UDC 330

FINANCIAL STATEMENTS AS A BASIS FOR IDENTIFYING FINANCIAL RISKS

Horvat Tatjana
University of Primorska, Koper, Slovenia

Monitoring financial statements for identifying accounting risks is very important for survival of the company. Management of the company is responsible for monitoring also other risks, which are close to accounting risks, such as currency risk, interest rate risk, legal risk, competitive and fraud risk. In our case study we recognize risks which could lead to bankruptcy of the company.
Key words*: accounting risks, balance sheet, management.*

ФИНАНСОВАЯ ОТЧЕТНОСТЬ КАК ОСНОВА ДЛЯ ВЫЯВЛЕНИЯ ФИНАНСОВЫХ РИСКОВ

Хорват Татьяна
Университет Приморска, Копер, Словения

Мониторинг финансовой отчетности для выявления бухгалтерских рисков очень важен для выживания компании. Руководство компании отвечает за мониторинг и других рисков, которые близки к учетным рискам, таким как валютный риск, процентный риск, юридический риск, конкурентный и мошеннический риск. В нашем исследовании мы выявляем риски, которые могут привести к банкротству компании.
Ключевые слова: *бухгалтерские риски, баланс, управление.*

Introduction

Financial statements are one of the most important indicators showing increased accounting risks, which could lead to bunkrupcy. The purpose of the paper is to show where in financial statements, especially in balance sheet, could be seen the highest financial risks. We will use the case study of aviation company in Slovenia with state's ownership. Namely, domestic aviation companies are important part of logistcs in agriculture.

Theoretical background

Risk can not be eliminated almost never, because some events can not be predicted or anticipated. Moreover, in the operation of controls necessary to take into account is the human factor (we are not hedged, if the responsible person is not implemented) (Toman Pfajfar, 2011, p. 30).

Management of the company is responsible by different companie's law in Slovenia for monitoring financial risks. The appearance of the unpredictable environment caused by the constant social, political and economic changes, it puts inevitably the management in the position of decisive search of new managerial ways for improving their professional performance (Turi, 2017, p. 198). The study shows that managers were enthusiastic about their experiences with strategic planning and largely satisfied with their achievement of goals and objectives (Poister, Streib, 2005, p. 3). Management of aviation company is usually responsible for further accounting and financial contents, connected with financial statements:

- financial position, business performance and liquidity;
- annual operations plan;
- elaboratong and providing the financial report to the Supervisory Board for consideration and approval;
- proposals for the use of distributable profit;
- accounting policies.

The Association of insurance and risk Managers (AIRMIC) in the context of risk management standards emphasize that organizations must dealing with risks divided into four groups. These are (IRM, 2002, p. 37):

- Financial strategic risks (competition, changes in customers, changes in the industry, acquisitions, research and development, intellectual capital);
- Operational risks (compensation culture, regulations, supply chain, information systems, accounting controls);
- Random risks (suppliers, natural events, contracts, assets, employment, access to public);
- Market risks (interest rates, exchange rates, loans, solvency, cash flow).

Once a year the supervisory board needs to institute considered and adopted the financial statements and annual report and hence financial risks. One of studies find out that managers make voluntary disclosures to reduce information risk (Graham, Harvey, Rajgopal, 2005, p. 3).

Case study: Structure of assets and liabilities

Below we are showing (Table 1) and explaining the structure of the balance sheet of chosen aviation company in Slovenia and related financial risks.

Table 1. Balance sheet of aviation company for two comparative years

Balance Sheet (In EUR)	31.12.2015	31.12.2014
Assets	50.372.220	46.948.663
A/ Long-term assets	30.337.753	30.678.301
B/ Short-term assets	15.150.028	13.319.304
C/ Other assets	4.884.439	2.951.058
Liabilities	50.372.220	46.948.663
A/ Capital	785.215	9.884.726
B/ Provisions	2.662.250	1.526.780
C/ Long-term liabilities	5.500.772	7.697.204
Č/ Short-term liabilities	35.788.507	24.626.499
D/ Other liabilities	5.635.476	3.213.454

The aviation company had 28% of total assets of the company in fixed assets, 36% in receivables, inventories are small, while investment property and accrued revenues are among the remaining assets. The largest volume of tangible fixed assets is represented by buildings (52%) and other equipment, mostly of them are invested in foreign aircrafts. The value of aircrafts and roto spareparts represents a 22% share and decreased relative to the previous year due to depreciation (Annual report, 2015).

