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THE NECESSITY OF EXAMINING THE NOTES TO THE FINANCIAL STATEMENTS

Review
Article

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Abstract

The notes to the financial statements are a part of the annual statement and the simplified annual statement. One of their main purposes is to provide data and information in order to make the balance sheet and profit and loss account figures clear and usable for owners, investors, creditors and all stakeholders. The notes are required to support the appropriate presentation of a reliable and realistic picture, based on the principles of accounting, in particular the principles of accuracy, clarity, consistency, continuity and full disclosure. Based on previously conducted research, the preparation of the notes to the financial statement and the achievement of their objectives have been frequently criticised. Consequently, in the scope of the present study, a questionnaire survey was conducted concerning the opinion of economic professionals and managers on the information contained in the notes of the stakeholders of their company and on the information that can be obtained from them, which they come across during the process of decision-making.

INTRODUCTION

The competitiveness of enterprises depends to a large extent on the efficiency of their information and decision-making system and on the relevant information available at the right place and time (Musinszki, 2012). A reliable and consistent information system is needed to obtain proper information and knowledge and to enable businesses to be well assessed, judged and compared. This need for data is fulfilled in Hungary by Act C of 2000 on Accounting, which defines the reporting and accounting obligations of the companies covered by it, the principles to be applied in compiling the financial statement and bookkeeping, the rules based on them, and the requirements concerning disclosure and auditing (Accounting Act, 2020). According to Sztanó (2013), the primary purpose of the annual statement, which is regulated by the Accounting Act, is to provide information (Sztanó, 2013). The form of the annual statement depends on multiple factors, such as the form and size of the company and the strength of its relationship with other business entities. According to the Accounting Act, the volume of annual net sales revenue, the balance sheet total, the number of employees and the method of bookkeeping are the factors that determine the form of the annual statement. Based on the above, the statement can be an annual statement, a simplified annual statement, simplified annual statement of a micro-enterprise, simplified statement and a consolidated annual statement (Orbán, 2015). The balance sheet presenting the financial position of the company and the profit and loss account informing about the income, costs and expenditures, as well as the notes to the financial statements provide information about the wealth, financial, and income situation of the company towards its external stakeholders. In addition to its external information system, the internal accounting information system must be designed in such a way that it can be put at the service of the business strategy of the company at all times (Böcskei & Hágen, 2017). The notes to the financial statements are a part of the annual statement, the simplified annual statement and the consolidated annual statement.

The notes to the financial statements shall contain the data and textual explanations required by the relevant legal regulations, as well as information supplementing the various entries of the balance sheet and profit and loss account, by means of which the asset, financial and income position of the company can be clearly assessed by external stakeholders. The notes to the financial statement should contribute to the more appropriate presentation of a reliable and realistic picture (Adorján, 2008), which is based on the principles

of accounting, in particular the principles of accuracy, clarity, consistency, continuity and full disclosure (Kresalek, 2007). Thus, the statement as a whole presents a reliable and true picture. If the balance sheet and the profit and loss account – which serves the comparison of the profit of different periods – present different data, then it is compulsory for business entities to report about these differences in the scope of their notes (Ónodi, 2005). Based on previous research (Kardos, 2009; Filyó, 2014; Fenyves, Böcskei, Bács, Zéman & Tarnóczy, 2019; Kántor, 2016; Böcskei & Hágen, 2017), numerous critical opinions have emerged about the notes to the financial statements published in Hungary and it can also be stated that the information contained by them is essential for businesses. This is also confirmed by a recent study, which examined the notes to the financial statements of 8266 Hungarian-based information-technology companies with the help of text mining. As a finding, it can be stated that in many cases the information published in the notes to the financial statements – both the general and the informative part – do not meet the minimum requirements stipulated by law (Fenyves, Bács, Zéman, Böcskei & Tarnóczy, 2018; Fenyves, Böcskei, Bács, Zéman & Tarnóczy, 2019).

