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## THE IMPACT OF FINANCIAL ACCOUNTING REPORT ON THE CORPORATE PERFORMANCE

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We would like to thank ....

# ABSTRACT

The rapid changes observed today are forcing institutions, organizations and companies to take long-term measures. The basis of effective management is to have as long a strategic sense of power as it is to get involved in decision-making. The accounting information system and management accounting, which are included in the accounting approaches, also have an important place in this development. Accounting, which is an important tool in business management, constitutes the basic information system for all phases of management and decision-making process, rather than being a purely financial indicator for businesses. The purpose of this study is to establish an interaction between the effectiveness of the accounting information system and performance management.

**Key words: Financial account, report, Corporate performance**

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# INTRODUCTION

The company has two important tasks of top managers; the first is to develop the strategy, and the second is to manage the performance of the company in accordance with this strategy. The hard one is the second. Here is the modeling and management of firm performance. To do so, it is first necessary to determine the operating procedure of the firm in which the firm is working (stakeholders, the industry it belongs to, the market it serves (the supplier), and then examining its business, operational and performance management models.

Corporate performance management (CPM), which is included in the control function of the management, includes determining performance targets, measuring performance, comparing performance with targets, calculating differences between measured performance and targets, and taking action to eliminate these differences. Each organization has its own set of reasons for measuring performance. However, in general, businesses are making performance measurements for the following reasons: to determine the overall success of the business, to determine the progress of the processes and processes, to learn the level of meeting customer needs, to have knowledge about the activities, to identify problematic and developable areas, .

Performance measurement is not just an issue of management or an internal business of the business. Business owners are interested in the performance of the business with regard to the different decisions that many groups will make, such as potential investors, lenders, sellers and customers. Performance measurement helps to implement the strategies developed by management and supports the strategic control system. The strategic control system is the design and establishment of a long-term control system covering the entirety of the operator. The strategic control system is intended to measure both the internal elements under the control of the operator and the influence of the external elements outside the control of the operator on the operational activities.

The rapid changes observed today are forcing institutions, organizations and companies to take long-term measures. The basis of effective management is to have as long a strategic sense of power as it is to get involved in decision-making. The use of the data in the financial information system in strategic decisions also initiated the strategic management process. Developments in economic and technological areas have brought the obligation to reveal the future goals of those at the management level and to prepare strategic plans to achieve these goals. This has brought with it the concept of performance management.

The accounting information system and management accounting, which are included in the accounting approaches, also have an important place in this development. Accounting, which is an important tool in business management, constitutes the basic information system for all phases of management and decision-making process, rather than being a purely financial indicator for businesses. The data obtained from the accounting information system are used in performance management to determine performance management and the degree to which institutions and businesses have reached the targets they have set. Management accounting is one of the most successful accounting systems for obtaining and using these data. The purpose of this study is to establish an interaction between the effectiveness of the accounting information system and performance management.

# CHAPTER I
# THEORETICAL FRAMEWORK REGARDING THE IMPACT OF FINANCIAL ACCOUNTING ON THE CORPORATE PERFORMANCE

## 1.1. The role of efficient financial accounting report on the corporate performance

The main object of financial analysis is the activity of any individual company or their associations. Subjects of analysis may be the economic structures, and their counterparties: commercial banks, other companies, audit offices, local and central government offices, real and potential partners, other individuals and legal entities.

Indeed, in order to assess the financial state of the organization and determine possible ways for its development, it is necessary to analyze not only the balance sheet and other reporting materials of the enterprise itself, but also describe the economic situation of its business partners, evaluate competitors, conduct marketing research of market conditions, etc.

The assessment of the balance sheet and financial reporting makes it possible to determine the overall financial position, the degree of liquidity, solvency, financial stability, businesslike activity, reliability, the level of risk of certain options, to find sources of own, borrowed and attracted funds, the structure of their placement on a fixed date or for a certain period , and still define the specialization of the company's activities.

Economic analysis includes (Schumpeter, 1995: 15):

assessment of the state of the organization's performance at the time of the analysis;

comparison of the state and results of activities for the period under review;

comparison of results with competitors' performance;

summarizing the results of the analysis and preparing recommendations for making managerial decisions aimed at improving the efficiency of the company's operating activities.

The information necessary for financial analysis can be grouped as follows (Данилов, 2016: 171):

financial accounting;

constituent and financial documents: constituent agreement, bank's charter, list of shareholders, licenses, audit reports, annual reports, operational information;

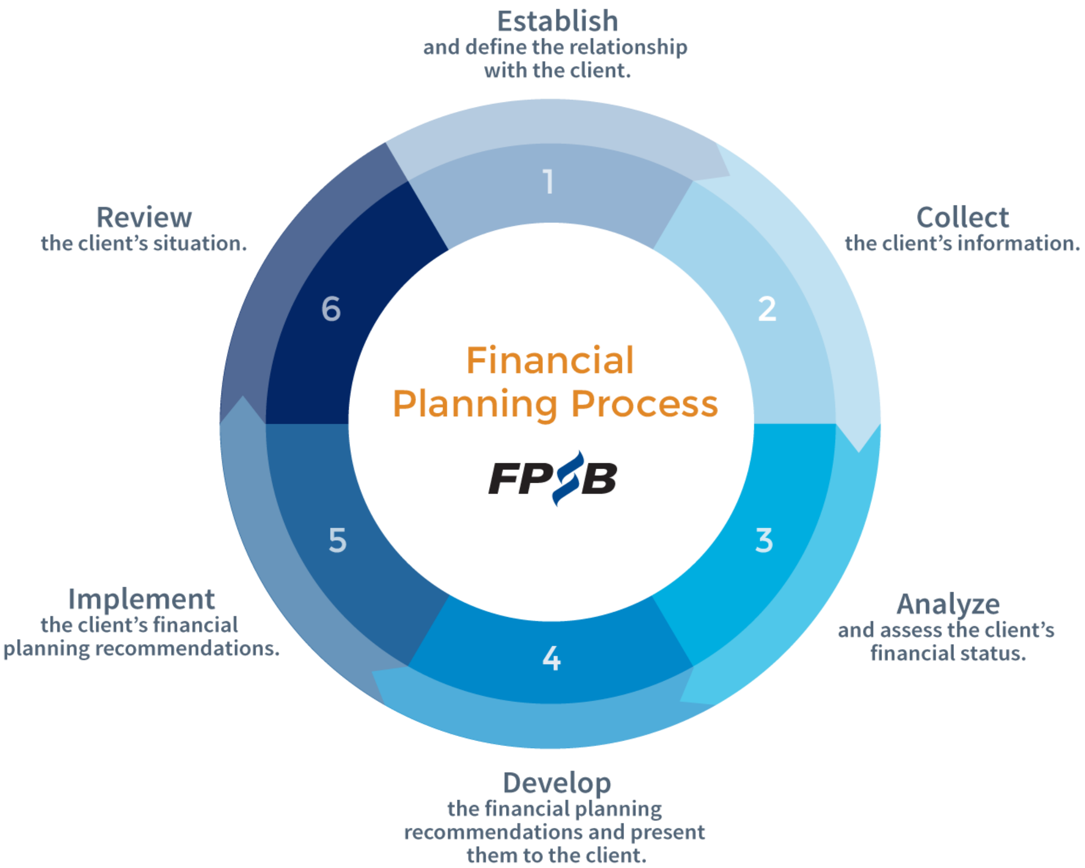
information in the mass media: ratings, analytical and business articles;

information received from a third party;

conclusion of specialized agencies, opinion of expert groups, specialists, feedback from buyers and suppliers.

The financial analysis, as a rule, is carried out in several stages, differing in composition and labor intensity of the work, the massifs of the processed information and the time of holding (Миркин, 2014: 52).

**Figure 1. Stages of financial analysis**




Stage 1 - preliminary - involves setting the purpose and objectives of the analysis; verification of the reliability of information and selection of source data; grouping, combining and structuring information; calculation of absolute and relative indicators.

Stage 2 - analytical - provides interpretation of the received materials by an estimation of dynamics, structure of indicators, their grouping, etc .; comparison of financial position of enterprises with the results of analysis of competitors and counterparties; statement of analysis results.

Stage 3 - final - is dedicated to assessing the level and quality of management; development of forecasts and recommendations. The main feature of the construction stages - their logical relationship, which involves moving from the initial stage to the final, from the simpler to the more complex (Евстигнеев, 2002:45).

Each previous stage is the base for the next stage, each next stage is the logical end of the previous one. That is why it is obvious that the quality of the analysis and its results depend on the correct definition of priorities at each stage.

