THE IMPORTANCE OF CHOOSING AND APPLYING ACCOUNTING POLICIES IN THE CORPORATE MANAGEMENT SYSTEM

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Abstract:

The accounting information system's output, financial reports, serves as both internal and external users' main information source. Users can use them to see the company's financial performance, evaluate the resource management sector, and forecast the company's future growth. The foundation of the company decision-making process is data from financial reports. Financial statements are prepared using a variety of techniques and steps, all of which have an impact on the numbers that are displayed in them. The chosen accounting policies have a significant impact on the accuracy of financial statements. The attainment of the company's goals, which are represented in the achievement of the highest profit as well as the preservation of liquidity and the continuity of operations, is aided by decisions that are in line with the business policy of the company.

Keywords:

accounting policies, international accounting standards, financial reports, business decision-making.

1. INTRODUCTION

The financial reporting system is part of the accounting system in every company. As such, the financial reporting system is externally oriented. This very fact indicates its enormous importance and the need for a quality basis on which the financial reporting system is based. Given the tremendous significance of financial reporting and the numerous decisions made by diverse interest groups, it becomes evident why extra attention is paid to the quality of this system. Comprehensive data collection was conducted during 2019, as part of doctoral thesis research and partial data and analysis are used in this paper (Raičević, 2021). High-quality financial reporting is a fundamental requirement for luring investments (both local and foreign), which raises the competitiveness of businesses and the overall national economy. Financial reports represent the basic output of the financial reporting system in every company. In order for users to be able to make appropriate business decisions, reports need to be reliable and credible. Reliability and trustworthiness of financial reports is achieved primarily by the correct selection of methods and procedures in the assessment of materially significant balance positions, that is, by the correct choice of accounting policies. The company management has a great responsibility when it comes to the choice of methods and procedures for compiling financial reports, because in this way the financial and profitability position of the company can be greatly affected. The purpose of this study is to emphasize the value of selection and consistency in the application of appropriate accounting policies, the purpose of which is primarily reliable and high-quality financial reporting.

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2. THE ROLE AND IMPORTANCE OF QUALITY FINANCIAL REPORTING IN THE CORPORATE MANAGEMENT SYSTEM

A modern business environment, which is characterized by a high degree of globalization of the world market and liberalization of international trade and financing, has conditioned the intensification of flows of goods, services and capital. Doing business in such conditions allows economic entities new opportunities for growth and development, but also more stakeholders who are interested in the achieved performance of the company.

Quality and credibility requirements of the presented financial reports, which are determined by interest groups, aim to ensure the safety and stability of business operations, as well as reduce exposure to, above all, financial risks. The significance of accurate financial reporting has been further questioned by several instances of financial fraud around the globe.

Financial reporting is well known to play a vital role in enhancing investor protection, luring foreign money, expanding the capital market, and spurring economic progress. A low level of confidence in the financial reporting process provides space to question "the functioning of the capital market, the stability of the financial system, increases the risk and costs of capital and slows down the development of companies and the national economy as a whole" (Malinić et al., 2016).

The question of financial reporting quality and financial reports is particularly important today, and the reasons for this can be found in the environment itself. Some of the expressed trends, characteristic of that environment, are:

- the number of companies whose shares are listed on the stock exchanges is increasing;
- financial reporting is standardized and harmonized at the international level;
- he number of scandals related to financial and accounting affairs is increasing;
- there is an increase in the number of users of financial reports;
- the number of users and requests for information from financial reports is increasing;
- an increasing number of decisions on the placement of funds are made on the basis of information from financial reports" (Dmitrović & Milutinović, 2011).

In order to define the concept of quality of financial reports, it is necessary to start from the objective of financial reports themselves. "The goal of financial reports is to truthfully and objectively present the financial position, the result of operations and changes in the financial position" (Republic of Serbia. Ministry of Finance, 2018). If the financial reports meet this previously defined goal, they can be considered of high quality, "from the point of view of the potentially negative consequences of low-quality reporting, the impact of truthful and honest reporting on the stability and efficiency of financial markets, the functioning of economic entities and the development of the overall national economy" (Malinić, 2013).

When discussing the caliber of financial reporting, it is important to note that there is a correlation between this grade and the grade of corporate governance. Modern corporate systems are characterized by corporate governance as "a process in which management professionally manages entrusted capital in an effort to achieve predefined business goals - liquidity, profitability and solvency" (Stevanović & Belopavlović, 2012). Failures in the financial reporting process are often linked to failures in corporate governance.