MATERIAL AND METHOD

A quantitative questionnaire survey was conducted related to company expectations in terms of the notes to the financial statements. The advantage of the questionnaire survey is that it is easy to perform, the questions are pre-defined (closed questions), they take relatively short time to answer, but the by evaluating the answers, the interviewer is able to obtain important information. As a disadvantage of the questionnaire survey, it is frequently mentioned that respondents may not be able and/or willing to answer, and that the answers may be deliberately dishonest. In terms of the form of the survey, the online questionnaire was chosen, because those can be completed more widely, in greater numbers than paper-based questionnaires. As questions, mostly closed questions were used, which are essentially formulated statements; multiple subtypes of these questions can be found in the questionnaire. On the one hand, there are single answer questions, such as questions concerning the main activity of the companies and the size of their turnover in the previous year. On the other hand, there are five-point Likert scale questions in which respondents determine the importance of the 44 statements of the notes to the financial statements required by the Accounting Act.

The questionnaire was prepared in Google Forms in a computer user friendly format and the responses were also collected using this software. The obtained results could be downloaded from the software in Excel format. The respondents were managers of companies and various organizations, as well as employees appointed by them. The respondents received the questionnaire via e-mail in September 2020. With the help of the questionnaire, the intention was to assess whether the economic experts and managers take into account the information contained in the notes to the financial statements of the stakeholders of their companies for their decision-making process. The questionnaire was sent to approximately 800 professionals and it was completed by 131 people by the end of the survey.

The composition of the sample by field of activity is as follows according to Figure 1:

- 39 respondents carry out productive activities
- 21 respondents are engaged in commercial activities
- five respondents work in financial institutions
- 19 respondents provide accounting services
- six respondents are engaged in auditing activities
- 32 respondents provide other services
- nine respondents belong to a budgetary body

Examining the respondents according to their revenue in the previous year, it can be stated that companies with lower revenue dominate within the sample, as more than 40% of the respondents did not reach a revenue of HUF 500 million in the previous year and almost 35% had a revenue between HUF 10 billion and HUF 500 million. Enterprises with a revenue of over HUF 10 billion were distributed in almost equal proportions among the different categories. The above is illustrated in the diagram of Figure 2.

In the course of the relationship analysis, the correlations between individual variables were examined. The χ^2 test was used, one of the non-parametric tests, with the help of which an independence test was performed. The use of the χ^2 test is popular because, apart from being suitable for the study of discrete variables, there is no other regulation concerning the distribution of variables. During the null hypothesis of the test, it is stated that the two examined variables are independent of each other, i.e. there is no relationship between them, and according to the alternative hypothesis, there is a relationship between the variables. The value of Pearson's chi-square test value can be used to perform the test. If the resulting P-value is less than 0.05 (5%), the null hypothesis can be rejected, in which case there is a significant difference between the two variables. If the obtained P-value is higher than 0.05, then the null hypothesis is acceptable, i.e. the two variables are independent of each other (Hunyadi, Mundruczó & Vita, 2001).

It was also possible to describe the tightness of the significant relationships by means of Cramér's V coefficient. Cramér's V coefficient shows the level of association between two nominal variables and one nominal and one ordinal variable. In the case of nominal scale, there is no quantitative correlation between the categories while the ordinal scale is based on order (Sajtos & Mitev, 2007). The value of the independence test can be between zero and one, which depends on the strength of the stochastic correlation between the two criteria. If its value is zero, then there is no correlation between the two variables, and if it is one, there is a deterministic correlation. The result of the calculation is independent of which variable is placed in the rows and which is in the columns (Hunyadi, Mundruczó & Vita, 2001).

One of the aims of applying principal component analysis may be to describe the structure of the covariance estimated from a sample of original variables with the least linear combinations of variables, so as to lose as little of the total explanatory power as possible. By default, as many principal components are created as the number of variables. Usually not all the main components are required, but it should be tried to describe or replace the original data set with the help of the first few main components (Tóthné Parázsó, 2011). The eigenvalues obtained in the course of principal component analysis are equal to the variance explained by the associated principal component. Any principal component with an eigenvalue higher than one has an explanatory power greater than the original variables. A commonly used rule for determining the number of principal components is to keep principal components the eigenvalues of which are higher than one (Münnich, Nagy & Abari, 2006). The variables for each principal component can be determined using principal component weights. The value of the principal component weights can be between -1 and +1. The principal component weight vectors are independent.

RESULTS OF THE QUESTIONNAIRE SURVEY

In the scope of the survey, the aim was to answer the question of how important a company considers the information in the notes to the financial statements of another company (if it takes into consideration such information), and what do companies that do not take it into account in their decision-making process think about it.