It should be noted that the methods of financial analysis include: (Rajan and Zingales, 2002: 559)

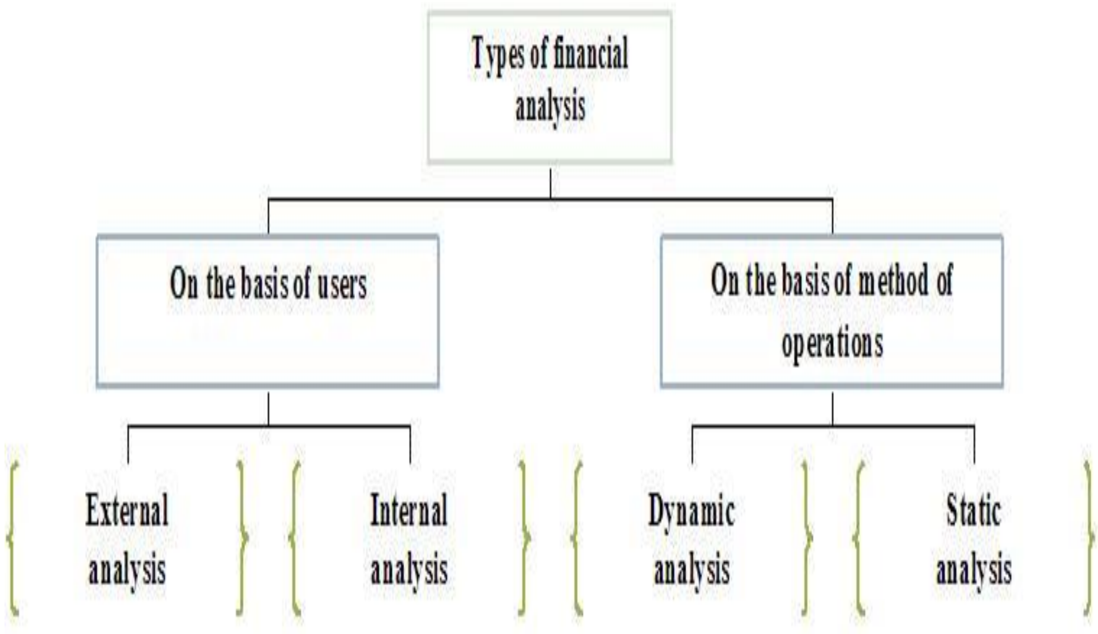
structural analysis of reporting (allowing to calculate specific weights and relative indicators);

method of grouping absolute coefficients for the calculation of relative indicators and the calculation of financial indicators;

normative method (calculation of ratios of coefficients);

method of assessing the level of indicators compared with the base (dynamic comparison of indicators), relative to the level of the comparable group.

**Figure 2. Methods of financial analysis**



Part of the most popular methods of analysis is the method of grouping, which, through the systematization of balance data, makes it possible to understand the essence of the analyzed phenomena and processes. In the analysis, groupings of balance accounts are used in terms of allocating own, borrowed and attracted resources; varieties of income; costs and profits. Articles can be further grouped by the degree of liquidity, profitability and cost, etc.

The quantitative relationship between different articles, sections or groups of balance sheet items makes it possible to reveal the method of coefficients. When applying this method, the specific weight of a certain article or group of articles in the total volume of the asset or liability or in the corresponding section is determined. It is necessary to consider the indicators in dynamics to see whether the situation is stable or random (Joseph, at all, 2001: 393).

It is also expedient to factor analysis of significant deviations. With a stable negative trend, this analysis is carried out on a number of dates in order to establish the causes of the deviations. The most widely used for these purposes are statistical methods of analysis: the method of grouping, comparison and coefficients (arithmetic differences).

The application of the comparison method makes it possible to find the causes and extent of the impact of dynamic changes and deviations in the balance sheet items on liquidity and profitability of activity, and also to discover reserves of increasing profits. Comparative analysis is allowed to produce for a certain period of activity not only one company (internal comparative analysis), but also a comparison of the reporting of two or more similar entities (external comparative analysis). The wider the scope of the organizations being compared, the richer is the capacity for disclosure, and then the dissemination of best practices. The acceptance of comparison is allowed to be applied for comparison of similar planned and actual indicators (Arrow, 1991:134).

Methods of coefficients, comparisons and groupings can be used in parallel. Active (passive) balance sheet accounts can be compared both with similar accounts of balances of previous periods, and with opposite accounts for liabilities (assets), grouped by common economic counterparties or single terms or types of transactions.

One method of visualizing the results of an analysis is the tabulation method. In this case, it is important to determine the types and number of tables that will be drawn up based on the results of the study. Another method is graphical, which allows you to compare the summary data of economic analysis in the form of diagrams, distribution curves, etc.. Graphical analysis is most often used to predict prices, determine the time of purchase and sale of securities on the market, to diversify investments using correlation-regression and variance analysis, and to reduce risks ((McLean at all, 2012: 313).

The method of system analysis is the most effective at the present stage. It allows solving complex management tasks based on the processing of entire data sets, rather than individual information fragments. The use of this method is possible if the computer is used. At the same time, the analysis becomes deeper, more effective, and more effective.

The method of elimination allows us to reveal the influence of individual factors on the generalizing index, by eliminating the influence of other factors. One of the methods of elimination is the method of valuable substitutions. The condition for its application is the presence of a multiplicative form of coupling, in which factors act as factors.

When using the absolute difference method, the changes in the effective indicator are calculated under the influence of each individual factor. In this case, the value of the deviation of the actual value of the factor from the basic (business plan) is multiplied by the actual values of all the factors preceding the considered one, and by the base factors of all subsequent factors (Schumpeter, 1995: 17).

The method of relative differences is that the increment of the effective indicator under the influence of a factor is determined by multiplying the base value of the result by the indices of the fulfillment of the business plan of all factors preceding the one considered in the analytical formula and by the reduced, by one, index of the business plan implementation for the considered factor.

The choice of these or other methods of analysis is determined by the tasks that are put before the analytical services. In addition, the types of analysis also depend on the objectives of the study (Евстигнеев, 2002:46).

## 1.2. Principal-agent theory in corporate governance

Corporate governance is a system of organizational and property relations, regulated by legal norms, with the help of which a corporate organization realizes, represents and protects the interests of its investors, primarily shareholders.

Three doctrines of corporate governance are best known (Eugene, 2003: 11):

· "Agency";

· "Managerial";

· The theory of "social responsibility".

According to the agency theory, directors are employees of shareholders who are accountable and whose interests for agents should be above all. In accordance with the "managerial" concept, directors act as managers with delegated powers, rights and responsibilities (ie their status is increased); they are made demands as to any decent person who honestly acts according to the law for the benefit of others. The theory of "social responsibility" expands the boundaries of the concept of "joint-stock company", which includes "other interested persons." The scope of the latter concept varies from workers to a combination of workers, creditors, suppliers, consumers and even the local community (Levine, 2004: 688) .

Simultaneously, in the analysis of corporate governance, two approaches are identified: the concept of shareholders and the concept of accomplices. In accordance with the first, corporate governance is considered in the narrow sense - as a system of accountability of senior managers to the company's shareholders. The emphasis is on the conflict between strong managers and weak disparate shareholders, practical measures are centered around the problem of monitoring and controlling the actions of managers with the help of tools such as the structure of the board of directors, the protection of shareholder rights, options, mergers and acquisitions, etc. But now the society with a large number of small shareholders give way to companies with a concentration of ownership. In addition, with this approach, other persons who participate with their labor and capital in the company's activities remain on the sidelines.

The second conception considers corporate governance in the broad sense of the word - as a system of formal and informal relations of all stakeholders (shareholders, managers, creditors, contractors, hired personnel, the state, etc.). Previously, the main problem was the practical impossibility of the firm fulfilling its obligations towards all partners, and therefore the concept of accomplices was subjected to a certain revision in the direction of narrowing the concept of "accomplice". The upgraded model of accomplices defines them as market participants, contributing to the growth of the company's assets.

Thus, the relationship between managers and shareholders is only part of a broader relationship between the corporation and the external institutional environment.

As in any system (regulation, management, impact) in corporate governance with a certain degree of conventionality, we can distinguish three elements (blocks) (Baumal, 1998: 25):

normative and legal,

organizational-structural,

functional, as well as the relationship between them.

The organizational and structural unit includes bodies and organizations that carry out practical activities. The regulatory and legal unit includes normative acts regulating the legal status of corporations and codes of corporate governance. The functional block includes a toolkit of activity, its directions, forms and methods, means, measures and is reflected in the corporate management models.

Also, the Anglo-American and Japanese-German models of corporate governance are singled out, although more often in the literature they talk about the outsider and inside models (systems)

The first distinctive feature of the outsider model is the dispersed ownership of shares, and in this connection it is also characterized as a diversification one. Share capital is dispersed between independent, non-corporation relations, in addition to the so-called participation relations, by individual and institutional investors. The share of the latter, as already revealed, is steadily growing. The volume of their capital and long-term goals of existence provide the conditions for the organization of venture business. Moreover, the most common scheme is the establishment of a corporate structure in the form of a joint-stock company for mastering the advanced scientific and technological achievement and promotion of a new product and the subsequent profitable sale of shares to the founders. Individual investors are mainly representatives of the "middle" class of the country, who keep their savings in securities and because of their lack of professionalism react less reactively to changes in the stock market environment than large holders of shares. Such voluntary accumulation of the population's resources creates a favorable investment climate in the country, increases the stability of financial markets. The controlling block of shares may not exceed 6 - 14% of their total number (Arrow, 2004: 91).

