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FINANCIAL REPORTING PRACTICES OF SERBIAN CORPORATE GROUPS: COMPLIANCE WITH GLOBAL PROFESSIONAL REGULATIONS

Praksa finansijskog izveštavanja korporativnih grupa u Srbiji – usklađenost sa globalnom profesionalnom regulativom

Abstract

In this study, we analyze compliance with global professional regulations on a sample of Serbian joint-stock parent companies, focusing on the selected disclosures in their consolidated financial statements. Providing relevant and transparent information on the corporate group as a whole, consolidated financial statements are proclaimed to be useful information sources for the existing and potential capital providers of parent companies. Conformity with global professional accounting regulations is seen as an important prerequisite of high-quality financial reporting. However, country- and entity-specific factors remain influential, resulting in financial statements of differing features. Lacking intense regulatory and market pressures, the management of Serbian corporate groups appears not to be strongly committed to achieving prime-quality disclosures in consolidated financial statements. We find that the differences in compliance levels of analyzed companies could be explained by the differences in the size of the parent company, its ownership structure, type of auditor and profitability of the group. The results of our research may be useful for investors, corporate managers, regulators and future researchers looking at the quality of consolidated financial reporting.

Keywords: *compliance with accounting regulations, consolidated financial statements, business combinations, IFRS, transparency.*

Sažetak

U ovom istraživanju analiziramo usklađenost sa globalnom profesionalnom regulativom na uzorku matičnih kompanija u Srbiji, organizovanih u formi akcionarskih društava, fokusirajući se na odabrana obelodanjivanja u njihovim konsolidovanim finansijskim izveštajima. Pružajući relevantne i transparentne informacije o korporativnoj grupi kao jedinstvenoj celini, konsolidovani finansijski izveštaji su proklamovani kao koristan izvor informacija za postojeće i potencijalne snabdevače kapitala matičnih društava. Usklađenost sa globalnom profesionalnom računovodstvenom regulativom smatra se važnim preduslovom visokog kvaliteta finansijskog izveštavanja. Ipak, faktori od uticaja na nivou države i izveštajnog entiteta ostaju od značaja, kreirajući finansijske izveštaje različitih karakteristika. U odsustvu jakih regulatornih i tržišnih pritisaka, deluje da rukovodstvo korporativnih grupa u Srbiji nije veoma posvećeno postizanju visokokvalitetnih obelodanjivanja u konsolidovanim finansijskim izveštajima. Mi nalazimo da se razlike u nivou usklađenosti za analizirane kompanije mogu objasniti razlikama u veličini matice, njenoj vlasničkoj strukturi, vrsti revizora i profitabilnosti grupe. Rezultati našeg istraživanja mogu biti od koristi investitorima, korporativnim menadžerima, regulatorima i budućim istraživačima kvaliteta konsolidovanog finansijskog izveštavanja.

Ključne reči: *usklađenost sa računovodstvenom regulativom, konsolidovani finansijski izveštaji, poslovne kombinacije, IFRS, transparentnost.*

Introduction

Increasing the demand of investors, creditors, professional analysts, regulators and other users for transparent and internationally comparable financial reporting, the globalization of capital markets is usually recognized as the main driving force behind the worldwide convergence of professional accounting regulations [13]. Relevant and faithfully represented financial information on reporting entities, which is also universally comparable regardless of the entity's domicile country, is considered to be a valuable means for decreasing informational asymmetries, enabling the users to better evaluate their expected returns from the respective company and to hold the management to account for the company's resources more efficiently. Thus, enhanced quality and transparency of external financial reporting are believed to lower the estimation risks and improve investment decisions of individual users, facilitating the allocation of capital, both locally and globally, and lowering the overall cost of capital for companies [16], [12]. Hence, an efficient financial reporting and disclosure system is considered to be crucial for the development of economically efficient corporations, capital markets and the national economy as a whole [4].

Repeatedly being in the spotlight in the periods of intense financial scandals and crises since the beginning of the 20th century, the matters of quality of financial reporting and usefulness of disclosed information for intended users are still not unequivocally definable and easily attainable in practice. Having a complex and comprehensive infrastructure [22], the quality of disclosed financial information is oftentimes mistakenly attributed to the quality of accounting standards alone, promoting them as an "instant solution" to all of the problems [5]. However, at least as important is the matter of their implementation [13]. Whether the company's management shall use the financial statements as a valuable communication channel, trying to motivate the existing and potential capital providers to invest [28], or not (potentially misusing them for other self-serving purposes), will ultimately depend on its reporting incentives, shaped by the local market and political forces. Research identify the strength of countries' enforcement systems, the development of

capital market, national laws, governance structures and cultural factors as significant country-level determinants of financial reporting features [5], [26], [13], [15]. At the company-level, preparer incentives vary according to the company's listing status, size, ownership concentration, profitability, the issuance of equity or debt, type of auditor (Big 4 vs. Non-big 4), existence of audit committees and industry [13].

Proclaimed as an obligatory financial reporting framework for publicly accountable entities in over 140 national jurisdictions worldwide [23], the International Standards of Financial Reporting (IFRS) imposed themselves as the "gold standard" of quality. Intended to develop a universal financial-accounting "language" for corporate entities across the globe, IFRS are believed to be especially beneficial for transnational groups. Hence, the European Commission introduced the mandatory use of IFRS in the preparation of consolidated financial statements of all publicly traded companies listed in the EU, starting from 2005 [9]. However, after more than a decade has passed, there is still evidence that financial reporting practices and the overall quality of disclosed information continue to differ across Europe [13].

Corporate entities registered in the Republic of Serbia mandatorily file their consolidated financial statements in accordance to IFRS since the Law on Accounting and Auditing came into force in 2002 (the enactment date for banks and other financial institutions was January 1st, 2003; for other legal entities and entrepreneurs, it was January 1st, 2004). Nevertheless, as an economy with an emerging capital market, the country struggles with relatively weak market forces and regulatory infrastructure not strong enough to boost the improvement in the overall quality of financial reporting [35]. According to the research of the World Bank from 2015 [36], economic decision-makers in Serbia generally lack confidence in the reliability of financial statements, and the overall use of disclosed information is not strong enough to create an incentive for corporate entities to invest in the improvement of quality, reliability and transparency of their accounting and auditing. In such circumstances, not perceiving any additional benefits from financial reporting other than legal compliance, reporting entities appear to focus solely on

minimizing the costs of disclosures, altogether producing financial information of disputable quality [36].