According to Table 1, 80% (105 people) of the 131 companies in the sample take the information of the notes into consideration during their decision-making process, while the remaining 20% (26 people) do not. The highest proportion is

represented by the statements 'important' and 'necessary', if the company takes the information into account. This represents 39% and 37%. Overall, almost 95% of respondents that use the notes to the financial statements in the course of their work consider at least its disclosures to be necessary (43%, i.e. 10 people). Only 18% of users consider it very important if they take into account information for a customer evaluation, while only 8% of those who do not take it into account in their work.

During the survey, respondents were asked to rate on a five-point Likert scale the importance of 44 findings in the notes to the financial statements required by the Accounting Act. Responses were evaluated using an independence test, which was performed using a χ^2 test. The null hypothesis was that the extent to which companies consider the information in the notes important does not depend on their type of activity. The alternative hypothesis is that the importance of the information in the supplementary annex depends on the type of activity.

If a significance level of 5% is expected, then the difference between the answers can be explained by the activity of the company in case of six statements, i.e. in their case the P-value is less than 0.05 (5%), thus the null hypothesis can be rejected, the two variables are not independent from each other, there is a connection between them. Companies with different activities had similar views on the importance of the following findings:

1. "Registered office of the enterprise", in which case the P value is 0.03
2. "Transactions carried out with affiliates", where the P value is 0.02
3. "The total amount of financial liabilities, which are significant for the assessment of the financial situation, but which do not appear in the balance sheet, in particular future pension and severance agreements and the amount of liabilities with affiliates.", where the P value is 0.00
4. "The opening value, increase, decrease and closing value of value adjustments in the detailed description of at least property rights, intellectual property, real estate, including property rights related to real estate, technical equipment, machinery, vehicles, as well as other equipment, facilities, vehicles, breeding animals, investments in permanent ownership in detail. ", for which the P value is 0.01
5. "The opening value of impairment, its increase in the current year, its decrease in the current year, the amount of the reversal of the impairment, the closing value of impairment at least by balance sheet items.", For which the value of P is 0.00
6. "Proposal for the use of the after-tax profit", for which the P value is 0.03

Overall, it can be said that the majority of the answers received are not influenced by the scope of activities of the company, because there is a significant difference only for over 20% of the questions, even if the 10% significance level is allowed. Examining the P values, it can be concluded that in the case of liabilities affecting the financial position, the difference between responses and can be explained with the activities of the company in terms of the assets analysis of impairments and value adjustments, i.e. there is some connection between the importance of these items and activities.

Cramér's V and Tschuprow's T association coefficient and the Chi-square test are presented using boxplot diagrams in Figure 3, which shows the summarized values of the probability values of the χ^2 test for the calculated statistical characteristics. It is clear that overall, there is a rather weak correlation between the importance of the business activities of the company and the different parts of the notes to the financial statements.

The maximum of the V value was 0.356, which suggests a weak medium correlation. This is confirmed by the fact that a significant correlation was also detected only in 20% of the variables. Both association coefficients can be said to have low mean values, 0.200 in one case, and 0.181 in the other, while their relative standard deviation is not high either (27.36).

In order to reduce the number of 44 statements to be included in the notes required by the Accounting Act, and to determine the background variables not included in the questions, a principal component analysis was performed. The primary objective was to reduce the number of 44 variables and to summarize and express the same information in a more concise form with the help of the new groups of variables and principal components obtained. The number of principal components was determined to keep only those in the study which had an eigenvalue higher than one. The principal component analysis reveals the internal structure of the data to best explain the deviation of the data set. Table 2 shows that the majority of the 44 statements were summarized into nine principle components, which explains 93% of the total variance. The column in the table called Explained Ratio shows the ratio of the variance that can be explained by principal components. The highest explanatory ratio is for principal component one, where the explained ratio is 16%, while the principal component with the lowest explained rate is listed with 5%. The findings belonging to each of the main components are as follows:

1. Information related to the complex economic situation of a company

2. Information related to non-cash flow economic events (e.g. asset analysis of depreciation and impairment)
3. Information related to various liabilities (e.g. liabilities relevant to the assessment of the financial position, off-balance sheet items)
4. Information related to funding programmes (e.g. values of the amounts received/provided in the scope of the funding programme)
5. Information about the accounting policy (e.g. presentation of the most significant elements of the accounting policy, evaluation procedures)
6. Information about the accounting policy (e.g. presentation of the most significant elements of the accounting policy, evaluation procedures)
7. Contact information (e.g. company seat, premises, online contact information)
8. Disclosures related to senior executives (e.g. amount of remuneration to be paid to them broken down by title)
9. Information on the cost of import procurement and research and development
10. Audit related information (e.g. name and contact information of the auditor).