The financing of the activities of corporations is distanced and depends on the current situation in the financial market, dominated by domestic sources, and the share of borrowed funds is small.

In this model, the separation of control and ownership from shareholders, managers, and the board of directors is clearly expressed. The latter acts as a competent internal management body, management sometimes exerts pressure on the board of directors to make decisions, but the dominant is the satisfaction of the interests of shareholders. The right of shareholders to control the company and the accountability of the board of directors and managers to them is guaranteed. On the priority of the interests of the private owner is based on the very concept of a market economy, in particular, in the United States.

At the same time, the dispersal of shareholders generates their weakness and strengthens the positions of managers. The basis of the Anglo-American model is the notion of the initially conflicting essence of the interests of these parties, which should be removed by a system of external balances.

External control mechanisms over the activities of corporations are more preferable. A decisive role is played by stock markets, on which the activities of the corporation as a whole and management in particular are carried out, the influence of shareholders on management is realized. (At the same time, the decisive role of the stock market stimulates, in the first place, activities aimed at increasing the company's value or profitability in the short term.) (Rajan and Zingales, 2001: 559).

In addition to market monitoring of the corporation's activity caused by fluctuations in quotations in the fictitious capital market of shares, mechanisms that make it possible to make transparent the management schemes of the company from the side of management with the purpose of increasing the shareholders' well-being, priority satisfaction of their interests.

Historically, the regime of administrative and legal regulation in the countries of this model was developed taking into account that the company's share capital is dispersed among a large number of investors operating in isolation from each other and in need of reliable and adequate information for making the right investment decisions. Detailed rules for providing investors with the most complete information and creating a relatively equal position of investors in terms of access to it, as well as preventing the situation when certain groups of shareholders exchange among themselves and share internal corporate information, are "cut off" from the rest of investors. Thus, an outsider system can be characterized as based on information disclosure.

So, the distinctive features of the outsider model are: 1) dispersed ownership of shares; 2) recognition of the priority of the interests of shareholders in the legislation on companies; 3) special emphasis on protection of minority shareholders in regulatory acts on companies and on securities; 4) relatively strict requirements for the disclosure of information by companies (Svirydzenka, 2016).

The first distinguishing feature of the insider model is the concentrated nature of ownership. Insider groups are usually relatively small in composition, representing a certain combination of individuals, including employees of companies, families, banks, other financial institutions, other corporate owners operating through holding companies or through a cross-shareholding arrangement.

Banks are simultaneously shareholders, creditors of the company and proxies of other shareholders, are engaged in placing newly issued securities, providing brokerage and advisory services when non-bank, foreign and government loans are received by corporations.

This determines the active participation of banks in the boards of directors of companies that they have, as a separate group, the ability to determine the composition of councils (with the exception of representation of employees) and block any changes in the charters and local legal acts, especially in cases of dispersal of capital. In aggregate, banks can concentrate in different ways more than 75% of all votes at general meetings of shareholders.

As a result, there is an interpenetration of groups of main actors in the Japanese-German model (bank, affiliated corporate shareholders, board, supervisory board). The motivation for acquiring shares is changing - participation in control takes the first place. At the same time, this helps to neutralize the dependence of management on short-term performance. Moreover, the very structure of shareholders focuses on the stability and effectiveness of the organization's activities, rather than on the frequency and level of dividends paid.

Financing demonstrates the high dependence of companies on bank capital, lending and a high debt-to-equity ratio. The appeal to the borrowed capital is connected with the great development in Europe of the bond market, including joint-stock companies, to which this instrument is not inherently inherent.

As stated earlier, the economy in the countries of this model is socially oriented, and, accordingly, the Japanese-German system is based on the representation of relations built on cooperation that can be subject to control using the internal communication mechanism between the parties.

Insider corporate control systems are usually formed around the head bank, are of a permanent nature. The stock market plays a much smaller role  (Sahay, at all, 2015).

The main conflict is between the controlling shareholders (controlling shareholders) and weak minority shareholders.

In comparison with market-oriented corporate control systems, which strictly demand public disclosure of corporate information, insider systems tend to selectively exchange information between investors. This confidential exchange of information is typical for the interaction of the bank with its borrowers.

The legislation establishes rather soft requirements for providing companies with information about their activities. Thus, Japanese banks are not required to publish information about their holdings of shares, if they do not exceed 25% of the total capital of the corporation. The right is tolerant of groups of shareholders who exercise joint control over the company, often ignoring the interests of small investors (Kunt, at all, 2015: 5).

## 1.3. Financial accounting information and its impact on investment decision

In a simpler form, the investment decision is called choosing one or several suitable investment methods from the entire list of proposed ones.

In order for this process to be effective, it is necessary that the decision-making be based on conformity with the strategic goals of the investor and his objective capabilities.

It is well known that each investor solves his own problems. Each of these tasks is different from the other. Execution of social debt, PR of own name, partnership relations, commercial benefits - all these are strategic goals of investors. The achievement of each of which is preceded by the adoption of one type of investment decision. Let's try to classify them (Feyen, 2010):

decisions, a direction on reduction of expenses on conducting the basic activity (here it is possible to carry expenses for release of the basic production, its quality increase, improvement of production technology, organization of work processes);

decisions related to the development and modernization of production (reconstruction, expansion and construction of new facilities in production);

solutions related to the development of new markets;

decisions aimed at the acquisition of various financial and intangible assets for the purpose of generating income in the future;

mandatory investments (improvement of working conditions, reduction of economic damage);

It should also be noted that financial analysis and strategic planning should be used to make an effective investment decision. The financial analysis procedure will help to determine the sources of financing of future investments, and strategic planning will coordinate new directions of development with those that are already in use;

Any process has its own specifics. So, the adoption of effective investment decisions has a number of features and criteria that must be taken into account (Евстигнеев, 2002:46):

investments must be made in the event that the potential income is higher than the income offered by bank deposits;

You need to invest when the income for the reporting period exceeds the level of inflation;

use the rule of balancing risks (the most risky investments the company finances at its own expense);

Priority is given to projects and assets with maximum profitability;

new investments should not be in line with the strategy of enterprise development, but rather reinforce the strategy already developed.

Activity, the results of which is the receipt or loss of finance, about its priority requires a careful logical approach and does not tolerate haste. Therefore, the owners of capital follow the basic stages of making investment decisions formulated earlier. If you disassemble this process from the beginning to the end, the specialists distinguish the following stages (Joseph, at all, 2001: 395):

First of all, it is necessary to identify a situation that would satisfy the existing need for investments in the organization;

selection of existing investment opportunities and proposals suitable for the company, their primary analysis and evaluation;

detailed analysis of all relevant proposals, investment decision making;

implementation and implementation of investments;

control over the implementation of investments, as well as post investment control.

Let's summarize the small results, primarily on the adoption of a particular investment decision for the most part affects the structure of capital in the enterprise. It must also be remembered that every decision on the implementation of investments should directly affect the economic and financial condition of the enterprise, namely it should increase its value, as well as its value and lead to an increase in future earnings from activities, and a reduction in associated investment risks. Also, any investment decision that seeks to become positive for an enterprise must meet the following criteria, namely, to have high profitability, low risk and, if possible, a short payback period (Levine, 2004: 690).

# CHAPTER II
# FINANCIAL ACCOUNTING INFORMATION AND ITS CHANNELS AFFECTING CORPORATE PERFORMANCE

## 2.1. High quality accounting information as a liquidity risk mitigation tool

Much attention in international standards is traditionally given to information disclosure, therefore, Notes to financial statements are an important and integral part of the reports themselves.

According to paragraph 36 of IFRS 4 "Insurance Contracts", the insurance organization is required to disclose in the Notes information explaining the amounts in the financial statements arising from insurance contracts, including (Feyen, 2010);

- accounting policies adopted for insurance contracts and related assets, liabilities, revenues and expenses;
- assumptions used in assessing assets, liabilities, income and expenses under insurance contracts, and the effect of a possible change in assumptions on current estimates;
- reconciliation of changes in insurance liabilities and reinsurance assets.

Under IAS 7 Financial Instruments: Disclosures, an insurance organization should disclose information that will enable users to assess the impact of financial instruments on its financial position and results of operations, including, in addition to the main accounting policies and the valuation methods used, information about the value of financial assets by category.

An important feature of IFRS 4 and IFRS 7 is their similarity in the requirement to disclose information about the nature and extent of risks arising from insurance contracts (paragraph 38 of IFRS 4) and on financial instruments (IAS 7, paragraph 31) that the entity is exposed to at the balance sheet date. These requirements are relatively new and in practice cause difficulties (Cihak, 2012: 25).

However, the recent financial crisis has highlighted the need for greater transparency in financial reporting, especially in terms of better disclosure of risk information. In these circumstances, the requirements of IFRS 4 and IFRS 7 are becoming more relevant than ever. Let's consider them in order to develop the necessary examples of Notes to the financial statements in relation to insurance organizations.