Focusing on compliance with the selected required disclosures in consolidated financial statements that are particularly characteristic of the group as a reporting entity, we investigate the financial reporting practices on a sample of Serbian corporate groups. Failing to fully comply with the accounting disclosure requirements in their financial statements, the management withholds potentially valuable information from the capital market [13]. Being either intentional or a consequence of neglect or misinterpretation of the disclosure rules, such practice undoubtedly hinders the usefulness, relevance and transparency of the financial statements, even though they remain formally presented as of “prime IFRS quality”. Aiming to analyze the possible company-level determinants of reporting quality, we explore the effects of parent company size, ownership structure, type of auditor and profitability of the group.

The paper is structured as follows. After the introduction, we briefly highlight the potential benefits of organizing a business as a group of companies, accentuating the significance of corporate groups as market participants and reporting entities, both globally and locally. The next section is a summarized presentation of the features of financial reporting on group’s (and parent’s) performance. The analysis of disclosure compliance in consolidated financial statements of Serbian corporate groups follows. The paper closes with a brief conclusion.

Group structure as a corporate advantage

Organizing a business in the form of a group of centrally managed companies can bring forth numerous potential advantages [32], including commercial, regulatory, legal and tax benefits, as well as the overall mitigation of risk. In general, a parent company can control more businesses, with less capital (not having to purchase the entire capital to obtain control over the targeted entity), diversifying investments across multiple industries and geographical segments. Centralizing the resources of a parent and its subsidiaries under common management can produce valuable synergies, increasing the purchasing and negotiating

power of an economic entity as a whole and enabling better financing terms and overall investment opportunities.

Subsidiaries can be used to ringfence valuable assets of the parent and protect it from liabilities and lawsuits that may arise from specific lines of business, especially when it comes to new ventures. Acquisition of companies is oftentimes seen as a fruitful strategy for diversification into new markets or lines of business. Likewise, the disposal of certain business segments will normally be much easier if they are organized as separate subsidiaries, instead of divisions. Having in mind that subsidiaries are usually safeguarded from possible financial problems of other group members (unless there are mutual guarantees), negative consequences of bankrupt subsidiaries remain localized.

Controlling a group enables the parent to centralize certain assets or functions, making them available to other group members by leasing or licensing, while protecting them from local commercial and financing risks. This is especially beneficial when it comes to special skills and know-how, held by the parent or any other subsidiary, which can be used across the entire group in creating value for shareholders. Inter-company transactions are a well-known tool for managing performance at group level, enabling the parent to exploit the resources it controls, both directly and indirectly, to the fullest. Finally, certain jurisdictions offer attractive tax exemptions and reliefs for groups of companies.

Making the most out of the aforementioned benefits, contemporary corporate groups dominate worldwide economies. According to 2015 data, 69 of the world’s top 100 wealthiest economic entities were corporations, rather than national economies [14]. As stated by the Fortune Global 500¹ list for 2019, nine out of top ten worldwide largest companies as measured by revenue [11] were in fact corporate groups, with parents organized as joint-stock companies. These entities had over 5 million employees in 2019, earning a profit of USD 216,544 million, with total revenues amounting to USD 3,213,475 million, and total assets of USD 3,500,198 million [11].

In the Republic of Serbia, corporate groups are recognized by the Companies Act, and their financial

¹ Annual ranking of top 500 corporations worldwide as measured by revenue, compiled and published by Fortune magazine.

reporting practices are regulated in accordance with the Law on Accounting, the Law on Auditing and the Law on the Capital Market. Business entities organized as groups, managed by parent companies registered in the Republic of Serbia, can be recognized as a significant determinant of the national economy. According to 2018 data, these groups employed 27.5% of the total corporate sector workforce, generating 32.5% of the total revenue and 32.7% of total expenses, while owning 34.8% of total assets and 36.2% of total equity [3]. Figure 1 presents the results of operations, assets and equity of Serbian corporate groups in 2018 and 2017 (latest available data at the moment of the analysis).

Financial reporting on group performance – Accentuating the economic substance

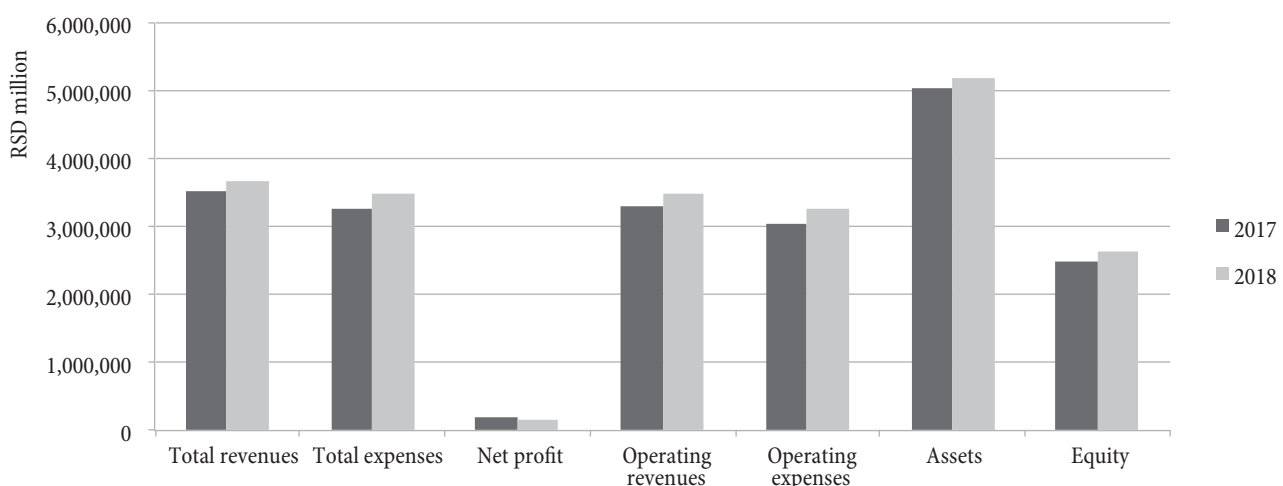
Considering the overall economic power of corporate groups, their international coverage, numerous existing and potential stakeholders, as well as their usually complex hierarchical structures and elusive internal transactions and relations, the importance of transparent financial reporting and disclosure at group level need not be particularly emphasized. Encircling the parent company and all the entities it controls, both directly and indirectly, corporate groups operate as unique economic structures with no legal personality. The mere existence of control, i.e., a parent-subsidiary relationship, becomes the matter of paramount importance in terms of financial reporting, urging the parent to lift the legal veil of its subsidiaries and

