

SELECTION OF CRITERIA AND DEVELOPMENT OF THE FINANCIAL TRANSPARENCY EVALUATION ALGORITHM

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ABSTRACT

In most cases the uncertainty of future business development makes it hard for an investor to opt for the one of many enterprises to invest. In conditions of uncertainty it is recommended to invest in companies with a good reputation, since such investments are regarded as less risky. In such a situation the attention is increasingly turned to the companies which meet the consumers' needs: trade, food production, construction.

It is known that the value of business is considered to be the main indicator of the company's reliability and attractiveness for investors. However, the financial transparency of the enterprise is an equally important factor in the investment attractiveness. The financial transparency is expressed in availability of reporting information on the current state of the enterprise and the company's operation prospects. The investor wants to be aware of not only the current financial state of the enterprise, but also the dynamics and reasons for its change for a certain period of time, and to identify the prospects for the development of the enterprise as well. Considering both the value of the business and the financial transparency the investor has a more accurate prognosis regarding to the company's position on the market in the future. Consequently, the decision of the investor concerning investments in a certain enterprise can be defined as more justified, as it is based on the public financial reporting.

In the paper the financial transparency evaluation algorithm based on the selected criteria is suggested and tested. This algorithm allows the investor to make a decision in favor of the companies with the high financial transparency, profitable for investment. The paper more specifically focuses on the investment attractiveness of construction companies in Krasnoyarsk, a major industrial center in the south-eastern part of Russia, though it should be mentioned that this algorithm can be used for companies in another manufacturing sector as well.

Key words: transparency, criteria, investment

INTRODUCTION

Transparency is a complex indicator of the openness of a subject of economy, reflecting the degree of completeness of disclosure and accessibility of reporting information about its current state and prospects of operation that is adequate to users' requirements [6]. Its essence lies in the system of the company's relations with investors and other

interested subjects on the basis of the principles of openness, reciprocal benefit, development and loyalty.

Current literature focusing on the problem of transparency pays sufficient attention to the issues of reporting and finance. Transparent financial reporting is defined as the reporting that completely reveals all important information about the company's operation, necessary for users to make a correct judgment about its financial state and operation results in order to make decisions about the interaction with it. The accounting reporting is the basis of financial transparency [10]. Nowadays the principles of Russian accounting are similar to international standards to large extent [3, 8].

Despite the theoretical studies conducted, at present there is no single approach to the quantitative evaluation of financial transparency. Consequently, two scientific problems arise:

- the selection of criteria for financial transparency evaluation;
- development of the financial transparency evaluation algorithm, based on selected criteria.

METHODS AND MATERIALS

Several conditions of financial transparency have been pointed out in the research both in Russia and abroad [4, 9]:

- the investors should get access to all information on time and without problems;
- the organization must have a website where the financial reporting and other important information for clients and investors should be posted;
- accounting reports and other information should be presented with the clear language and performed at a high level.

When calculating financial transparency the information from two main sources: annual reports and websites should be considered. The first group of sources includes annual reports that are prepared according to International Financial Reporting Standards (IFRS) and notes, if the organization indicates that they are an integral part of the annual report. It should be noted that the use of IFRS ensures the proper level of transparency, which is verified by the requirements of the world's largest stock exchanges [1]. The second group of sources includes all data posted on the company's website, including hyperlinks to documents belonging to the organization [5, 11].

The fact of the availability of information in the open access (regardless of the source of disclosure) gives 80% of the maximum score for each criterion of financial transparency. The rest 20% is added if the necessary information is available in the second source as well. This method is based on the assumption that the availability of duplicate information in various sources is an undoubted advantage, as it increases its accessibility of the information for the investors. Although the very fact of information duplication has less value in comparison to the fact of primary disclosure of information.

Information is processed in early August of the current year. All data provided after this date is considered as insignificant for evaluation of the transparency level, since it is given more than seven months after the end of the reporting year. Consequently, the

information that appeared after this date is no longer of value to investors whose target is to assess the current state of the company on the basis of previous year data.