Improvements in the quality of corporate governance, which includes the quality of rules related to the independence of the board of directors, the independence of the audit committee and the roles of directors, can improve the quality of the financial reporting process. The board of directors and the audit committee are independent bodies protecting the interests of capital owners and the corporate governance process. Within the scope of defined competences and responsibilities, "the board of directors performs internal supervision over the company's operations" (Official Gazette, 2019). The audit committee, as a supervisory body, "was appointed by the company's board of directors in order to supervise the accounting process, the process of financial reporting and the audit of financial reports" (Petković, 2010). The independence of the members of the board and the audit committee in the process of implementing tasks is necessary so as to ensure the effectiveness of the process of making and implementing decisions.

3. THE INFLUENCE OF THE CHOICE AND APPLICATION OF ACCOUNTING POLICIES ON THE QUALITY OF FINANCIAL REPORTING

Accounting practice and theory strive continuously to define rules and procedures that will enable adequate preparation and presentation of financial reports in accordance with the needs of end users. Given that financial reports represent the primary step in the business decision-making process, it is necessary to include methods and procedures in their preparation that faithfully present the valuesexpressed in them. The methods and procedures used for those purposes represent the domain of accounting policies.

Accounting policies can be defined as "specific accounting principles assessed by economic entities as the most appropriate for their circumstances, and adopted with the aim of preparing and presenting financial reports" (Britton & Waterston, 1999).

The selection of accounting policies should always be based on the higher-level objectives of the company's business strategy in order to facilitate the achievement of those objectives, first of all "achieving maximum profit while ensuring liquidity and stability of business in the long term" (Todorović, 2012).

In this way, accounting policies represent an indispensable instrument for shaping accounting information for the needs of external users, with the aim of making positive business decisions in relation to a given company.

The procedure for choosing accounting policies is a "teamwork involving the accountant, finance manager, procurement manager, sales manager, production manager, as well as representatives of other functions of the entity" (Todorović, 2012). Accounting policies have a variety of objectives, but they all have the same goal - to improve the company's financial performance and position. The following variables will determine how much of an effect the selected accounting policy will have on the financial reports:

- "the share of a certain position in the total structure of assets, liabilities, income or expenses,
- characteristics of the chosen method,
- observed time period and
- other influences" (Žager & Žager, 1999).

For the purpose of comparing financial reports, certain accounting policies should be used over a longer period of time, and changes to those policies may be influenced by "requirements of changed international standards, changes in legislation or management assessment, so that a different accounting policy would contribute to a more objective presentation of a certain balance sheet position" (Todorović, 2012).

4. ACCOUNTING POLICIES IN THE PRACTICE OF CORPORATE MANAGEMENT

Modern business conditions, accompanied by economic globalization, imposed the need for transparent, timely and reliable financial reports. In addition, the users of financial reports have increasing demands regarding the publication of various types of information. In this sense, the management of the company is responsible for the management of the business entity, as well as its performance shown in the financial reports. Today, company management has independence in making decisions regarding the choice of methods and procedures when compiling and presenting financial reports. Therefore, it must select accounting practices that support the company's established business objectives. All of these policies must be in compliance with generally accepted accounting principles (GAAP) and/or international financial reporting standards (IFRS), even if they may vary from firm to company.

Accounting procedures that are extremely complex, such as depreciation methods, goodwill recognition, compilation of research and development costs, inventory valuation, and financial reports consolidation, require implementation of apropriate accounting policies (Investopedia, 2019). Therefore, the management must decide on the allowed accounting procedures taking into account several factors (what are the costs according to one method and what according to the other, what will be the value of the inventory, etc.). In the case of a deliberate choice of inadequate accounting policies for the management of a business entity, it can be said that it does not operate according to the "principle of a good host" (Vićentijević, 2013). Inadequate choice of accounting policies significantly affects the reliability of financial reports.

It should be emphasized that the accounting profession strives to respond to the increasing demands of users, by creating a normative basis that would ensure quality financial reporting, and thus the trust of users of the information contained in financial reports. However, sometimes the normative basis is not a sufficient condition for achieving that goal, especially when the management, which is responsible for the compilation and accuracy of financial reports, does not apply it adequately.