IFRS 7 applies only to the financial assets of an insurance organization, and the assets and liabilities under insurance contracts are governed by the requirements of IFRS 4. IAS 38 requires the insurer to disclose in the financial statements:

- a policy for managing risks arising from insurance contracts;

- Information on insurance risk (both before and after risk reduction through reinsurance), including (Beck, 2004):

analysis of sensitivity to insurance risk (how profit and capital will change under the influence of changes in the level of risk);

concentration of insurance risk;

actual requirements in comparison with previous estimates (development of losses);

- information on credit risk, market risk and liquidity risk that would have to be disclosed in accordance with IFRS 7 if insurance contracts were within the scope of IFRS 7.

Under the insurance risk in IAS 4 is understood the risk of possible losses of the insurer, accepted from the insurer as a result of the occurrence of the insured event. The size of the insurance risk depends on the amount of formed reserves, the change in which, in turn, affects the indicators of profit and capital.

IFRS 7 requires disclosure of qualitative and quantitative information about exposure to financial risks: credit risk, liquidity risk, market risk. Qualitative disclosures describe the objectives of management, policies and procedures for risk management. Quantitative disclosures should, on the basis of internal management information, provide users with information about the extent to which the organization is exposed to risk.

Therefore, IFRS 4 and IFRS 7 require insurers to carry out descriptive disclosures about risk management and to analyze the sensitivity to risks for all classes of financial instruments and insurance contracts.

The definitions of each type of risk and the required disclosures in accordance with IFRS 7 are systematized in Table. 2.

With regard to insurance, the credit risk is manifested in the fact that the insurer may suffer losses as a result of the fact that the reinsurer can not pay off its obligations under the reinsurance contract or the issuer of the financial obligation held by the insurer as a financial asset will default on this obligation (Beck, 2004).

The risk of lack of liquidity for insurance organizations is the possible shortage of funds to pay off insurance liabilities as a result of the occurrence of insured events. Expected terms and amounts of repayment of obligations under contracts depend on estimates regarding the time of occurrence of the insured event and the amount of losses.

Market risks of insurance organizations include currency risks (under contracts concluded in foreign currency, for financial assets, the value of which is expressed in foreign currency) and the risks of changes in the interest rate on financial assets and the discount rate used to calculate the amortized cost of financial assets.

The analysis showed that insurers usually disclose the description of insured risks, risk management policies, concentration of risks for operating segments in the annual report in the section "risk management" or in a separate document. Similar descriptive disclosures are made outside of financial reporting and financial instruments. IFRS 4 and IFRS 7 do not prohibit such practices, but the list of disclosed information must comply with the requirements of these IFRSs, and a reference to the relevant document should be made in the financial statements.

In our opinion, quantitative information on possible changes in the value of assets and liabilities and, as a result, profit and capital as a result of changes in the risk variables used in the estimates will be relevant in the financial statements.

As a result of the analysis of the requirements of IFRS 4 and IFRS 7, the following basis for the preparation of Notes can be singled out (Kunt, at all, 2015: 6):

- Disclosed risk information must be consistent with internal information provided to management for risk management.

- There must be a balance between qualitative and quantitative disclosures, allowing users to understand the risks and their possible impact on the financial statements.

- The insurer independently determines how to summarize information on insurance contracts. The grouping may correspond to that approved by the regulatory authorities, but IFRS does not require this.

- Information about risks is more useful if it shows the relationship between classes of insurance contracts with other items, for example financial instruments that are subject to the same risk.

Developed by us for insurance organizations, the Notes to the financial statements on the disclosure of quantitative information on insurance risk and financial risks are presented in the examples given in Table. 2.

**Table 2: Disclosure of information about insurance risk**

| Four differences | | Two similarities |
|---|---|---|
| **1. Institutional interconnectedness** | | **1. Financial intermediaries** |
| **Banks** are institutionally connected through the interbank market | **Insurers** are stand-alone operators | **Banks** and **insurers** are financial intermediaries between savers and investors |
| **2. Maturity transformation and leverage** | | **2. Financial investors** |
| Maturity transformation and leverage are inherent in **banking** | **Insurers** match asset-liability duration; leverage is quasi-absent | **Banks** and **insurers** are large-scale investors in financial markets |
| **3. Exposure to liquidity risk** | | |
| **Banks** face an inherent liquidity risk | **Insurers** are liquidity-rich | |
| **4. Role on money and payment system** | | |
| **Banks** create money and they constitute the payment system | **Insurers** do not create money; they use the payment system | |

## 2.2 Asymmetric Information in financial reporting

Asymmetric information is understood as a situation in which part of the participants in a transaction owns exhaustive and accurate information, while other participants in the transaction do not own it. So, the sellers of products know about their quality better than the buyers.

Workers are aware of their abilities to work more than entrepreneurs. Managers know their capabilities more fully in comparison with the owners of firms.

Asymmetric information makes it possible to understand why, for example, various firms provide different guarantees and services to buyers of their products, or why shareholders of companies should closely monitor the behavior of managers, and so on.

Asymmetric information covers various areas of economic activity (Glen, 1999):

♦ market of products;

♦ the labor market;

♦ insurance market;

♦ loan market;

♦ market of livestock, etc.

The substance of asymmetric information lies in the fact that sellers and buyers do not always have free access to comprehensive and accurate information in order to make the most effective decision, as a result of which the markets become uncompetitive and ultimately insolvent.

Unlike neoclassicists who maintained that information is distributed symmetrically, many foreign economists believe that it is available at the beginning to a small number of interested economic agents and only after a certain time begins to embrace new producers and consumers of goods and owners of production factors. Information is distributed by various means (Евстигнеев, 2002:40):

♦ prices;

♦ market signals;

♦ increase of wages;

♦ guarantees and obligations, etc.

The last decades of the twentieth century. in the world economic thought, the problem of information, about which there are ambiguous theoretical and methodological positions, is gaining more and more interest. For example, neoclassicists do not always recognize the existence of an information market. On the contrary, their opponents consider information to be one of the most important factors affecting the functioning of the market, and they make a judgment about the revision of the theory of general competitive equilibrium. They reject the assertion that price is the only factor determining the behavior of economic agents, because firms receive information not only with price, but also with non-price signals (through the press, consultants, the education system, etc.). The firm, which has little information, has little hope of winning the market. Meanwhile neoclassicists underestimate the importance of the interconnection of information flows within the firm.

The important economic role of information is to reduce the level of uncertainty and reduce losses. But, according to the winner of the Nobel Prize in Economics 1972 K. Arrow, greater importance for the revision of the neoclassical theory has two provisions. First, information is a commodity and has a value, that is, it is an object of purchase and sale. Secondly, there is asymmetric information (Stiglitz, 2003: 10).

Based on the first provision, he argues that the more informed the economic agents, the higher their welfare. Almost all researchers of the problem of welfare link it to the existence of asymmetric information, which creates conditions for uncertainty in certain decisions that affect the behavior of economic agents. Reduce the measure of uncertainty is possible through information. According to J. Hirslayfer, under the conditions of asymmetric information, it becomes possible to form monopolies and enrichment of some at the expense of others, since there is an interest in extracting super profits by possessing information that is unknown to other economic agents.

The owner of the information, realizing it, makes profit. However, often the owner of information not only does not make a profit, but also does not reimburse the costs associated with its search, incurs losses.

Neoclassical theory proceeds from the fact that in a market economy there is perfect competition. In the real world, the mechanisms of perfect competition often "do not work." The price in the conditions of the monopolized market is deprived of the information function, as a result of which it becomes necessary to have non-price signals. The Hungarian economist-mathematician J. Korven and the American economist K. Errow criticized the theory of general equilibrium for exaggerating the role of price and ignoring the influence of natural-physical indicators on the behavior of economic agents. K. Arrow in his Nobel lecture noted that in many cases, market equilibrium is established when there is equality of supply and demand in physical terms. At the same time he referred to the conclusion made by JM Keynes.

The most actively and fruitfully develop the theory of asymmetric information is the economists of a number of countries, which were awarded Nobel Prize in Economics. Among them, American economists John Charles Harsagni, John F.-M. Nash, William Spencer Vickrey, George Akerlof, Michael Spence, Joseph Stiglitz, British economist James Mirrlees, German economist Reinhard Selten (Levine, 2004: 670).

Nobel Prize laureates in economics 1994, 1996, 2001. opened a new look at the problems of the modern market economy. Investigating the important problem of markets with asymmetric information, they showed the weaknesses of the "invisible hand" of the free market. Having put forward the concept of markets with asymmetric information, they proved that economic entities, not having exhaustive and accurate information, can not make the most effective business decisions. Imperfect information requires active government intervention in the economic life of society.

The problem of markets with asymmetric information is typical for Azerbaijan both in domestic and international economic relations. Let us touch on the latter aspect and confine ourselves to the market of used cars. It is known that second-hand cars in large quantities are imported to Azerbaijan from Europe and Japan. What are the consequences of their importation? Let us single out two points. First, the increase in imports of used cars can significantly exacerbate environmental problems in the country, since after a certain time, cemeteries of foreign cars will arise. Secondly, the import of second-hand cars adversely affects the financial situation, as it causes the outflow of domestic capital abroad at the present time. Moreover, the diversion of the national capital abroad will continue in the future, as the purchase of spare parts in exchange for the worn out will also be carried out abroad.