Based on the foregoing, a list of evaluation criteria has been compiled. The research questionnaire consists of 28 criteria of financial transparency evaluation related to the four components:

- structure of internal documents;
- information about the participants;
- financial information;
- operating information.

The list of criteria for each component is given below.

Component 1. Structure of internal documents

1. Content of the Code or the Corporate Governance Regulation.
2. Content of the Code of Corporate Conduct and Ethics.
3. Regulations of the Company's Charter (including changes).
4. Regulation on the Internal Audit Service.
5. Agreement on the establishment of the Company.
6. Protocol on the establishment of the Ltd.
7. Full protocols of general meetings of the Company.
8. Disclosure policy.

Component 2. Information about the participants

1. List of Company participants (surnames).
2. Data on current jobs, positions.
3. If the founder (s) is/are in the list of Company participants.
4. Data on the share of the participants in the Authorized Capital.
5. Making of decisions by the general meeting participants on the distribution of the share in the Authorized Capital.
6. Information on the meeting attendance by the participants.

Component 3. Financial information

1. Accounting policy of the company.
2. Standards used in reporting.
3. Annual Financial Statements (reports) in accordance with IFRS.
4. Notes to the Annual Financial Statements in accordance with IFRS.
5. Publication of Audited Financial Statements in accordance with IFRS.
6. Name of the auditor of the company.
7. The amount of remuneration paid to the auditor for audit services.

Component 4. Operating Information

1. Information on the Company's activities.
2. Information on the production or services offered.
3. Characteristics of the assets used (including licenses).
4. Performance Indicators.
5. Discussion of corporate strategy.
6. Investment plans for the nearest years
7. Market share of some or all of the Company's activities.

Based on the selected criteria, the financial transparency evaluation linear algorithm for the certain enterprise has been developed, that results in a total score (%) of financial transparency in the enterprise. The algorithm consists of the following steps:

1. Financial transparency on each criterion is calculated, depending on the availability of information in the open access. Financial transparency ($Ftransp$) is equal to 80% if information is available in one source, 100% – in two sources, 0% – in none.
2. Financial transparency on each component is calculated as the arithmetic mean on all criteria in the component:

$$Ftransp_k = \frac{1}{n_k} \cdot \sum_{i=1}^{n_k} Ftransp_i$$

where $Ftransp_k$ – the financial transparency of the k-component, n_k – the number of criteria in the k-component, $Ftransp_i$ – the financial transparency of the i-criterion in the k-component.

3. The total score (%) of financial transparency in the enterprise is calculated as the arithmetic mean of the four components. The ratio of the number of criteria in the relevant component to the total number of criteria in the questionnaire is used as the weighting factors. The total score of financial transparency is calculated with the formula:

$$Ftransp_{sum} = \sum_{i=1}^k \frac{n_i}{n} Ftransp_i,$$

where $Ftransp_{sum}$ – the total score (%) of financial transparency in the enterprise, $Ftransp_i$ – the financial transparency of the i-component, k – the number of components, $\frac{n_i}{n}$ – the weighting factor, n_i – the number of criteria in the i-component, n – the total quantity of criteria.

RESULTS

The previous studies [7] offered the calculations of the business value on the basis of the income approach using the modified model CAPM A. Damodaran [2] for 5 companies of the construction industry in the city of Krasnoyarsk: Monolitholding, Restoration, Alfa, Economgilstroy, Alexstroy. This paper contributes to understanding of their financial transparency evaluation.

The evaluation of financial transparency is implemented on the base of the data of the end of 2015, since it is the last available financial statement (balance sheet and profit and loss statement).

According to the above-mentioned linear algorithm financial transparency is calculated for each criterion used in the study, depending on the availability of information in the open access. The results of the calculations are given in Table 1.