It often happens that management shapes financial reports according to their own goals. The aproach towards achieving high earnings (bonuses) and gaining a reputation as a good manager due to the company's performance shown in the balance sheets, leads managers to deviate from international and national accounting regulations, which means that the results shown in the financial reports are not credible and reliable.

Such management behavior can create not only material losses suffered by the most important stakeholders, but above all it can affect the reduction of trust in financial reports. The loss of user confidence in the information presented in financial reports would have unforeseeable consequences for the financial markets, and thus the economy as a whole.

By preserving the integrity of the company's management with the help of an efficient system of internal control, independent external audit and by improving and encouraging the ethical behavior of management, accountants and auditors, the quality of financial reports as well as decisions made on the basis of information contained in financial reports is secured.

True and honest financial reporting ensures the "successful functioning of the reporting entities themselves, financial markets and the overall market economy" (Novićević, 2016). The production of high-quality financial reports fosters the inflow of foreign money, boosts investor confidence, investment activity, and overall economic activity.

5. RESEARCH ON APLLIED ACCOUNTING POLICIES

In this study, we examined the accounting practices used by businesses in the Republic of Serbia. These businesses were split into two categories: those with subsidiaries (i.e., those that consolidate) and those without subsidiaries (that is, that do not consolidate). The examination encompasses the analysis of the effects of applied accounting policies on the company's financial and profitability situation in the areas of intangible assets, real estate, plant and equipment, depreciation, long- and short-term financial placements and receivables, capital, and others. Individual balance sheet situations of the companies in the investigated groups of companies were different, as seen in the financial reports, due to variations in the accounting policies that were used in the aforementioned areas (Raičević, J. 2021).

"Collection of primary data was carried out using the survey method, using the questionnaire technique, which was sent by mail. The research was conducted during January and February 2019. The questionnaire was sent to 120 company addresses in the Republic of Serbia. The answer came from 49 companies, which represent the sample on which this analysis was made. For the purposes of statistical analysis, SPSS version 2017 software was used" (Pallant, J. (2011).

Table 1. Research on applied accounting policies

Question		Company size per employee number								N	%	χ2	df	p	φ/V
		Micro		Small		Medium		Big							
		f	%	f	%	F	%	f	%						
"Are there deviations in the application of accounting policies in relation to the accounting policies defined by the company's internal act?"	Yes	4	23,5%	1	7,1%	0	0,0%	2	28,6%	7	14,3%			0,488	
	No	13	76,5%	13	92,9%	11	100,0%	5	71,4%	42	85,7%				
"Are the disclosed accounting estimates and judgments made by management reasonable in the circumstances and consistent with the conclusions drawn from the audit working papers?"	Yes	10	58,8%	10	71,4%	11	100,0%	7	100,0%	38	77,6%			0,004	
	No	7	41,2%	4	28,6%	0	0,0%	0	0,0%	11	22,4%				

"Does the entity change an accounting policy if it turns out that the adopted accounting policy does not contribute to the truthfulness, objectivity and fair presentation of the financial report?"	Yes	15	88,2%	13	92,9%	10	90,9%	7	100,0%	45	91,8%			0,530	
	No	2	11,8%	1	7,1%	1	9,1%	0	0,0%	4	8,2%				
"Whether the entity discloses information for events occurring after the balance sheet date"	Yes	9	52,9%	10	71,4%	10	90,9%	6	85,7%	35	71,4%	4,250	1	0,039	-0,295
	No	8	47,1%	4	28,6%	1	9,1%	1	14,3%	14	28,6%				
"Did applying a new accounting policy result in:"	Unchanged result	14	82,4%	13	100,0%	10	90,9%	7	100,0%	44	91,7%			0,516	
	Increasing profit	3	17,6%	0	0,0%	1	9,1%	0	0,0%	4	8,3%				

Source: http://www.eknfak.ni.ac.rs/dl/doktorske/2021/Dis_UNI_Jelena_R_Raicevic_2021.pdf, pp. 215

The result of Fisher's test indicates that companies by size according to the number of employees do not differ in the answer to the question: "Are there deviations in the application of accounting policies in relation to the accounting policies defined by the internal act of the company?", p=0.49. Out of 49 companies, 42 (85.7%) do not deviate from the accounting principles outlined in the internal act of the organization when applying its accounting policies. The greatest number of accounting policy applications that deviate from the internal act of the organization are found in micro enterprises (23.5%).