So, the basic idea of the theory of asymmetric information is that the state should actively interfere in the regulation of a market economy, because the spontaneous functioning of non-competitive markets, creating unequal conditions for the activities of economic agents, thereby leading to the failure of competitive markets. From what has been said, the conclusion inevitably follows that in order to reduce economic shocks, it is necessary to increase the role of the state in regulating economic processes in society.

## 2.3 The Impact of Accounting Information on Stock Prices

Accounting for securities is maintained in Account 58 "Financial Investments" (Order of the Ministry of Finance of October 31, 2000 No. 94n) in accordance with PBU 19/02.

At the same time, analytical accounting in account 58 is carried out according to the types of financial investments and objects in which these investments are made (to organizations that sell securities, to other organizations to which the organization is a participant, etc.). In addition, analytical analysis requires the separation of securities into short-term and long-term assets(Svirydzenka, 2016).

It should be borne in mind that organizations do not relate to financial investments (paragraph 3 of PBU 19/02):

own shares redeemed by the joint-stock company from shareholders for subsequent resale or cancellation;

bills issued by the organization-issuer of the seller organization when calculating for the goods sold, products, works performed, services rendered.

Consequently, these objects are recorded not on account 58, but on accounts 81 "Own shares (stakes)" and on a separate subaccount to account 62 "Settlements with buyers and customers", respectively.

In our consultation, we will talk about securities that are for the organization of financial investments.

Securities are accepted for accounting at historical cost. n.

Types of securities are listed in art. 143 of the Civil Code of the Azerbaijann Federation (hereinafter referred to as the Civil Code of the Azerbaijann Federation). It :(Eugene, 2003: 11)

- government bond;

- bond;
- bill of exchange;
- check;
- deposit and savings certificates;
- bank savings bank to bearer;
- Bill of lading;
- stock;
- privatization securities;
- other documents that are classified as securities by securities laws or in the manner prescribed by law.

The subject of our consideration will be shares and bonds, most often used in business transactions of commercial enterprises and organizations.

Reflection in the accounting of transactions related to the circulation of securities is carried out in accordance with the requirements and rules established by the Federal Law of November 21, 1996 N 129-FZ "On Accounting", the Regulations on Accounting and Reporting in the Azerbaijann Federation, approved by the order of the Ministry of Finance Azerbaijan dated 26.12.94 N 170, the Chart of Accounts for the Accounting of Financial and Economic Activities of Enterprises and the Instruction for its Application approved by Order No. 56 of the Ministry of Finance of the USSR dated 01.11.91 (hereinafter - c, Instructions for the use of the Chart of Accounts). Some practical recommendations on the organization of such accounting are given in Order No. 2 of the Ministry of Finance of the Azerbaijann Federation of 15.01.97 "On the Procedure for Reflecting Operations in Securities in Accounting" (hereinafter - Order No. 2), which came into force on July 1, 1997 (Baumal, 1998: 25).

In accordance with Federal Law No. 39-FZ of April 22, 1996 "On the Securities Market" (as amended on November 26, 1998), the share is an equity security that secures the rights of its owner (shareholder) to receive part of the profit of the joint-stock company in the form of dividends, to participate in the management of the joint-stock company and to a portion of the property remaining after its liquidation. Issue of bearer shares is permitted in a certain respect to the amount of paid up authorized capital of the issuer in accordance with the standard established by the Federal Commission for the Securities Market.

The issue of shares is the sole prerogative of joint-stock companies. From the above definition, we can conclude that all issued shares should, in accordance with their total nominal value, correspond to the size of the authorized capital of the joint-stock company.

It is customary to distinguish between the primary issue of shares (when a joint-stock company is established) and the issue of additional shares.

At the initial issue, the issue and placement of shares are related to the formation and payment of the authorized capital. The organization of analytical accounting should provide a separate summary of information on the stages of formation of the authorized capital. To do this, in joint-stock companies, account 85 "Authorized capital" is accepted to open at least three sub-accounts (Rajan and Zingales, 2001: 559):

85-1 - announced authorized capital;

85-2 - subscribed capital;

85-3 - paid-in capital.

Thus, the following transactions will be recorded:

Д-т 75 К-т 85-1 - for the amount of declared capital (specified in the constituent documents)

Д-т 85-1 К-т 85-2 - for the amount of the subscription for shares;

Д-т 85-2 К-т 85-3 - for the amount of actually paid shares.

Simultaneously with the last posting, the following posting is done:

Д-т accounts of the account of property and money resources contributed as a contribution to the authorized capital, К-т 75.

In addition, since the shares are forms of strict accounting, they must be accounted for on the off-balance account 006 "Forms of strict accountability." This is due to the fact that there is a certain time interval between the production of forms in the printing house and their placement.

When paying for the cost of manufacturing, the following entries are made:

Д-т 20 К-т 60 and Д-т 60 К-т 51 - for the amount of actual manufacturing costs paid by the printing house;

Д-т 006 - for the amount of the nominal value of the issued shares.

As far as the placement of shares (the actual disposal of the shares forms), their nominal value is debited from the account 006. In other words, the K-t-006 wiring is executed simultaneously with the posting of the Dr 85-2 K-m 85-1.

When placing shares, there may be a situation when the shares are sold (placed) at a price higher than the nominal value. To reflect the amount of excess of received funds over the par value of shares, account 87 "Additional capital", sub-account "Share premium" is used and posting is made:

Д-т accounts of the account of property or money resources received in payment for shares, К-т 87-3.

The procedure for recording the issue of additional shares in accounting records unequivocally with regulatory documents is not regulated. Based on the requirements for securing the nominal value of shares with the size of the authorized capital, it can be assumed that any decision on an additional issue of shares should be accompanied by a decision to increase the authorized capital. The question may arise that if the primary issue of shares is exclusively intended for placement among the founders and shareholders of the company and has as its goal the formation and payment of the authorized capital, subsequent issues may be directed to attract additional funds for the obligations of the organization. Thus, it is logical to assume that in this case, account 85 should correspond not with the account of accounting settlements with the founders, but with accounts of accounting settlements with debtors (for example, with account 76 "Settlements with different debtors and creditors"). However, the very definition of a share as a security implies granting to any of its owners the right to participate in the management of the company on an equal basis with the founders of the joint-stock company. Hence, in accounting when placing shares of additional issues, the same transactions will be made as with the initial issue.

The current legislation (Federal Law of December 26, 1995 No. 208-FZ "On Joint Stock Companies") provides for the emergence of situations in which shareholders have the right to demand from the company the repurchase of previously placed shares or the company itself is interested in such redemption (Levine, 2004: 674).

In order to reflect transactions related to the redemption of shares, the Accounts Accounts Plan provides for account 56 "Monetary documents". In this case, the account is opened with the subaccount "Own shares redeemed from shareholders".

The redeemed shares are kept in the cash register of the joint-stock company on a par with cash and other monetary documents. For all shares redeemed from shareholders, an inventory is drawn up indicating their type, number, series and nominal value.

In the future, repurchased shares can be realized or canceled.

The sale of shares bought out by the joint-stock company is carried out in a similar manner to the sale of other assets of the organization.

The cancellation of treasury shares is intended to reduce the authorized capital and requires the execution and processing of appropriate legal and organizational procedures, the consideration of which is not within the scope of the issue under consideration.

Clause 3.6 of Order No. 2 emphasizes that when purchasing organizations own shares from shareholders it should be borne in mind that if the price of redemption differs from the registered (nominal) price of shares to be redeemed, the resulting difference in accounting is reflected in account 80 "Gains and Losses" (at a price redemption below the par value) or on the accounts of own sources (at a repurchase price higher than the nominal value) simultaneously with the organization's acceptance to the accounting records on account 56 "Other monetary documents" of the repurchased shares.

In reality, the circumstances surrounding the emergence of conditions for the repurchase of shares practically exclude the possibility of profitability of such an operation (that is, the acquisition of shares at a price below the nominal value). Nevertheless, in theory, this possibility should be considered (Eugene, 2003: 9).

In accounting, the redemption and subsequent sale or cancellation of shares purchased are issued by postings:

Д-т 56 К-т 50 (51) - for the sum of the cost of the repurchased shares at actual expenses for their acquisition;

Д-т 56 К-т 80 - for the amount of excess of the nominal value of shares over the redemption;

Д-т 88 К-т 56 - for the amount exceeding the redemption value over the nominal.

If the redemption of shares is made with a view to their subsequent cancellation, the posting should be made:

Д-т 85-3 К-т 85-1, which reduces the amount of the cost of paid-up capital.

Further, depending on the decision taken on the use of treasury shares, the following transactions are made:

Д-т 85-1 К-т 56 - for the amount of canceled shares (of course, in this case, the constituent documents of the company should be amended accordingly) (Baumal, 1998: 25);

or

Д-т 48 К-т 56 - for the amount of the nominal value of the shares sold;

Д-т 51 (50) К-т 48 - for the sum of money resources received in payment for the sold shares;

Д-т 48 (80) К-т 80 (48) - for the amount of profit (loss) received (received) from the sale of shares.