Long-term financial investments represent investments in shares of companies in the group: subsidiary Amadeus Slovenija d.o.o., NMC Skopje, NMC Tirana, Adria Airways Kosovo L.L.C. and Adria Airways Flight School d.o.o. and other shares in the market.

Long-term operating receivables represent in most of them the given guarantee for aircrafts and a spare engines in a long-term business lease (Annual report, 2015). Short-term assets for sale include holiday apartments and business premises, which are in the process of sale (Annual report, 2015).

Short-term financial investments consist mainly of the securities received and one short-term deposit for a bank guarantee. Short-term receivables increased by 13% due to additional business receivables in Estonia (Annual report, 2015).

The highest risks in assets is in our opinion the ownership of companies in group, because if they will not be successful in their business, financial costs could appear and they could worsen the financial situation. The second risk is in Estonia's receivables where it should be examined whether there is any possibility of non-payment of receivables.

Structure of liabilities in 2015, changed significantly primarily as a reduction of share capital as well as an increase in short-term financial and operating liabilities to sources.
The company's capital declined, namely realized losses in 2015, reaching EUR 0.8 million at the end of 2015, representing 2% of total assets of the company. Long-term loans to domestic banks, as compared to 2014 decreased by 29% due to the repayment of loans. Long-term operating liabilities decreased by 0.45 million on account of transfer of deposits to short-term. Compared to the year before, short-term operating liabilities to suppliers rose by 26%, as the company faced a worsening liquidity position.

The highest risks in liabilities are decreased capital, increased financial liabilities (loans) and increased liabilities to suppliers.

Management of aviation logistics company must in order to reduce financial risks constantly check whether at financial statements applies the so-called golden balance sheet rule. This rule is based on the balance sheet, with its assistance we observed the company's ability to finance long-term assets with long-term liabilities in order to avoid problems with solvency. Golden balance rule says, it should be all fixed assets covered by long-term and permanent sources or. commitments. The company, which is subject to this rule, has no problems with solvency and there is no danger of bankruptcy.

In practice, there are two variations of the golden balance sheet rule:

- In the first case the long-term debt are financing by current assets, while in long-term liabilities prevails capital. This example is not ideal, because it is more expensive financing of companies compared with short-term loans. Thus, deviation from the rules is safe in the case that the long-term total liabilities are covered with more than 50% in the equity.
- In the second case short-term liabilities financing the assets. This case is also not ideal, but unlike the first case is dangerous, it can leads to long-term insolvency and bankruptcy. Thus, in most cases the company recorded a loss, which reduces the company's capital.