report to the public on their consolidated financial position, performance, cash flows and changes in equity, as if they were nothing but divisions of a standalone legal entity. Obligatory for parent companies (with certain exemptions, as stated in [19, par. 4]), consolidated financial statements are proclaimed to be “useful for existing and potential investors, lenders and other creditors of the parent in their assessment of the prospects for future net cash inflows to the parent” [20, par. 3.15]. Meanwhile, separate financial statements of a parent may be optionally required by local regulations, but they can never serve as a substitute for consolidated statements.

Parent company as a standalone reporting entity

The overall objective of external financial reporting can be summarized in the presentation of relevant and faithfully represented financial information on the reporting entity, useful to its existing and potential capital providers, i.e., to their investment decisions related to the respective entity [20]. These decisions usually depend on the users’ perceptions of the amount, timing and uncertainty of future net cash inflows to the relevant reporting entity, and their assessments of management’s stewardship of the entity’s resources [20]. Hence, financial statements are designed to inform about the economic resources of the entity, claims against the entity and their changes during the reporting period, including the financial consequences of the management’s decisions related to deployment of

Figure 1: Results of operations, assets and equity of Serbian corporate groups



Source: Author’s illustration based on [3].

entity's economic resources. Seeking to predict, compare and evaluate cash consequences of their economic decisions, users are believed to find such information valuable [2].

However, when it comes to parent companies, setting the boundaries of a reporting entity within the lines of its legal personality has the potential to jeopardize the informational interests of its primary users. Namely, the power of control, as "a valuable right with numerous benefits" [8, p. 27], implies that some of the economic resources controlled by the parent, and some of the cash consequences of its management's decisions are actually located and materialized within other entities, not necessarily recognized as reporting entities in their own right (subsidiaries). Presenting those resources as a single aggregate line item of financial investments in a subsidiary, separate financial statements of a parent inevitably prevent their users from clearly seeing the actual businesses – their resources and related claims – the parent has invested in. Hence, users remain denied of the complete insight into different sources of the parent's income streams [1].

Regardless of the selected accounting method for valuation of investments in subsidiaries [18, par. 10], it is evident that the very focus on the parent as a legal entity suppresses the ability of its separate financial statements to inform the users on the value of its subsidiaries – focusing solely on the parent's share of that value and ignoring possible non-controlling interests. By legally paying (or transferring some other form of compensation) for the proportion of the subsidiary's economic resources equal to its capital share, the parent is able to claim only commensurable amounts of the subsidiary's profit. However, the fact that the parent's management administers the total economic resources of a subsidiary and is responsible for the subsidiary's earned profit in its entirety, makes the complete picture a necessary decision-making prerequisite.

Recognizing profits stemming from investments in subsidiaries only in the amount of their declared dividends attributable to the parent, its separate financial statements will reflect only a portion of the subsidiary's earnings that was actually absorbed by the parent during the reporting period (unless these investments are measured by using the equity method, in which case dividends will be

recognized as a decrease of the investment). This single information is of little value when it comes to evaluation of past performance of the parent's financial investments and assessment of its expected future outlooks. Lacking completeness and persistence, dividends from subsidiaries are not good indicators of the parent's actual earnings, related to the investments in controlled entities [25]. This can be attributed to various factors: the nonbinding legal nature of dividends (the relation between profits earned and dividends declared is not causal by default), the fact that they are usually declared after the reporting period in which the distributable profit was actually earned (becoming a lagging performance indicator), the fact that they are seldom equal to the subsidiary's annual net profit (while their entire profit can be seen as a result of the parent company's management efforts), and the fact that they are susceptible to the effects of transfer pricing.

The power of the parent to direct relevant activities and economic resources across the entire group enables the management to design, initiate or limit the transactions of the parent and its subsidiaries for the sake of achieving "higher" group-level goals. Consequently, separate financial statements of group members become "biased and as such incapable to provide significant information to third parties" [31, p. 12]. Although this quality is usually attributed to financial statements of subsidiaries, it is important to note that it is also true when it comes to the statements of a parent alone, especially if the parent is not a pure holding and engages in commercial activities, as well.

Providing information about the parent's directly owned assets, related liabilities, equity, income and expenses, separate financial statements of the parent can be useful for its existing and potential capital providers, having in mind the usual legal link between their claims against the parent and net assets and earnings of a parent as a standalone legal entity. Namely, dividends declared to the parent's shareholders are generally tied to the amount of net profit of the parent. Likewise, a claim against the parent typically doesn't imply a claim against its subsidiaries, as well. However, this piece of information is considered insufficient to meet the information needs of the parent's users [20]. Namely, separate financial statements of a parent do not enable the users to perceive the net cash inflows

to the subsidiaries, which are a major determinant of subsidiaries' further distributions to the parent, i.e., the total net cash inflows to the parent alone.

Consolidated financial statements – Expanding the borders of a parent company

Considering the aforementioned informational limits of a parent company's separate financial statements, stemming from their focus on the parent as a legal entity, consolidated financial statements emerged as a medium that enables a more complete and transparent presentation of the overall economic power and earnings of the parent company, thereby providing more useful inputs for the assessments of its past performances and the projections of its future outlooks, promising the investors and creditors more reliable estimates and better economic decisions.