It should be noted that the issues of taxation of operations related to the use of securities are not considered in this article.

Sometimes, for various reasons, it may be necessary to change the nominal value of shares by splitting or consolidating them. At the same time, if as a result of splitting or consolidation, the total nominal value of new shares is exactly equal to the size of the authorized capital, additional entries in synthetic accounting are not drawn up. Changes are made only to the analytical accounting and the register of shareholders. If the size of the authorized capital is not divided without a remainder by the number of new shares (for example, with an authorized capital of 7,000 rubles, the number of shares decreases from 350 to 30), then when deciding whether to split or consolidate shares, a decision should be made to change the authorized capital. Accounting entries will in this case be similar to the above. [18]

The accrual and payment of dividends to the owners of shares are not related to the consideration of securities. Therefore, we will not dwell on this question.

The owner of shares (investor)

Accounting, organized by the issuer of shares (as, indeed, other securities), is associated with the facts of their issue, placement, redemption, cancellation or sale. In other words, the reflection of the corresponding operations in the accounting is periodic. A legal person acquiring shares is forced to register accounting entries much more often - at least at the end of the reporting period.

Order N 2 considers in detail the issues of reflection in the investor's accounting of transactions related to the acquisition of securities, including shares. Some changes in the order of this reflection occurred in connection with the adoption of the Regulation on Accounting and Accounting, approved by Order No. 34n of the Ministry of Finance of the Azerbaijann Federation of July 29, 1998, and enacted from January 1, 1999 (hereinafter - Regulation on Accounting and accounting reporting).

Investments in securities of the organization are reflected in accounting as financial investments. 06 In order to account for the purchased shares of the organization, the account 06 "Long-term financial investments" (when the stated maturity date exceeds one year or the investments were made with the intention to receive revenues over them for more than one year) or account 58 "Short-term financial investments" (when the stated maturity does not exceed one year or the investments are made without the intention to receive income over them for more than one year).

It should be noted that in practice, commercial (industrial) organizations rarely purchase shares in order to receive dividends within a few months. More often, shares are used by professional participants of the securities market (Евстигнеев, 2002:43).

In accordance with clause 44 of the Regulations on Accounting and Financial Reporting, the investor takes the financial investments into account in the amount of actual costs.

The composition of actual costs included in the cost of acquired shares is listed in paragraph 3.2 of Order No. 2. This:

amounts paid in accordance with the contract to the seller;

amounts paid to specialized organizations and other persons for information and consulting services related to the acquisition of securities;

remuneration paid to intermediary organizations, with the participation of which securities were purchased;

expenses on payment of interest on borrowed funds used to purchase securities before they are accepted for accounting;

other expenses directly related to the acquisition of securities.

Naturally, the question arises: what expenses can be considered expenses related to the acquisition of securities? In normative documents there is no exhaustive interpretation of this concept. However, we draw attention to the fact that, in accordance with the answer to the question of the taxpayer from 05/21/98 N 05-02-12 / 181 prepared by the State Tax Service of Azerbaijan, the investments made by the winner of the investment competition, being a condition for winning share trades, do not increase the book value of the block of shares , have a strict purpose of use and are carried out at the expense of profits remaining at the disposal of the enterprise - the winner of the investment competition.

Objects of financial investments (other than loans) that are not fully paid up are shown in the asset of the balance sheet in the full amount of the actual costs for their acquisition under the agreement, with an amount outstanding under the creditors in the balance sheet passable in cases where the rights to the object were transferred to the investor. In other cases, the amounts deposited in the account of the objects of financial investments that are to be acquired are shown in the asset of the balance sheet in the debtors' item (Данилов, 2016: 170).

For the preliminary accounting of the actual costs of the organization for the purchase of securities, Order No. 2 provides for the use of account 08 "Capital investments", the subaccount "Investments in securities". Note that due to the release of Order N 2, the corresponding changes to the Chart of Accounts were not made, therefore, among subaccounts to account 08 this subaccount is absent.

With the increase in the market value of securities for which securities were previously created, the debit of account 82 is made in correspondence with an account of 80. At the end of the reporting period, a similar entry is made on the write-off from the balance sheet of securities for which the respective reserves were previously created. If until the end of the year following the year of the provision for impairment of investments in securities, this reserve has not been used in any part, then in the preparation of the balance sheet at the end of the year, unspent amounts accede to the financial results of the organization of the corresponding year.

It should be noted that all of the above applies only to shares and other securities quoted on exchanges and special auctions. In other words, the issuer's notice of a decline in the market value of shares to create a reserve or to register relevant accounting entries is clearly not enough.

# CHAPTER III
# THE IMPACT OF FINANCIAL ACCOUNTING REPORT ON THE CORPORATE PERFORMANCE ON THE EXAMPLE OF SOCAR

## 3.1 Organizational and economic characteristics of SOCAR

The State Oil Company of the Azerbaijan Republic (SOCAR) was established under the Presidential Decree of 13 September 1992 and operates in the Republic of Azerbaijan. SOCAR is engaged in production, transportation and processing operations. The main activity of SOCAR is the production, processing and transportation of oil, gas and gas condensate, as well as the sale of oil, gas and oil and gas products. SOCAR is 100% owned by the State of Azerbaijan ("State"). Legal address of SOCAR: Baku city, AZ 1000, Neftchilar avenue 73. Information on subsidiaries The Group's consolidated financial statements include the following significant subsidiaries:

| Name | Main activity | Country of origin | 2014 | 2013 |
|---|---|---|---|---|
| •SOCAR Turkey Enerji A.Ş.<br>•Azerbaijan (ACG) Ltd<br>•Azerbaijan (Shah Deniz) Ltd<br>•Company (CDC) SOCAR Energy Georgia LLC<br>•SOCAR Overseas LLC<br>•SOCAR Trading Holding | • Processing<br>• Oil Production<br>• Drilling operations Azerbaijan<br>• Sales and distribution<br>• Sales and distribution<br>• Sales and distribution | •Turkey<br>•Cayman Islands<br>•Cayman Islands<br>•Azerbaijan<br>•Georgia<br>•UAE<br>•Malta<br>•Cayman Islands<br>•Hollanda | 100%<br>100%<br>92 %<br>51%<br>100%<br>100%<br>100%<br>99.9%<br>100%<br>100%<br>100% | 100%<br>100%<br>100%<br>92.4%<br>51%<br>100%<br>100%<br>100%<br>99.9%<br>100%<br>100%<br>100% |

| | | | | |
|---|---|---|---|---|
| • Azerbaijan (BTC) Ltd<br>• Cooperative Menkent U.A. SOCAR Energy Holdings AG SOCAR Energy Ukraine<br>• Azerbaijan (SCP) LTD | • Sales and distribution<br>• Sales and distribution<br>• Sales and distribution | • Switzerland<br>• Ukrine<br>• Cayman Islands | | |

Fundamentals of preparation of financial statements. These consolidated financial statements of SOCAR, its subsidiaries, joint ventures and joint ventures (together referred to as "the Group") are prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Committee ("IASC"). The following are important accounting policies used in the preparation of these consolidated financial statements. These accounting policies have been applied in accordance with all periods presented.

Basis for Consolidation. Consolidated financial statements have been prepared from the financial statements of the Group and its subsidiaries at 31 December 2013.

Subsidiaries are all entities where the Group is able to exercise control. Control arises when the Group is exposed to the risk of its involvement with the investee or has the right to variable returns and that it has the ability to influence its revenues through the control of an investee. Specifically, the Group is only in control of an investee and only in this case the Group:

- Having control over the investee (ie, existing voting rights currently allow the investee to manage its relevant activities);

- Have the right to participate in an investment project or to receive variable returns, and,

- Have an opportunity to use an investee control to influence revenue.

When the Group has less than the majority of voting rights or has similar rights to an investee, the Group reviews all relevant facts and circumstances, including the following, when evaluating whether there is a control over the investee:

- contractual arrangement with other owners of voting rights at an investment object;

- rights derived from other contractual arrangements;

- Group voting rights and potential voting rights.

Basis for Consolidation (Continued). In the event that the Group has a controlling interest in the investee, it reassesses that the facts and circumstances indicate that there is a change in one or more of the three control elements. Subsidiary consolidation begins when the Group obtains control of a subsidiary and when the Group loses control over the subsidiary.

Intangible assets, balances and unrealized gains on transactions between Group companies are eliminated from the consolidated financial statements. Also, unrealized losses are deducted from the consolidated financial statements, but are considered as impairment of the transferred asset. Where necessary, the accounting policies of the subsidiaries are changed to comply with the rules adopted by the Group.

Total gross receipts of the subsidiary are included in such non-controlling interests as if they were impaired. Business Combinations. Business combinations are accounted for using the acquisition method. The acquisition value is measured at the acquisition-date fair value of the acquisition-date fair value and the amount of the non-controlling interest in the acquire. For each business combination, the acquirer measures the non-controlling interest in the acquire at the fair value, or the proportionate share of the net identifiable assets of the acquire. The resulting acquisition costs are deductible and include administrative costs. When the Group acquires any entity, it assesses its financial assets and liabilities for the purpose of classification and contractual terms, economic conditions and contractual terms and conditions. This includes the allocation of derivative instruments by the acquire in the underlying agreement.