Discrepancies in micro-enterprises can be explained by the fact that these enterprises are not obliged to submit Notes to the financial reports. Namely, according to Article 2 of the Law on Accounting, the annual regular report of a micro-enterprise consists of a balance sheet, a profit and loss account and a statistical report.

The result of the Fisher test indicates that companies by size according to the number of employees differ in their response to the question: "Are the disclosed accounting estimates and judgments made by management reasonable in the circumstances and consistent with the conclusions of the audit working papers?", p=0.00. Out of 49 companies, in 38 (77.6%) the management's accounting estimates and judgements are reasonable under the circumstances and consistent with the findings from the audit working papers. Small businesses (28.6%), followed by micro enterprises (41.2%), exhibit the greatest degree of disagreement. Only medium-sized businesses do not have a mismatch between management's assessments and accounting estimates, the findings from the audit's working papers, and the conditions.

The result of Fisher's test indicates that companies by size according to the number of employees do not differ in the answer to question: "Does the entity change an accounting policy if it turns out that the adopted accounting policy does not contribute to the truthfulness, objectivity and fair presentation of the financial report?", p=0.53. If it turns out that the adopted accounting policy does not support the accuracy, objectivity, and fair presentation of the financial report, 45 out of 49 companies (91.8%) change it.

In response to the question, "Does the business publish information for events occurring beyond the balance sheet date?", the Chi-square test result shows that companies vary in size according to the number of employees: 2(1, n=49)=4.25; p=0.04, =-0.30. Out of 49 corporations, 35 (71.4%) share information concerning occurrences following the balance sheet date. The opinions of microbusinesses differ on this matter. The number of the companies that give information about the events that happened after the balance statement date is 9 (52.9%), while 8 (47.1%) do not.

The result of Fisher's test indicates that companies by size according to the number of employees do not differ in the answer to the question: "Did applying a new accounting policy result in:", p=0.52. Out of 48 companies, 44 (91.7%) had an unchanged result by applying some new accounting policy.

6. CONCLUSION

Quality financial information, i.e. quality financial reporting, is the basis of the financial system stability, which can encourage the development of national economies and attract investors. Information is especially important in the functioning of the capital market. Namely, a developed and stable capital market, a developed private sector and credit institutions contribute to economic effectiveness and efficiency, and generally to an increase in social well-being.

Each business's operations are a unique confluence of objectives, dealings, constraints imposed by the political, social, and economic environments, risks, and uncertainties. Therefore, the way of evaluating materially significant balance positions is decided by the company's management in accordance with the objectives of the business. Additionally, when it comes to management decisions, the accounting treatment of specific transactions and the established disclosure strategy impact the quality of financial reporting.

Financial reports are the accounting information system final product, and their preparation involves various methods and procedures, which have different effects on the values shown in the financial reports. By legal and professional regulations, the company is given the option of choosing between basic and alternative procedures for displaying and evaluating individual positions in financial reports.

Managers who are in charge of selecting accounting policies must give the matter their undivided attention as it can be very delicate and intricate. The responsibility of management is to advance the interests of all parties involved, particularly capital owners, investors, creditors, and other parties. The reasons, objectives, and results of selecting particular accounting rules are significant because they have an impact on how the public perceives the organization and, consequently, how stakeholders behave and make decisions. The financial situation and operational success of the company can be significantly impacted by the manager's selection of accounting policies.

Research on applied accounting policies was conducted in companies in the Republic of Serbia. Based on the analysis, we concluded that the most deviations in the application of accounting policies were observed in micro and small companies, because these companies generally do not have a clearly defined internal act. When it comes to medium-sized and large companies, we concluded that these companies have consistency in the application of the chosen accounting policies, that is, they adhere to the rulebook on accounting policies. Although small and micro enterprises have internal rules that define the treatment of certain business events, they often deviate from them. Likewise, small and micro enterprises are not subject to external supervision, i.e. audit, but only the control of tax authorities. Accordingly, in order to improve the quality of financial reporting in our country, it is necessary to work on further improvement of the regulatory framework. Likewise, all economic entities, regardless of size, should respect the adopted internal acts, such as the rulebook on accounting policies, because in this way quality is achieved and trust in financial reports is created, which as the final result also has trust in financial reporting of a country, as well as its quality. A quality financial reporting system enables transparency and comparability of financial reports, which is of particular importance for developing countries, such as our country.

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