CONCLUSIONS

Previous research shows that the notes to the financial statement do not always achieve its purpose. The assessment of the notes has been specific from the beginning, as its information content is often barely more than an explanation of the figures in the balance sheet and profit and loss account. Therefore, there are market players who consider it important, and it is thought to be unnecessary by others. There are business entities that put sufficient emphasis on preparing it, while some others simply neglect it. Based on the present research, it can be stated that in the scope of their decision-making process, companies take into account the information contained in the statements and notes of their partner companies and consider them to be important on average, at least necessary. The importance of the information in the notes is not affected by the scope of the business activities of companies, because even at a level of 10% there is a significant difference in the case of slightly over 20% of the explanations. The maximum of Cramér's V value is 0.35, thus the association between the two variables is also weak. Finally, based on the principal component analysis, the majority of the 44 statements were summarized into nine principal components, which explains 93% of the total variance. It is considered important by the authors of the present article to examine the notes to the financial statements to confirm that it contains everything specified by the Accounting Act. It is essential that only statements prepared by a registered professional with

appropriate qualifications can be published. This is one of the basic conditions for high quality accounting work and usability.

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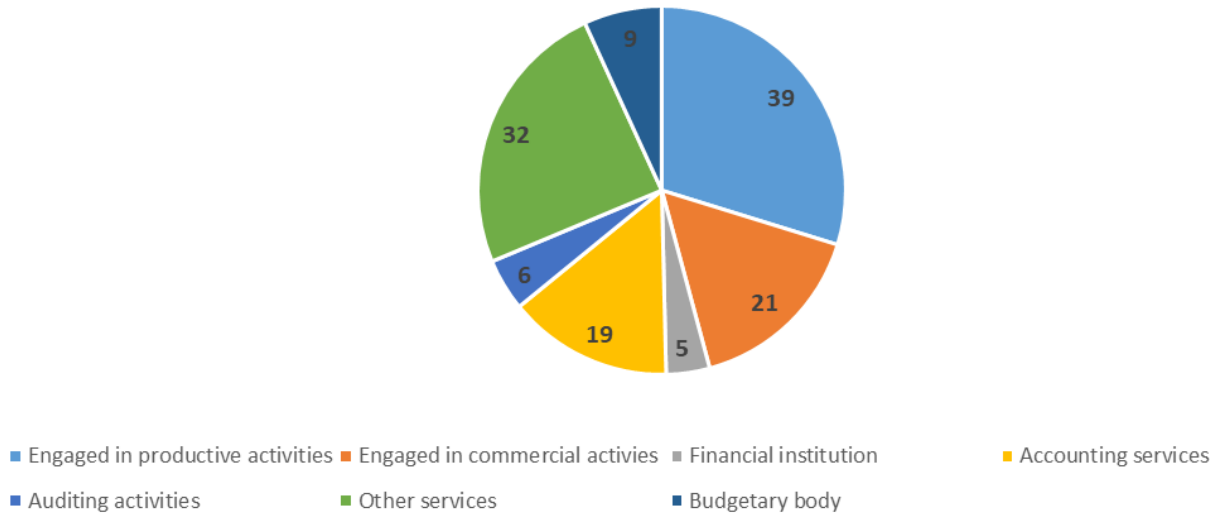