In the case of a business combination, the acquirer's share of the acquiree at each acquired entity is premeasured at fair value at the acquisition date and the gain or loss is reflected as a gain or loss for the year.

Operations with Non-controlling Shareholders In the event that control is not reversed, the change in the Group's interest in a subsidiary shall be accounted for as equity transactions (such as transactions with owners of shares). In such cases, the carrying amounts of control and non-controlling interests shall be adjusted to reflect the change in the proportion of ownership interests in the subsidiary. The difference between the amount of the adjustment and the consideration paid for the non-controlling interest should be recorded directly in equity and should be attributed to the Group's shareholders.

Associations with Joint Ventures The Group represents the combination of jointly controlled entities with the acquisition method of accounting. Investment in associates and jointly controlled entities. An associate is an entity that has a significant influence over the Group. Significant influence is the right of an investee to participate in making decisions on its financial and operating policies, but does not involve control or joint control over that policy.

A jointly controlled entity is a contractual arrangement by which the parties exercising the joint control acquire rights over the net assets of the jointly controlled entity. The joint arrangement agreed upon by the agreement exists only when the joint arrangement of the parties exercising joint control is required to make decisions on the relevant action.

When determining whether there is significant influence or joint control, the same factors that are used to determine the control of subsidiaries are taken into account.

Investments in associates and joint ventures are included in the financial statements in accordance with accounting method. Based on the share-based payment method, an investment property is recognized at an associate or jointly controlled entity. After the acquisition date, the carrying amount of the investment is adjusted to recognize the Group's share of the net assets of the associate or joint venture. Goodwill relating to an associate or joint venture is included in the carrying amount of the investment, not depreciated and individually assessed for impairment.

Shares in joint operations (continued). Depreciation, depletion or amortization is eliminated on the basis of the appropriate depreciation or amortization method in the current GAAP period or the expected useful life of the related assets (whichever is less).

Foreign currency conversion. The amounts in these consolidated financial statements are presented in millions of Azerbaijani Manats ("AZN"), except as specifically stated.

Functional currencies of the Group's consolidated entities are the currencies of the major economic environment in which they are operated. The functional currency of SOCAR and its subordinate 23 structural units and the Group's reporting currency are the national currency of the Republic of Azerbaijan AZN. However, in most of the Group's subsidiaries, subsidiaries and joint ventures, receivables, revenues, expenses and debt liabilities in majority of their investments are US Dollars, Swiss francs ("IF"), Georgia ("GL"), Ukrainian hryvnia ") And the Turkish Lira (" YTL "), these currencies are considered as functional currency in those institutions for which they are assessed, deducted, paid or measured.

Transactions in foreign currencies are initially recorded at the functional currency of the Group's related entities using the effective exchange rates prevailing at the date of the transaction.

Monetary assets that are not measured with the functional currency of the Group's subsidiary

The liabilities are translated into the functional currency of the same entity at the respective exchange rates prevailing at the balance sheet date.

Exchange gains and losses arising from the revaluation of the Group's functional currencies are recognized in profit or loss.

## 3.2 Analysis of the financial accounting of SOCAR and its impact on the corporate performance

The Group's operating results and financial position are translated into the following currency when the functional currency of those entities differs from the Group's reporting currency and is not measured by the Group's reporting currency (the functional currency of any of these entities is that of hyperinflation economies)

(i) the assets and liabilities for each statement of financial position are translated at the closing rate at the date of the statement of financial position;

(ii) revenues and expenses on each gross income statement are revalued at the rate of exchange (if the average exchange rate is not closely related to the cumulative effect of the exchange rates on the transaction date, the income and expense are translated at the exchange rate ruling at the date of the transaction); and

(iii) all exchange differences are accounted for separately in equity (difference in exchange rates).

As at 31 December 2013 the major exchange rates used for the translation of foreign currency balances are as follows: 1 US Dollar = 0.7845 AZN, 1 Euro = 1.0780 AZN, 1 IF = 0.8792 AZN, 1 GL = 0.4521 AZN, 1 UH = 0.0952 AZN, 1 YTL ($ 1 = 0.7850 AZN, 1 euro = 1.0377 AZN, 1 IF = 0.8594 AZN, 1 GL = 0.4744 AZN, 1 UH = 0.0975 AZN, YTL = 0.4387 AZN, 100 YY = 0.9126 AZN).

Financial instruments - basic valuation techniques. Depending on the classification form, the financial instruments are recorded at fair value or at amortized cost. These valuation techniques are set out below. Fair value is the price that would be incurred for the sale of the asset in the ordinary course of business between the market participants or for the transfer of the obligation. When measuring fair value, it is assumed that the sale of an asset or a transfer of a liability will be carried out on the most advantageous market for an asset or liability when the asset or liability is not available on the primary market or the primary market. The group should have access to the key or most affordable market. The fair value of an asset or liability shall be measured using the assumptions used by the market participants in assessing the asset or liability and should therefore be assumed that the market participants have the best economic interests in their actions.

Assets Liquidation Liabilities. When the Group has a commitment to liquidate or liquidate a portion of the unit or equipment and recover the area in which they are located, and when the reasonable assumptions are made regarding the liability, the commitments for the disposal of assets are accounted for. New installations, such as oil and natural gas extraction and transportation facilities, are accounted during construction or installation. Liquidation commitments may arise during the life of the facility in connection with a change in legislation. The amount recognized in the statement reflects the present value of expected future costs determined in accordance with local conditions and requirements. Additionally, the amount of the cost of the fixed assets is adjusted for the amount of the obligation for the asset retirement obligations.

Any change in the present value of the liability for changes in estimate of the amount and timing of future expenditure is reflected as an adjustment to the reserve for capital and fixed capital expenditure. Changes in the estimated amount and timing of future expense for the demolition or liquidation of an entirely outdated facility or equipment are recognized in profit or loss and other comprehensive income. Changes in the present value of the liability resulting from adjustment to the discounted amount are recognized as a finance charge in the statement of profit or loss and other comprehensive income.

Commitments and Expenses. Commitments and contingent liabilities include liabilities that are indefinite or indefinite. When the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and the amount of the obligation can be measured fairly. Reserves are not recognized for future operating losses. In the case of a number of similar commitments, the likelihood that resources will be utilized to meet these obligations are generally set out for all obligations. The reserve is recorded even when the probability of using resources on any particular substance that is included in the same class with the liability is small.

Reserves are measured at the present value of the expenditure required to settle the obligation, using the interest rate before tax. Before tax, the interest rate reflects the current market prices and the risks inherent in the carrying amount of the cash flows. As time passes, the increase in inventories is recognized as interest expense.

Oil and Gas Assessment (Continued). Approved oil and gas reserves are the estimated amount of crude oil and natural gas in the current economic and operational environment (ie valuation date and expense estimation) of geological and engineering data, with adequate certainty in the payment of known costs in future years. Approved inventories mean that the existing wells are expected to be recovered through existing equipment and their exploitation methods. The initial estimates of oil and gas reserves are essentially uncertain, demanded by the judiciary, and should be revised in the future. Accordingly, the financial and accounting benchmarks (inventories for depletion and amortization and asset retirement obligations) that have been approved or approved have been reversed.

Approved reserves are estimated based on reservoir and well data. All assessments (upgrades or reductions) based on proven inventories should be reviewed (eg drilling and production-related activities or changes in economic factors, including product prices, contract terms or development plans). Changes in the technical exploitation of hydrocarbon reserves as a result of obtaining new information on development plans are the main reason for annual revaluations. Changes in the technical exploitation of hydrocarbon resources as a result of obtaining new information on development and production activities are the main reason for annual revaluations.

Generally, unexplored or partly explored reserves are exposed to greater uncertainty over the expected life of the plant compared to the undeveloped or depleted fields. Once the extraction is started at the field, and additional information on the long-term reservoir's long-term operation in the drilling or extraction of the wells, the amount of proven reserves should be revised in the future. As these deposits are developed, new data can lead to changes. As of January 1, 2014, SOCAR's proven reserves are based on reports prepared by independent reservoir engineers in accordance with the rules of the Society of Petroleum Engineers.

Assets Liquidation Liabilities. As discussed later in Note 21, management generates revenues for future environmental recovery, based on estimation of oil and gas production facilities, pipelines and auxiliary equipment, and estimated future useful lives and useful lives. Determination of future impairment commitments is a complex issue and requires management to make estimates and judgments on disposal of liabilities that will arise in the foreseeable future. Changes in the extent of existing commitments may arise from the estimated time, future costs, or changes in discount rate used in the measurement.

## 3.3 Recommendations for the improvement of the financial accounting system of SOCAR

The Group evaluates its assets in accordance with the International Financial Reporting Interpretations Committee ("IFRIC") 1, Revised Standard, Amendments to Current and Similar Liabilities. The amount recognized as a provision reflects the most accurate estimates of an existing liability at the reporting date in accordance with the laws and regulations in force, and may also change depending on the legislation, regulations and related interpretations and reassessments.