Focusing on a group as an economic entity in its own right, consolidated financial statements provide information about its assets, liabilities, equity, income and expenses, treating the parent and its subsidiaries as a single reporting entity. These statements are based on special accounting procedures of aggregating separate line items of the group members' financial records (previously adjusted as necessary to ensure their formal and substantial uniformity), followed by careful eliminations of effects of all undertaken intra-group transactions and events, presenting solely the results a group has earned in transactions with third parties. Although the consolidated result is not usually available for distribution to shareholders of a parent in its entirety (due to legal restrictions and minority interests), it is a maximum amount that can be distributed without compromising the net economic substance of the group. As such, consolidated earnings are considered to be of great importance and of useful value for investment decisions of the existing and potential investors and creditors of a parent company.

Due to the limited scope of this paper, in continuation of this section we shall briefly focus on key informational features of consolidated financial statements, which determine their potential competitive advantages as decision-making inputs for primary users – the presentation of the composition of the group, business combinations and their

financial effects. In the remainder of the paper, we shall examine those features in greater detail on a sample of Serbian corporate groups.

Presentation of group's composition. Lacking the status of a legal entity, corporate groups have reporting boundaries that are somewhat subject to the discretion of their management. Obliging the investor to consolidate all of his subsidiaries, international professional accounting regulations award him the right to determine whether he actually controls the entity he has invested in [19]. Not being able to fully comprehend the relations between a parent and all of his potential subsidiaries, external investors and creditors of the parent company rely upon the veracity of information the management has publicly disclosed, as well as on its choices and estimates in the preparation of consolidated financial statements.

Careful recognition and consolidation of all the entities a parent actually controls, whether directly or indirectly, are the essential preconditions of consolidated financial statements' informational capacity. The usual nonexistence of group-level accounting records, coupled with the resulting reliance of consolidated financial statements on group members' separate financial information, make consolidation perimeter an appealing mean for the managing group's disclosed financial position and performance. In this respect, research warn of managements' tendencies to conceal some of its underperforming subsidiaries, keeping them off-balance sheet [30], [6] and to strategically structure the parent's ownership percentage to avoid consolidation of certain investees [7]. Coming in the spotlight during the global financial crisis of 2007, consequences of such behavior turned out to be extremely serious and far-reaching, resulting in thorough revision of global professional accounting regulations for corporate groups in the following years.

Setting out the definition of control, as a main identifier of the parent-subsidiary relationship, accounting standards underpin the preparation of consolidated financial statements, ensuring the completeness and accuracy of the consolidation perimeter. Prevailing regulations introduce three constituents of control: power over the investee; exposure (or rights) to variable returns from the investor's involvement with the investee and the ability of the investor

to use its power over the investee to affect the amount of his own variable returns [19, par. 7]. Considered more appropriate [7], such principle-based definition of control requires parent companies to consolidate (controlled) entities in which they have variable (both positive and negative) returns, limiting the discretionary power of the management to willingly exclude the loss-making subsidiaries from the consolidation perimeter. Likewise, the focus on the power of the parent to influence his own returns from the investee makes the actual percentage of the parent's ownership less relevant, disabling the management to use it as an excuse for non-consolidation.

In order to enable the users to evaluate the nature of a parent company's interests in its investees, their effects on the parent's overall financial position, past and future performance and cash flows, including the associated risks, the management of the parent company is required to provide detailed and relevant disclosures in its consolidated financial statements. Allowing the users to better understand the structure of the group, its internal relations and transactions and their effects on the parent company, i.e., the amounts, dynamics and risks of their own expected future returns (coming from the investment in the parent company), the following disclosures are considered to be of special importance [17]:

- Significant judgments and assumptions made by the parent's management in determining the existence of control over a subsidiary, including the changes in these judgments and assumptions during the reporting period. This is particularly beneficial for the comprehension of atypical cases, i.e., investees that are not consolidated as subsidiaries even though the parent holds more than half of the voting rights, and subsidiaries that are controlled despite the parent having less than half of the voting rights.
- Information about the composition of the group and related changes during the reporting period, including the consequences of changes in ownership interest in subsidiaries, whether they result in loss of control or not.
- Information about the interest that possible non-controlling interests have in the group's activities and cash flows, including the nature and extent of

significant restrictions on parent's ability to use the group's assets and settle liabilities.

Presentation of business combinations and their financial effects. Attainment of control and the establishment of a parent-subsidiary relationship is probably the single most important event in the life of a corporate group, being not just its cornerstone, but also one of the key mechanisms of its future growth. Reporting on the financial consequences of the acquisition of subsidiaries, consolidated financial statements aim to provide relevant and faithfully represented information on the overall economic strength of the consolidated entity at the moment of the acquisition. This includes the moment of the group's establishment (i.e., when a parent gains control over its first subsidiary, becoming obliged to present consolidated statements), but also any other moment in a group's life when the consolidation perimeter is expanded to include new subsidiaries.

Based on the postulates of the entity theory, financial reporting on a corporate group's performance rests on the belief that by acquiring control over an entity, the parent company actually acquires the rights to the entity's economic resources, including the related claims against that entity and respecting its possible non-controlling interests. Hence, at the acquisition date, a parent shall recognize (in consolidated financial statements) the subsidiary's identifiable assets acquired, liabilities assumed and any non-controlling interests in the subsidiary, including the resulting goodwill (or bargain purchase gain) from the acquisition, measuring them at fair value (with certain exceptions) [21].

Bearing the costs of the acquisition, equaling the fair value of transferred cash or other assets, incurred liabilities, issued equity interests or some other form of consideration, a parent shall recognize the financial effect of the acquisition as goodwill (when the costs of the acquisition exceed the fair value of the subsidiary's recognized net assets, including the assets that become recognizable in the very moment of acquisition) or a gain from a bargain purchase (otherwise). Representing the "future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized" [21], goodwill is undoubtedly a

valuable informational input for the users' decision making. Considering the motives of the parent to pay more than the actual value of acquired net assets, two components of goodwill can be recognized. The first one comprises a going concern value, i.e., the value of the ability of the acquired business to continue its operations in the future (for example, due to its competitive position, established processes, know-how and culture). The other component is the value of various synergies that a parent expects to occur from combining the business of the new subsidiary with the existing operations of other group members.