Table 1 – Financial transparency of the company on each criterion for 2015, %

	Monolitho lding	Restoratio n	Alfa	Economgils troy	Alexstroy
<i>Component 1. Structure of internal documents</i>					
Content of the Code or the Corporate Governance Regulation	100	80	0	0	0
Content of the Code of Corporate Conduct and Ethics	100	80	0	0	0
Regulations of the Company's Charter (including changes)	100	100	80	80	80
Regulation on the Internal Audit Service	100	100	0	0	0
Agreement on the establishment of the Company	80	80	0	0	0
Protocol on the establishment of the Ltd.	80	80	80	80	80
Full protocols of general meetings of the Company	80	0	0	0	0
Disclosure policy	80	80	0	0	0
<i>Component 2. Information about the participants</i>					
List of Company participants (surnames)	100	100	80	100	80
Data on current jobs, positions	100	100	80	80	80
If the founder (s) is/are in the list of Company participants.	100	100	80	100	80
Data on the share of the participants in the Authorized Capital	80	80	80	80	80
Making of decisions by the general meeting participants on the distribution of the share in the Authorized Capital	80	80	0	80	0
Information on the meeting attendance by the participants	80	0	0	0	0
<i>Component 3. Financial information</i>					
Accounting policy of the company	100	100	0	80	80
Standards used in reporting	100	80	0	80	80

Annual Financial Statements (reports) in accordance with IFRS	100	100	80	80	80
Notes to the Annual Financial Statements in accordance with IFRS	100	80	0	0	0
Publication of Audited Financial Statements in accordance with IFRS	100	80	80	0	0
Name of the auditor of the company	100	80	80	0	0
The amount of remuneration paid to the auditor for audit services	80	80	0	0	0
<i>Component 4. Operating Information</i>					
Information on the Company's activities	100	100	100	100	100
Information on the production or services offered	100	100	100	100	100
Characteristics of the assets used (including licenses)	100	100	0	80	0
Performance Indicators	100	100	0	80	0
Discussion of corporate strategy	100	100	100	100	0
Investment plans for the nearest years	80	80	80	80	0
Market share of some or all of the Company's activities	100	100	0	0	0

Financial transparency of the companies on each component and the total score of the financial transparency (for 2015) are presented in the Table 2.

Table 2 – Financial transparency of the companies on each component and the total score of the financial transparency for 2015, %

Component Company	Component 1. Structure of internal documents	Component 2. Information about the participants	Component 3. Financial information	Component 4. Operating information	Total score
Monolitholding	90	90	97	97.1	93.5
Restoration	75	76.6	85.7	97.1	83.5
Alfa	20	53.3	34.2	54.2	39.2
Economgilstroy	20	73.3	34.2	77.1	49.2
Alexstroy	20	53.3	34.2	28.5	32.8

The information provided in the table 2 has defined Monolitholding and Restoration as the leaders in accordance to the total score. The least total score of the financial transparency is given to Alfa and Alexstroy.

CONCLUSION

On the basis of the research, 28 criteria of financial transparency evaluation related to four components have been selected:

- structure of internal documents;
- information about the participants;
- financial information;
- operating information.

Based on the selected criteria, the financial transparency evaluation linear algorithm for the certain enterprise has been developed, that results in a total score (%) of financial transparency in the enterprise.

The financial transparency evaluation algorithm has been tested for 5 companies of the construction industry in the city of Krasnoyarsk: Monolitholding, Restoration, Alfa, Economgilstroy, Alexstroy. The analysis of the data has identified Monolitholding and Restoration as the leaders of the financial transparency.

The results of the research can be useful for both investors to identify the certain enterprise as profitable for the investment, and the executives of the enterprises to assess the transparency of the enterprise and develop the measures aimed to improve it.

The future research will be focused on the development of the algorithm for sharing of business value and financial transparency for the investment attractiveness evaluation with the purpose of increasing certainty in the decision-making process by the investors.

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