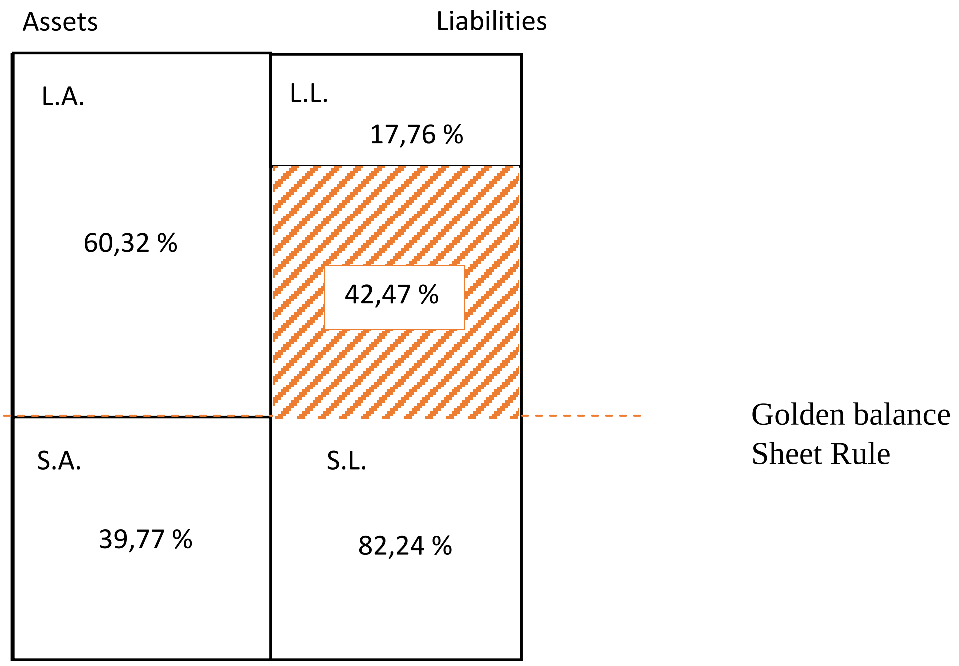
Calculation of golden rules in the case of aviation company in Slovenia for 2015:

The share of long-term assets: $\frac{long-term\ assets\ in\ EUR}{assets\ in\ EUR} *100 = \frac{30.337.753}{50.372.220} *100 = 60{,}23\ \%$

The share of short-term assets: $\frac{short-term\ assets\ in\ EUR}{assets\ in\ EUR} *100 = \frac{20.034.467}{50.372.220} *100 = 39{,}77\ \%$

The share of long-term liabilities: $\frac{long-term\ liabilities\ inEUR}{liabilities\ in\ EUR} *100 = \frac{8.948.237}{50.372.220} * 100 = 17{,}76\ \%$

The share of short-term liabilities: $\frac{short-term\ liabilities\ in\ EUR}{liabilities\ in\ EUR} *100 = \frac{41.423.983}{50.372.220} *100 = 82{,}24\ \%$



In the case of this aviation company goes for second deviations from the golden rules when long-term assets are financed with short-term liabilities. It is a dangerous situation, mainly because the company shows a loss, which in turn reduces the capital. Calculated golden balance rule for the year 2014 reveals that the situation in 2015 has deteriorated. In 2014, approximately 25% of short-term liabilities financed long-term assets. There is a high risk of bankruptcy. Short-term solution is adding of capital (capitalization), but it would be, for the long term success of the company, recommended the restructuring of the entire company.

Other financial risks in aviation company

Fiancial risks usually have the efect on the value of profit. Typical financial risks of European aviation logistics company are:

- currency risk:

European aviation logistics company is usually, depending on the geographical spread of its business activities, exposed to currency risk which may be result, due to changes in foreign exchange rates, by reduceing the economic benefits of the company. The key currency pair is still EUR / USD, as well as currency pairs whose open positions are relatively low: EUR / CHF, EUR / GBP, to a lesser extent of other. Operations of the company are most affected by the movement of the USD, because the currency USD is in close connection with: purchase of aviation fuel, aircraft rent, aircraft maintenance reserves, and some other maintenance costs such are insurance of aircrafts. In 2015, the exposure was higher than in previous years due to decreased sales in the US market. The strengthening of the US dollar has a negative impact primarily on operators in Europe, the majority of its turnover is generated in euros, while the major part of costs are paid in dollars. On average, all over 2015, the euro was worth around 1.11$, which is significantly less than in 2014 (1.33$). Currency risk management reduces by the natural hedging, balancing inflows and outflows, and purchasing derivative financial instruments (Adria Airways, 2015).