Trying to understand whether the price paid for the subsidiary was reasonable and whether the acquisition was a success [24], users rely on the quality of goodwill-related disclosures in consolidated financial statements. Better information could improve their ability to assess the overall performance of the group, as well as of the parent alone, in the years following the acquisition, and to hold the parent's management to account for its acquisition-related decisions more effectively. Information which could help the users to improve their understanding of the acquisition's subsequent performance, i.e., how well an acquisition is performing in relation to the management's initial expectations, is considered paramount. However, the prevailing accounting regulations do not specifically require such disclosures. Even so, the obligatory annual goodwill impairment test could provide certain information in this regard. With an objective to ensure that the company's assets are carried at no more than their recoverable amounts, the impairment test still cannot measure goodwill (and its impairment) directly, but in conjunction with other assets it was allocated to (considering the fact that goodwill does not generate independent cash flows).

Analysis of compliance with IFRS-required disclosures in consolidated financial statements of joint-stock parent companies in Serbia

Sample, data collection and research design

Our study is based on a sample of 76 Serbian joint-stock parent companies, mandatorily filing audited consolidated financial statements for 2018 in accordance with local

regulations that stipulate the implementation of the International Financial Reporting Standards (IFRS). These companies make up for 1.39% of the total 667 parent companies registered in the Serbian Business Registers Agency's database for 2018 (the latest available data at the time of the analysis)[3]. However, they controlled 24.84% of the total consolidated assets and generated 22.76% of the total consolidated operating revenue for 2018 [3]. The audited consolidated financial statements of the selected 76 companies for 2018, with the accompanying Notes, were hand-collected from the Serbian Business Registers Agency's public database of financial statements.

As "the most significant organizational form of corporate entities" [27, p. 67] specially designed to accumulate substantial sums of capital via a large number of individually small investments, joint-stock companies have numerous and diversified shareholders. Despite not being the most frequent form of economic entities, joint-stock companies earn the largest amounts of revenue worldwide [11]. Hence, the reliability and transparency of their external financial reporting become matters of the utmost importance. Ensuring the credibility of consolidated financial statements by providing an independent and competent assurance that the financial position and performance of the group are fairly presented, their external audit is deemed mandatory. Having in mind the overall importance of joint-stock parent companies as reporting entities, we consider our research focus to be valid and our sample to be representative.

We analyze the disclosures in consolidated financial statements of the selected companies, including the face of the financial statements and accompanying notes, aiming to investigate their compliance with the prevailing disclosure requirements regarding the following matters:

- Composition of the group and changes in the consolidation perimeter during the reporting period,
- Significant judgments and assumptions used in determining control,
- Sources of the parent's control over subsidiaries,
- Existence of non-controlling interests and disclosures of their share in a group's activities and cash flows,
- Acquisitions during the reporting period and related disclosures (description of acquisitions, fair value of

the consideration transferred, fair value of acquired net assets, goodwill/bargain purchase gain),

- Goodwill recognition, subsequent impairment and related disclosures (description of goodwill, implementation of the annual impairment test, description of the assumptions used or explanation for the absence of test/impairment) and
- Disclosure of consolidated earnings per share.

Additionally, we examine the frequency of different types of auditors' opinions on the consolidated financial statements for 2018 filed by the companies from the sample, aiming to get a clearer insight into their overall quality. Making an effort to better understand possible determinants of financial reporting quality and compliance with the required disclosures, we further investigate the effects of company-related factors, including the size of the parent company, its ownership structure, type of auditor and profitability of the group.

Results and discussion

The results of the analysis of the disclosure of information that could help the users to better understand the composition of the group, changes in the consolidation perimeter during the reporting period, as well as the parent's sources of control and shares of the group's activities and cash flows attributable to non-controlling interests on a sample of 76 consolidated financial statements for 2018 for the selected parent companies in Serbia are provided in Table 1.

The overall impression is that the management of Serbian parent companies does not seem to perceive or use consolidated financial statements as a communication channel with external shareholders. Namely, even the elementary requirement to disclose the composition of the group is not met in 2.63% of the cases. The quality of disclosures regarding the changes in the structure of the group could be improved in terms of clarity and completeness, having in mind that in 42.11% of the analyzed consolidated statements it is impossible to discern whether such changes have occurred or not and what their financial consequences were. Especially worrying is the finding that almost 65% of parent companies do not publish any information on the judgments and assumptions that were used in determining the existence of control over subsidiaries. According to available disclosures, the majority of ownership (i.e., voting rights) is the prevailing source of control in Serbian companies. Hence, it is possible that the management finds the disclosures on the sources of control redundant. Less than half of the analyzed groups have non-controlling interests, but only one third of them discloses additional information in this regard. Even though a negligible number of groups had new acquisitions during the analyzed period, it is very promising that all of them provided necessary disclosures regarding the fair values of transferred consideration, acquired net assets and the resulted goodwill, including the additional descriptions on the nature of the acquisitions and the assumptions and estimates used.

Table 1: Disclosures on the composition of the group and scope of consolidation in consolidated financial statements

Disclosures in notes to consolidated financial statements	Disclosed		Not disclosed	
	n	%	n	%
The composition of the group	74	97.37%	2	2.63%
Changes in the composition of the group in the reporting period	44	57.89%	32	42.11%
Significant judgments and assumptions used in determining control	27	35.53%	49	64.47%
Majority of ownership is the primary element of control	63	82.89%	13	17.11%
Group has noncontrolling interests	31	40.79%	45	59.21%
For the subsample of groups with noncontrolling interests:				
The interest that noncontrolling interests have in the group's activities and cash flows	9	29.03%	22	70.97%
Group had new acquisitions during the reporting period	3	3.95%	73	96.05%
For the subsample of groups with acquisitions:				
Description of acquisitions	3	100.00%	0	0.00%
Fair value of the consideration transferred	3	100.00%	0	0.00%
Fair value of acquired net assets	3	100.00%	0	0.00%

Source: Author's calculation.

