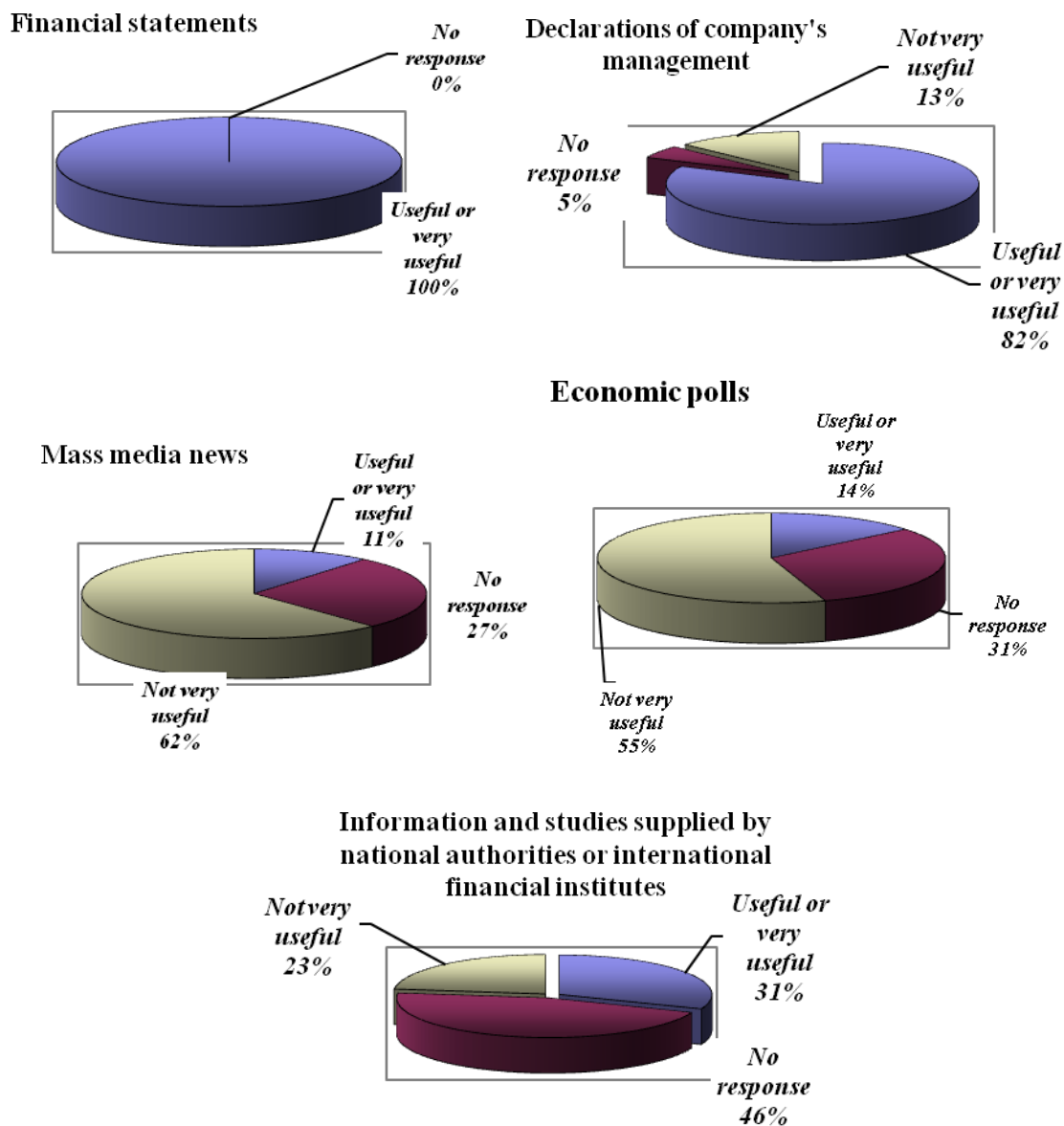


Fig. no.2. General results to question no. 1

Source: realized by the authors

The objective of question 1 was to determine the relative importance of the accounting and financial information for the decision-making process. The responses indicate the fact that: respondents believe the financial statements and declarations of the management team as being the most useful sources of accounting – financial information; other financial information forms are deemed less important by accountants and managers / owners, while the creditors mention, in a descending importance order, as being fairly useful the next types of accounting – financial information too: mass media news, economic polls, information and studies supplied by national authorities (National Fiscal Administration Agency, Ministry of Finance, National Statistics Institute, etc.) or international financial institutes, information from the market (www.marketalerts.ro, etc.), and other financial statements supplied by companies (income and expenses budget, clients – suppliers list, etc.).