Government agencies regularly review environmental legislation and its application. Therefore, the Group's key commitments to the disposal of assets may be different from amounts recognized. As these reserves are of subjective nature, there is uncertainty about the amount and timing of such expenditures. Commitment Expenses for Oil and Gas Production Facilities, including Expenses for Reclamation and Recovery

As of December 31, 2013, it comprised AZN 371 (2012: AZN 621). Any change in these conditions may lead to adjustments to the reserves allocated to the Group.

Management determines the discount rate used to discount the recoverable amount of the site and the pre-tax interest rate that reflects the current market prices of the time value of money and the risks attributable to the related liability when necessary. The discount rate used for the year ended 31 December 2013 was from 7.9 percent to 6.33 percent (2012: 5.97 percent).

Environmental Protection Commitments. As noted in note 22, as a result of the operations and legacy of the Group prior to the formation of the Group, it mainly allocates a provision for estimated costs for environmental damage in the Absheron peninsula.

The amount recognized as a provision reflects the most accurate estimates of an existing liability at the reporting date in accordance with the laws and regulations in force, and may also change depending on the legislation, regulations and related interpretations and reassessments. Government agencies regularly review environmental legislation and its application. Therefore, the Group's major environmental restructuring commitments may differ from those accounted for. Because these resources are of subjective nature, there is uncertainty about the amount and timing of such expenditures. As at December 31, 2013, the estimated environmental liability was 116 AZN (2012: AZN 195). Any change in these conditions may lead to adjustments to the reserves allocated to the Group.

Management determines the discount rate used to discount the environmental restoration costs as the pre-tax interest rate that reflects the current market prices for the time value of money and the risks attributable to the reporting date, if appropriate. The discount rate used for the year ended 31 December 2013 was 7.21% (2012: 7.13%). Management believes that discount rates reflect all risks and uncertainties related to the exploration, evaluation, development and distribution of oil and gas in the Republic of Azerbaijan. Changes in any of these conditions may result in adjustments to the reserves held by the Group.

If the estimated discount rate used during the calculation was less than or equal to 1% of the management's estimate, the carrying amount would be AZN 2 less than AZN 2 /, respectively. Useful lives of fixed assets and intangible assets. Management determines the estimated useful lives and the corresponding depreciation expense of fixed assets and non-current assets. These estimates are based on the period in which the Group plans to obtain economic benefits from those assets. When the useful life is less than the estimated useful life in the previous years, management increases the depreciation charge or eliminates the technically outdated assets that have been canceled or sold. The useful life is reviewed at least at the end of each fiscal year. If there is a change in any of the above conditions or estimates, it may result in future amortization adjustments.

Checking the carrying amount of goodwill relating to the acquisition of Petkim (continued). Sensitivity is evaluated by changing the assumptions used in relation to the key parameters described below when assessing the carrying amount of Petkim's value in use:

- WACC is estimated to be 0.4 percent higher or lower than base WACC rates;

- Growth rate forecasts are estimated to be 0.5 percent higher or lower than estimates of long-term growth rates.

As a result of sensitivity analysis, the carrying value of Petkim's value is estimated between AZN 737 and AZN 866.

Checking the carrying value of goodwill relating to the acquisition of SOCAR Switzerland. At 31 December 2013, the carrying amount of goodwill was reviewed for impairment as compared to recoverable amount. The recoverable amount was determined based on the cost estimates used by SOCAR Energy Holdings AG and its subsidiaries. Predictable cash flow projections are based on the financial budgets covering the 3-year period. Management believes that estimated cash flows represent more accurate and reliable forecasts. Cash flow projections exceeding three years are extrapolated with expected growth rates of 1 percent per year and then discounted to their net realizable value.

The following key assumptions were used to evaluate goodwill from impairment:

- EBITDA / Net Sales ratio is 2.5% per annum;

- EBITDA / Total margin ratio, with final value - 9 per cent per annum;

- The rate of increase in cash flows is 1% per annum;

- WACC used as discount rate - 6.76 percent per year.

There has been no impairment on the performed inspection. If the estimated discount rate used in the calculation was 0.25% higher / lower than the management's estimate, the estimated use value would be AZN 8 / AZN 14, respectively.

If the increment rate used during the calculation was less than or equal to 1% of the management's estimate, the estimated value of use would be less than 58 AZN / 36 AZN, respectively. Goodwill test of goodwill relating to the acquisition of SOCAR Trading: The carrying amount of goodwill relating to the acquisition of SOCAR Trading at 31 December 2013 was tested for impairment by comparing the recoverable amount. The recoverable amount was determined based on the cost estimates of SOCAR Trading and its affiliated companies. For the purpose of this purpose, cash flow projections are based on a 6-year financial statement and a management-approved financial statement. Cash flows for this period are based on existing and new projects and discounted to net present value. Management believes that the cash flow projections are accurate and realistic. The final rate of growth of cash flows out of the 6-year period is 1%. For the goodwill test, the following assumptions were used:

- Evaluation is sensitive to the estimated average value of the Group's 11-12% interest rate;

- The assessment is also sensitive to the Group's closing rate of 1%.

Impairment was not detected as a result of the test performed. If the discount rate used in the calculation was 0.25% higher / lower than the management's estimate, the amount of use would be 11 AZN lower / 10 AZN, respectively.

# CONCLUSION

The state of the non-banking financial sector in recent years is characterized by stagnation or a clearly pronounced negative dynamics. For example, in various market segments (collective investment institutions, professional participants in the securities market, insurance subjects, non-state pension funds, microfinance organizations), the number of operators is decreasing, the ratio of their assets (funds in management) to GDP is decreasing, and the degree of implementation by financial the sector as a whole its main functions within the framework of the social economic system, including:

• transformation of savings into investments;

• ensuring an adequate evaluation of financial assets;

• effective allocation of resources and risks.

At the same time, it loses its positions in terms of international competitiveness and comparable characteristics of the development of the national financial market, which stimulates an additional outflow of capital and removal of domestic capital formation processes and transformation of risks outside the country.

Thus, the Azerbaijann financial sector as a whole at the current stage is unable to fulfill the most important task of helping to overcome the investment stagnation and the withdrawal of the country's economy to the trajectory of sustainable growth. Conversely, the solution of this task, as well as the closely related tasks of correcting the deformed structure of savings and available sources of capital, ensuring effective management of risks and cash flows, is impossible without the fulfillment of these functions by the national financial sector.

In the course of repeated attempts to reform the non-banking financial sector in Azerbaijan, certain positive results were achieved, but on the whole they did not bring the desired return. At the current stage, the government actually refused to change the financial sphere. However, if the current state policy continues in relation to this sphere, further degradation of the non-banking financial sector and the loss of its positions both within the country and on a regional global scale are inevitable.

The transition from the stagnation of the non-banking financial sector to its development and transformation into a significant mechanism of socio-economic development is a complex complex task, in the solution of which it will be necessary to overcome numerous obstacles.

Some of these obstacles (groups of problems) go beyond the financial sector (the deformed structure of the Azerbaijann economy, the lack of market confidence, the domination of the state and its poor quality). The remaining problems are typical for the sector itself. Among them we identified such enlarged problem areas as capital formation, risk management and price efficiency of the market. The key is the problem of capital formation, which does not allow the sector to concentrate long-term investment resources in large volumes.

The main resource base for the future investment breakthrough may be only financial resources at the disposal of households (estimated at over 40 trillion rubles or about 50% of the country's GDP). The involvement of these unused capital resources in active circulation is possible mainly due to a change in the deformed structure of savings (a reduction in the share of cash in rubles and foreign currency, and investment in real estate in favor of a corresponding increase in the share of equity market instruments, collective investment, insurance and pension products and etc.).

International comparisons point to growth potential:

• the ratio of financial assets of households and GDP is 2 to 4 times;

• shares of securities in the structure of financial assets of households from 2 to 3 times;

• instruments of investment funds, pension instruments and life insurance instruments - from 3 to 6 times.

Taking into account the prioritization of disclosure of the investment potential of the population, the following should be considered as the mandatory conditions for reform:

• increasing the level of protection of rights and legal interests of investors;

• Increase of confidence in the financial market institutions and in the state as a regulator and guarantor of observance of fair "rules of the game";

• stimulation of the development of the pension savings system, including fixing of the right of ownership for future pensioners with respect to their pension savings;

• privatization of state-owned blocks of shares, with the predominant use of mechanisms leading to an concentrated (dispersed) ownership structure, as well as impeding further growth of monopolization of the economy;

• stimulating competition in all segments of the non-banking financial market in order to reduce the transaction costs of small investors and prevent their discrimination;

• use of the best world practices for ensuring transparency of information on securities and financial products.

The tasks solved during the transformation can be conditionally divided into three closely interconnected levels. Meta-queries go far beyond the functioning of the financial sector and are associated with systemic problems of political economy and should be considered in a broader context. The tasks of the micro level and me so level correspond to internal problems for the financial sector, simultaneously affecting one or more of its segments.

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