When it comes to financial effects of previous acquisitions, only 15.79% of the analyzed groups recognize goodwill in their consolidated financial statements. Reaching a similar finding on a different sample of Serbian parent companies, Spasić [33] concludes that high costs and complexity of the allocation of purchase price discourage the management to recognize goodwill. Additionally, we must also bear in mind that the selected groups may have been operating for a long time without new acquisitions, in which case they would have probably already fully impaired possible goodwill in their consolidated statements. In the subsample of companies that recognize goodwill, one third doesn't provide any additional disclosures in the accompanying notes. The recognition of impairment losses occurs in 33.33% of the cases, which is similar to the European average of 36%, according to the research of the European Securities and Markets Authority (ESMA) [10, par. 32]. However, only 25% of the companies that recognize goodwill provide additional valuable information regarding the annual impairment test. The results of the analysis of the disclosure of information on the subsequent measurement of goodwill on a sample of 76 consolidated financial statements in the Republic of Serbia for the analyzed period are presented in Table 2.

Providing an independent and competent assurance that consolidated financial statements give a true and fair view of the financial position and performance of the group, in accordance with the prevailing accounting regulations and policies, the auditor's opinion can serve as a preliminary indicator of their overall quality, awarding the management's statements and estimates in the financial reports much needed credibility. Signaling that either the financial statement contains substantially significant errors and omissions, or that the auditor could not obtain

sufficient evidence to be able to express an opinion, a modified auditor's opinion is normally considered to be alarming. The expectedly undermined trust of the existing and potential capital providers could result in limiting the availability of financing sources and raising its costs for the company, making the modified auditor's opinions a serious matter in developed countries. However, when it comes to emerging economies such as Serbia, where market forces and regulatory mechanisms are usually not strong enough to sanction the inadequate quality of financial reporting, the frequency of modified auditors' opinions is not low [35]. Our research shows that 43.42% of the analyzed consolidated financial statements for 2018 had modified auditor's opinion (the frequency of different types of auditors' opinions is provided in Table 3). Investigating a sample of Serbian listed companies for the 2015-2017 period, Vučković Milutinović finds an average proportion of modified auditors' opinions of 30.4%, with a peak of 42.4% in 2016 [35].

Aiming to comprehend the effects of company-specific factors on the management's tendency toward transparent and complete disclosures in consolidated financial statements, we further investigate the differences in disclosure compliance of the selected companies according to the size of the parent, ownership structure and type of auditor. Findings are presented in Table 4.

Table 3: Types of auditors' opinions on consolidated financial statements

Type of auditors' opinions	n	%
Unqualified opinion	43	56.58%
Qualified opinion	21	27.63%
Disclaimer of opinion	10	13.16%
Adverse opinion	2	2.63%

Source: Author's calculation.

Table 2: Recognition of goodwill and goodwill impairment and relevant disclosures in consolidated financial statements

Disclosures in consolidated financial statements and accompanying notes	Disclosed		Not disclosed	
	n	%	n	%
Group recognizes goodwill in the consolidated balance sheet	12	15.79%	64	84.21%
For the subsample of groups recognizing goodwill:				
Description of goodwill	8	66.67%	4	33.33%
Annual goodwill impairment recognized	4	33.33%	8	66.67%
Description of annual goodwill impairment test – Assumptions used or reasons for the absence of implementation	3	25.00%	9	75.00%

Source: Author's calculation.

Size. Disclosure costs, public scrutiny and political pressures create a positive association between the size of the reporting entity and compliance with accounting requirements, making high-quality financial reporting more easily attainable and more important for large-sized companies [13]. The dominant share of large enterprises in total assets, revenues, number of employees and the creation of value, as well as their possibility of attracting high amounts of capital and undertaking projects unavailable for small-sized companies, make the large-sized public corporate entities crucial in the emerging economies [29]. Hence, the quality of their financial reporting becomes a

matter of paramount importance. Figure 2 presents the total assets and total revenues of the sampled parent companies according to size. Classification of parent companies by size was carried out in accordance with the prevailing provisions of the Serbian Law on Accounting, i.e., by using the data from their separate financial statements.

Our findings speak in favor of the company size as a determinant of compliance with international standards. Namely, the frequency of unqualified auditors' opinions increases with the size of the parent company. The same is valid for the disclosure of consolidated earnings per share (EPS), leading to a conclusion that large-sized

Table 4: Possible determinants of disclosure in consolidated financial statements