The second question of the survey aimed at highlighting the level of satisfaction with the accounting and financial information that exist in the: financial statements, declarations made by

the company's management, other information sources mentioned in the users' responses to question no. 1.

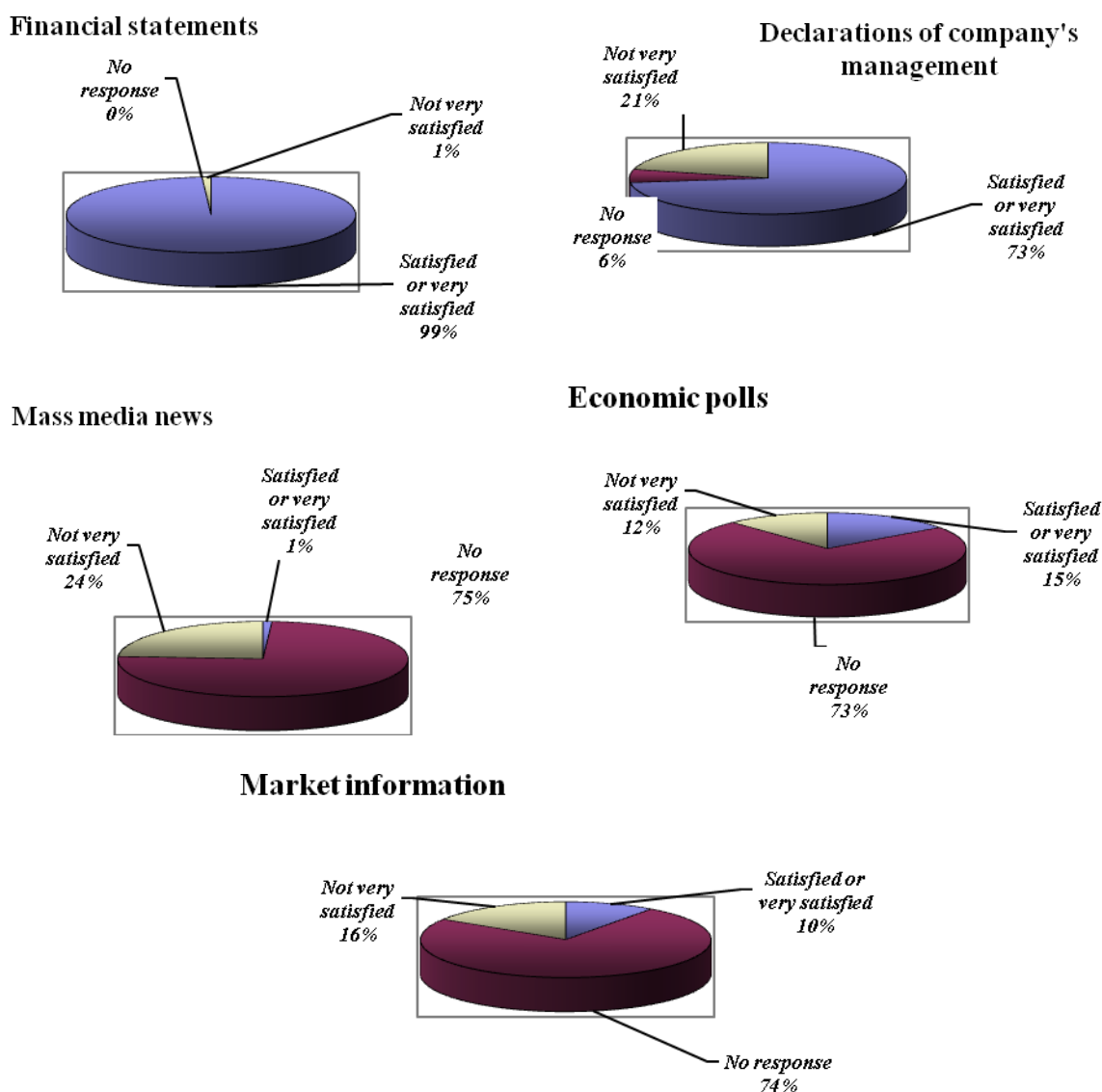


Fig. no. 3. General results to question no. 2

Source: realized by the authors

The objective of question no. 2 was to determine the users' satisfaction degree in connection to the information sources identified in question no. 1. The responses indicated the fact that:

- all users have a high satisfaction degree in connection to the financial statements (99% being satisfied or very satisfied) and a lesser degree for the declarations of company's management (73%);
- all user categories are less satisfied with the declarations of the management team, mass media news, economic polls and information that appeared on the market;
- if one would classify the last three information sources, one would be able to state that most users (creditors, administrators/managers, and financial analysts) are moderately satisfied in connection to the information on the market (information and studies supplied by the national authorities (National Fiscal Administration Agency, Ministry of Finance, National Statistics Institute, international financial institutes, other market information,

and other financial statements supplied by the companies) and have a low satisfaction degree or are even unsatisfied in connection to the accounting and financial information included in the other information sources they identified (mass media news, economic polls);

The third question of the survey asked the users to identify a possible area in which where they believed that the financial information could be improved. The following answers were given:

- Forecasted financial information
- More information concerning risk management
- Competition analysis
- Sectoral information
- Information seizing the growth and profitability trends
- Others (economic polls, mass media news, information that appeared on the market, etc.)

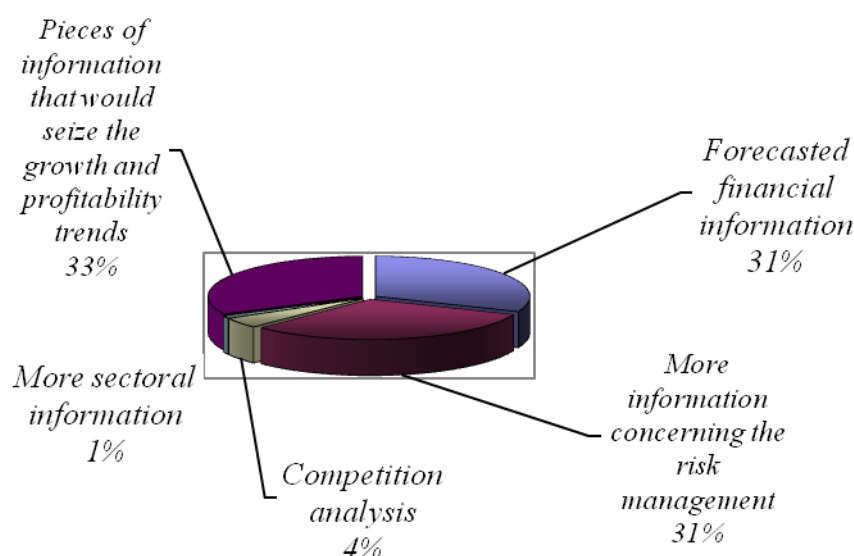


Figure no. 4. General results to question no. 3

Source: realized by the authors

The fourth question asked the users to identify a place where the mentioned improvement can be made. The following answers were given:

- Financial statements
- Declarations of the management team
- Other places

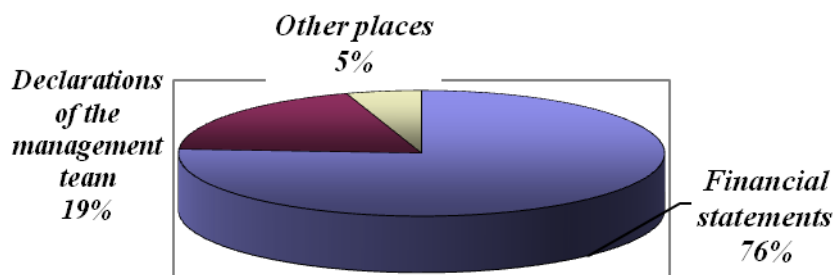


Figure no. 5 – General results to question no. 4

Source: realized by authors

The objectives of the third and fourth question were to identify the most important field in which the accounting and financial information can be improved, namely indicating which of the financial information sources (financial statements, declarations of the management, other sources) requires improvements concerning that area.

As regards the first question, the domains where improvements should be brought to the financial information were identified as being the next:

- forecasts (31 % of the users);
- risk management (31 % of the users);
- growth and profitability trends (33% of the users);
- competition analysis (4% of the users);
- sectoral analysis (1% of the users).

As regards the second question (question no. 4), the users were asked in connection to the place where the information they identified for the previous question (question no. 3) should be found. 90 % of the users (including here 80 % of the creditors) believed that this information should be found in the declarations of company's management, while 76 % of them believed that it should be found in the financial statements. This thing seems to indicate the fact that the users in general and creditors in particular believe the management's declarations as being incomplete. There are no variations from the standpoint of this aspect if one considers different user categories.

Conclusions

After reviewing the literature and the results of the applied questionnaire, we have come to the general conclusion that the current financial statements provide useful financial and accounting information for the users, but require still some qualitative and quantitative improvement. The majority of the users of accounting and financial information would rather trust in financial statements and management public statements (as they see as the most useful financial information sources), than in the news, surveys or market information. The areas where improvements should be brought to the financial and accounting information are related mainly to forecasting, risk management, respectively growth and profitability trends.

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