Figure 1
Distribution of the surveyed companies by their business activity

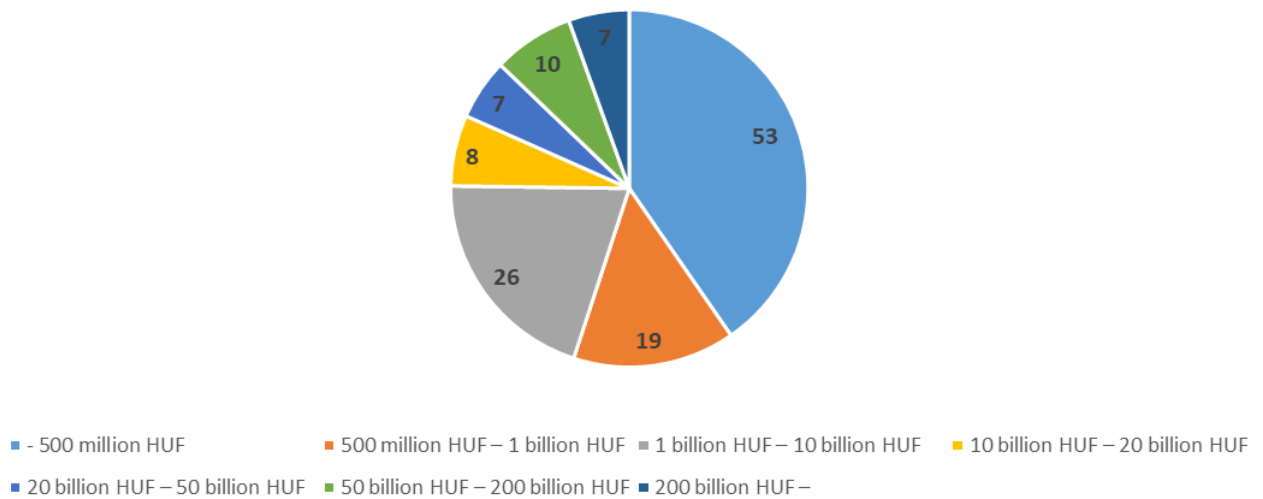


Figure 2
Distribution of the surveyed companies by their revenue in the previous year

Table 1

If the information in the notes to the financial statements is taken into account in the decision-making process, how important are they considered?

Is the information in the notes important and if yes, to what extent?	YES		NO	
	Number of respondents (people)	Distribution of respondents (%)	Number of respondents (people)	Distribution of respondents (%)
Very important	19	18%	2	8%
Important	41	39%	5	18%
Necessary	39	37%	7	24%
Less necessary	6	6%	10	43%
Unnecessary	0	0%	2	7%

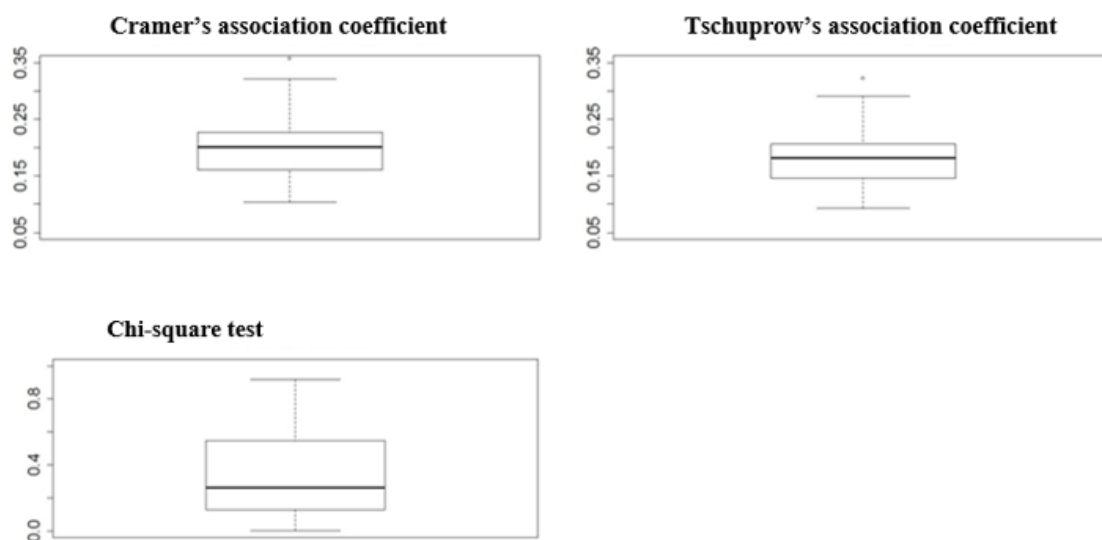


Figure 3

Examination of the association between corporate activity and the importance of different parts of the notes

Table 2

Principal components concerning the importance of data in different parts of the notes

Principal components	Eigenvalues	Explained ratio	Accumulated explained ratio
1	5,51	16%	16%
2	4,46	13%	29%
3	4,38	13%	42%
4	4,04	12%	54%
5	4,03	11%	65%
6	3,05	9%	74%
7	2,31	7%	81%
8	2,3	7%	88%
9	2	5%	93%