Disclosures in consolidated financial statements and accompanying notes	Size of the parent						Ownership of the parent				Type of auditor			
	Micro and small (27)		Medium (19)		Large (30)		Dispersed (18)		Concentrated (58)		Big4 (13)		Other (63)	
	n	% of subsample	n	% of subsample	n	% of subsample	n	% of subsample	n	% of subsample	n	% of subsample	n	% of subsample
Disclosures on the composition of the group	27	100.00%	18	94.74%	29	96.67%	17	94.44%	57	98.28%	13	100.00%	61	96.83%
Disclosures on the changes in the composition of the group in the reporting period	14	51.85%	13	68.42%	17	56.67%	9	50.00%	35	60.34%	10	76.92%	34	53.97%
Disclosures on the significant judgments and assumptions used in determining control	5	18.52%	10	52.63%	12	40.00%	6	33.33%	21	36.21%	8	61.54%	19	30.16%
Majority of ownership is the primary element of control over subsidiaries	23	85.19%	16	84.21%	24	80.00%	16	88.89%	47	81.03%	11	84.62%	52	82.54%
Group has non-controlling interests	8	29.63%	8	42.11%	15	50.00%	5	27.78%	26	44.83%	11	84.62%	20	31.75%
<i>Disclosures on the interest that non-controlling interests have in the group's activities and cash flows</i>	0	0.00%	2	25.00%	7	46.67%	2	40.00%	7	26.92%	5	45.45%	4	20.00%
Group had new acquisitions during the reporting period	0	0.00%	0	0.00%	3	10.00%	0	0.00%	3	5.17%	2	15.38%	1	1.59%
<i>Description of acquisitions</i>	-	-	-	-	3	100.00%	-	-	3	100.00%	2	100.00%	1	100.00%
<i>Disclosures on the fair value of the consideration transferred</i>	-	-	-	-	3	100.00%	-	-	3	100.00%	2	100.00%	1	100.00%
<i>Disclosures on the fair value of acquired net assets</i>	-	-	-	-	3	100.00%	-	-	3	100.00%	2	100.00%	1	100.00%
Group recognizes goodwill	2	7.41%	4	21.05%	6	20.00%	2	11.11%	10	17.24%	4	30.77%	8	12.70%
<i>Description of goodwill</i>	2	100.00%	2	50.00%	4	66.67%	1	50.00%	6	60.00%	3	75.00%	5	62.50%
<i>Annual goodwill impairment recognized</i>	0	0.00%	1	25.00%	3	50.00%	0	0.00%	4	40.00%	2	50.00%	2	25.00%
<i>Description of annual goodwill impairment test – Assumptions used or reasons for the absence of implementation</i>	0	0.00%	0	0.00%	3	50.00%	0	0.00%	3	30.00%	2	50.00%	1	12.50%
Unqualified opinion	12	44.44%	10	52.63%	21	70.00%	8	44.44%	35	60.34%	11	84.62%	32	50.79%
Qualified opinion	10	37.04%	5	26.32%	6	20.00%	7	38.89%	14	24.14%	2	15.38%	19	30.16%
Disclaimer of opinion	4	14.81%	4	21.05%	2	6.67%	3	16.67%	7	12.07%	0	0.00%	10	15.87%
Adverse opinion	1	3.70%	0	0.00%	1	3.33%	0	0.00%	2	3.45%	0	0.00%	2	3.17%
Disclosure of consolidated EPS	2	7.41%	7	36.84%	12	40.00%	3	16.67%	18	31.03%	8	61.54%	13	20.63%

Source: Author's calculation.

companies possibly have more awareness of the consolidated statements as a communication channel with the existing and potential capital providers. As opposed to micro and small parent companies, the larger ones generally show higher levels of compliance, except when it comes to disclosures of the group's composition and the description of previously acquired goodwill. Similar conclusions can be found in the research of Spasić and Denčić-Mihajlov, who find a difference in the transparency of disclosures between large and small companies listed in the Serbian regulated market [34].

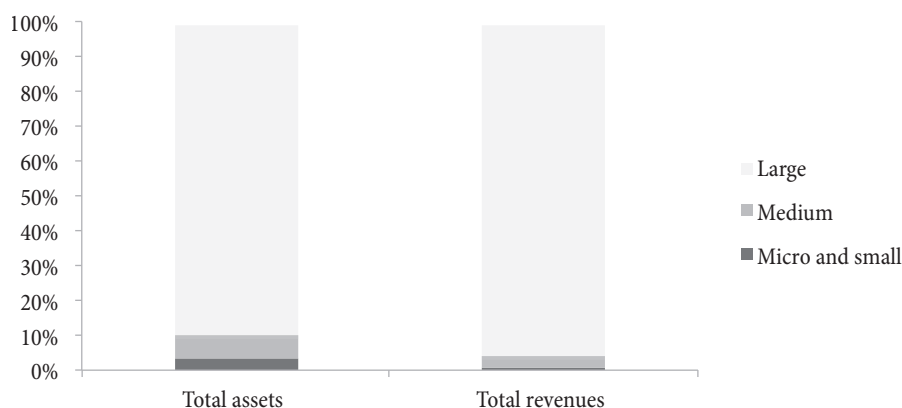
Ownership. Investors of companies with widely dispersed ownership usually lack the power and economically reasonable incentives to be able to monitor the management. Hence, such companies generally tend to adopt the policy of increased transparency in their financial statements, trying to overcome the agency problems and reduce information asymmetries. On the other hand, the majority owner is expected to be able to actively monitor and direct the management's decisions, and to have private access to all the necessary information. Accordingly, such closely-held companies may have little interest in disclosure. Glaum, Schmidt, Street and Vogel find that the level of compliance is the highest in companies with a moderate level of ownership concentration [13]. Our findings suggest that parent companies with concentrated ownership show better compliance levels when it comes to the analyzed disclosure requirements in consolidated financial statements. The fact that these companies also have a significantly higher frequency of the Big4 auditors than the companies with dispersed ownership (20.69%

as opposed to 5.56%) may have been relevant, as well. Analyzing further the effects of the type of the majority owner (state, domestic natural person, domestic legal entity, foreign legal entity) we find that parent companies that are majority-owned by foreign legal entities achieve the highest levels of compliance in terms of the analyzed disclosure requirements (these findings are not tabulated). Hence, it is possible that good financial reporting practices of foreign corporate owners have been translated onto their Serbian companies.

Type of auditor. The reputation of the auditor is usually considered as an additional "guarantee" of the financial statements' quality. Having in mind their size and international presence, the Big4 audit firms have particularly strong interests in preserving their credibility. They also have more available resources to invest in high-quality audit and are less dependent on individual clients compared to smaller-sized and local auditors. Hence, generally there is a positive association between the type of auditor and the perceived quality of audited financial statements [13]. However, we must also bear in mind that some of the greatest international financial scandals involved companies with prestigious auditors and unqualified opinions (a well-known example is Enron; see more in [28]).

Our findings confirm the expected relationship. Namely, corporate groups with Big 4 auditors showed higher levels of compliance in all categories of the analyzed disclosure requirements. They also exhibited a higher frequency of unqualified opinions on their consolidated financial statements. The proportion of modified auditors' opinions is higher in the subsample of groups with other

Figure 2: Total revenues and total assets of the analyzed parent companies according to size



Source: Author's illustration based on [3].

auditors, which is somewhat unexpected since local auditors are oftentimes associated with “selling of opinions” [36]. However, these results are in line with the analysis of Vučković Milutinović conducted on a different sample of Serbian listed companies [35].