- interest rate risk:
  It is the uncertainty associated with the future values of reference (variable) interest rates, LIBOR and EURIBOR. Almost all long-term loans are denominated in euro and linked to the 3-month EURIBOR. Interest rate risk are related to the loans granted by the aviation logistics company in their financial statements. Less the bank loan, the lower are the risks. In recent years, interest rates fell, so that the risks were not significant.
- legal risk
  These risks are due to violation or improper application of laws, regulations, instructions, recommendations, contracts, good practice or ethical norms. The aviation logistics company manages this risk by establishing internal control system and by adoption of internal acts, which reduces the likelihood of harmful consequences. Since the company also operates in international markets, it must also adapt to foreign law. The risk of adverse outcomes lawsuits (impact on society expenditure) decreases with the assistance of external legal representatives (Adria Airways, 2015).
- risks in the area of airport services
  This reduces the risk of planning the type of aircraft depending on the number of passengers, the cost of airport and flight length. At airports to procure only those services they desperately need.
- competitive risk
  Competition of aviation logistics companies are low cost providers and network carriers. They try to avoid competition risks by linking with road hauliers and Airports. Companies also offer "Last Minute" and "First Minute" price advantage.
- fraud risk
  Typical risk of fraud at aviation logistics company are:

- stealing data about the key customers,
- forgery of airline tickets,
- hacking into the system of electronic booking flights,
- accounting fraud,
- fraud as regards the dispensing of aviation fuel (poured a smaller amount of the ordered).

Management of aviation logistics company reduces the number of fraud through the following internal controls (Annual Report, 2015):

- Code of Ethics, which defines the principles of ethics and ethical rules of conduct and behavior of the company management and all employees,
- Quality and independent internal audit. The main task of internal audit is an independent control over the accuracy and cost-effectiveness of company operations, with special emphasis on the quality and adequacy of the internal control system,
- Creation of support services to establish transparency in all departments,
- Simplifying of IT structures in order to reduce data entry errors and data analysis in the IT system and establish a secure website for buying and booking plane tickets,
- Recruitment of new professionals in the area of marketing and e-commerce, for the purpose of using modern data customers base (Star Alliance).

Conclusion

Management of aviation company must constantly monitor financial risks, which are typical for logistics and aviation companies. If the management company does not monitor them financial risks can lead to the losses that deteriorating profitability of company or even to its bankruptcy. Namely, the importance of entrepreneurship for one country's economy is given by the value of investments made in the enterprise capital, which generates substantial revenues to the consolidated general budget and local budgets, being a development vector of that nation (Nastase, Morosan-Danila, 2016). In future we recommend management of companies to insvet more time and money in education of financial indicators of business performance. In wider view it has been proved beyond doubt that companies that have invested in education have reformed modernly the economies, recorded high growth rates and have redefined the foundations of sustainable competitiveness (Nastase, Hodoroaba, 2011).

References

1. Annual report of Adria Airways. (2015).
2. Graham, J. R., Harvey, C. R. and Rajgopal, S. (2005). The economic implications of corporate financial reporting. Journal of Accounting and Economics, 40(1-3), pp. 3-73.
3. IRM. (2002). Available at: https://www.theirm.org/ [Accessed 7 Apr 2016]
4. Nastase, C. and Morosan-Danila, L. (2016). Taxation implications on entrepreneurship in Romania. Available at: https://www.researchgate.net/publication/311738952_TAXATION_IMPLICATIONS_ON_ENTREPRENEURSHIP_IN_ROMANIA [Accessed 15 Sep 2017].
5. Nastase, C. and Hodoroaba, A. (2011). Education - an economic growth factor. *The Annals of the "Stefan cel Mare" University of Suceava. Fascicle of The Faculty of Economics and Public Administration*, 10(2(12)), pp. 53-60.
6. Poister, T. H. and Streib, G. (2005). Elements of Strategic Planning and Management in Municipal Government: Status after Two Decades, 65(1), pp. 3–127.
7. Toman Pfajfar, M. (2011). *Izpolnjevanje standardov značilnosti delovanja IIA. Education materials for obtaining the professional title of certified internal auditor*. Ljubljana: Slovenian Institute of Auditors.
8. Turi, A. N. (2017). International labour law principles as guidelines to foster employment relations. *The USV Annals of Economics and Public Administration*, 17(1(25)), pp. 198-208.