The involvement of Big 4 auditors is generally much lower than it is common in the developed markets (17% of the sampled companies had Big 4 auditors). Vučković Milutinović finds an average proportion of one third Big 4 audits for Serbian listed companies in the 2015-2017 period [35]. This might have been a consequence of the significant number of poor-performance corporate groups in the analyzed sample (42% with net losses), which probably cannot afford a Big 4 auditor. Additionally, Big 4 auditors might also avoid such clients due to avoiding risk [35]. We find that Big 4 auditors are mostly oriented toward large-sized companies (84.62%), companies with concentrated ownership (92.31%) and companies with positive net results (84.61%).

Finally, we wanted to additionally investigate the effect of the profitability on corporate groups’ compliance levels in consolidated financial statements. Having in mind the overall problems in the Serbian economy, much of the corporate entities struggle to keep their businesses going.

In the absence of capital market pressures for high-quality financial reporting, the incentives of the management of the loss-making companies will probably be directed towards cutting all costs that are perceived as non-vital for the company. Those could include the costs of accounting, disclosure and audit. Hence, underperforming corporate groups are expected to show lower levels of compliance and transparency in their financial statements (in the absence of capital market and regulatory pressures). As presented in Table 5, our analysis confirms these expectations.

Conclusion

Reducing asymmetries between the supply and demand for financial information on the corporate entities’ activities and performance, an efficient financial reporting and disclosure system is one of the key mechanisms for building trust in the capital markets. Enabling the users to better evaluate their expected returns from the respective company and to hold the management to account for the company’s resources more efficiently, relevant, faithfully represented and globally comparable financial information on reporting entities are believed to reduce the estimation

Table 5: Profitability of the group as a determinant of disclosure in consolidated financial statements

Disclosures in consolidated financial statements and accompanying notes	Type of the consolidated net result			
	Profit (44)		Loss (32)	
	n	% of subsample	n	% of subsample
Disclosures on the composition of the group	42	95.45%	32	100.00%
Disclosures on the changes in the composition of the group in the reporting period	21	47.73%	6	18.75%
Disclosures on the significant judgments and assumptions used in determining control	30	68.18%	14	43.75%
Majority of ownership is the primary element of control	38	86.36%	25	78.13%
Group has non-controlling interests	17	38.64%	14	43.75%
<i>Disclosures on the interest that non-controlling interests have in the group’s activities and cash flows</i>	7	41.18%	2	14.29%
Group had new acquisitions during the reporting period	3	6.82%	0	0.00%
<i>Description of acquisitions</i>	3	100.00%	-	-
<i>Disclosures on the fair value of the consideration transferred</i>	3	100.00%	-	-
<i>Disclosures on the fair value of acquired net assets</i>	3	100.00%	-	-
Group recognizes goodwill	9	20.45%	3	9.38%
<i>Description of goodwill</i>	6	66.67%	2	66.67%
<i>Annual goodwill impairment recognized</i>	4	44.44%	0	0.00%
<i>Description of annual goodwill impairment test – Assumptions used or reasons for the absence of implementation</i>	3	33.33%	0	0.00%
Unqualified opinion	34	77.27%	9	28.13%
Qualified opinion	7	15.91%	14	43.75%
Disclaimer of opinion	3	6.82%	7	21.88%
Adverse opinion	0	0.00%	2	6.25%
Disclosure of consolidated EPS	17	38.64%	4	12.50%

Source: Author’s calculation.

risks and improve investment decisions of individual users, lowering the overall cost of capital, facilitating its allocation and driving the development of the economy as a whole.

Dominating economies and capital markets worldwide, corporate groups become reporting entities of special importance. Having in mind their overall economic power, international coverage, numerous stakeholders, complex hierarchical structures and elusive internal transactions and relations, the importance of transparent financial reporting and disclosure at the group level need not be particularly emphasized.

Being one of the pillars of the financial reporting system's quality infrastructure, high-quality standards of financial reporting are important, but not sufficient guarantees of the veracity and transparency of a company's disclosed financial information. Equally important are the numerous factors that shape the management's incentives for providing relevant and user-oriented financial statements.

Our study examines compliance on a sample of Serbian joint-stock parent companies mandatorily preparing their consolidated financial statements in accordance with IFRS. We focus on the disclosures we believe to be the key informational advantages of consolidated financial statements as decision-making inputs for the existing and potential capital providers of parent companies. Namely, we examine the compliance with the IFRS-required disclosures regarding the structure of the group and its changes during the reporting period, as well as financial effects of previous and new acquisitions. Despite introducing IFRS as a "gold standard" of high-quality financial reporting, Serbia is still struggling with weaknesses in regulatory mechanisms and a lack of activity in the capital market. In the absence of strong market and regulatory pressures, the quality of financial reporting is expected to deteriorate.

Our overall impression is that the management of Serbian parent companies does not seem to use the consolidated financial statements as a communication channel with the existing and potential capital providers of the parent. Our in-depth analysis confirms the effects of company-specific factors on compliance levels, including the size of the parent company, its ownership structure, type of auditor and profitability of the group. We believe that increasing the clarity and completeness of the provided

disclosures could help the users to better understand the expected amounts, dynamics and uncertainties of the parent company's different income streams. Being more informed, investors and creditors are expected to be more willing to invest, adjusting their required returns downwards with the decrease of the entity-specific estimation risks. Restoring confidence in the capital market, improved disclosures in financial statements could prove beneficial for renewing investments, market activity and the economy as a whole.

We believe our study has informational benefits for various capital market participants, raising awareness on the importance of relevance and veracity of the reporting entities' disclosed financial information. The existing and potential capital providers, as primary users of financial statements, could be reminded of the need to evaluate the quality of financial statements prior to making any final investment-related decisions. The company's management could be motivated to enhance its compliance levels and financial reporting transparency, seeking to attain new financial resources at acceptable terms. Finally, regulatory authorities could be alerted of the importance of building effective and working enforcement mechanisms that will translate IFRS standards into financial statements of desirable qualities for their intended users.

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