

**APPROACHES TO FINANCIAL ANALYSIS OF INSOLVENT ENTERPRISES:
INTEGRATING ACCOUNTING AND TAX REPORTING**

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Abstract. This study explores at the financial analysis techniques used on insolvent businesses in different countries, using Russia as an example. It finds significant deficiencies in the current regulatory structure put in place by the government. Even though business bankruptcy is uncommon, the economic effects on different stakeholders make a thorough analytical approach to evaluating financial distress necessary. The study highlights the outdated nature of the current financial analysis rules and their inconsistency with modern financial reporting standards. In terms of insolvency, it examines the specifics of examining both accounting and tax reporting. In order to improve decision-making in bankruptcy procedures, the article promotes a more thorough methodology that incorporates dynamic analysis and predictive modeling by assessing coefficient analysis methodologies and the informational potential of tax reporting.

Key words: insolvency, financial statements, accounting, tax reporting, ratio analysis, coefficients, profitability, balance sheet, dynamic analysis, assets, investment, ledger.

Introduction. Corporate bankruptcy is a rare event. According to statistics, the number of bankruptcies does not exceed 0.3% of registered Russian organizations [1]. However, the insolvency of an enterprise, especially in the case of medium and large businesses, affects the interests of many parties, which is naturally reflected in the literature. The phenomenon of corporate bankruptcy is studied in legal, sociological, psychological, and economic contexts. Significant attention is paid to the financial aspects of insolvency: the methodology for forecasting bankruptcy is being actively improved, and the theory and practice of managing high-risk investments are developing [2].

A relatively new scientific direction is the financial theory of corporate bankruptcies, which addresses the problems of financial restructuring, assessment of direct and indirect costs of insolvency, and comparative analysis of financial models for default resolution [3]. Financial analysis in the context of insolvency is characterized by significant specificity; however, its content is primarily determined by the requirements of bankruptcy legislation.

In Russia, the financial analysis of insolvent organizations is regulated by special rules approved by a resolution of the Government of the Russian Federation (hereinafter referred to as the Rules). Surprisingly, given the constantly changing legal climate, this methodology has not been revised for more than ten years, despite obvious shortcomings and numerous inconsistencies with current legislation.

Literature review. Criticism of the Rules is widely presented in publications by domestic authors [4, 5, 6, 7, 8]. In general, it is noted that the existing methodological support does not allow for making economically justified decisions on the choice of bankruptcy procedures [9].

The heightened discussion on this issue is related to the publication of the draft Federal Standard for the Activities of Arbitration Administrators concerning the Financial Analysis of Insolvent Debtors (hereinafter referred to as the Project) [9, 10, 11].

In their research, the authors address the specifics of analyzing insolvent enterprises based on accounting and tax reporting. It should be noted that the methodology of accounting reporting analysis is sufficiently detailed in the literature, including great attention is paid to the corresponding information capabilities and limitations [12, 13, 14].

At the same time, works devoted to the specifics of analyzing accounting reports under conditions of insolvency are not so diverse and numerous. As for the analysis of tax reporting, this issue is generally not addressed, whereas, from the perspective of the authors, it is of significant interest, especially from the standpoint of internal analysts, to whom arbitration managers also belong. We examine the challenges in developing a methodology for analyzing a debtor's financial statements, taking into account the provisions of the current regulations and the draft federal standard. Additionally, we will propose recommendations for the analysis of tax reports.

Methodology. The study evaluates the methods used in financial analysis of insolvent enterprises, and focuses on the existing government-approved rules and some standards. The methodological framework includes assessing ratio analysis techniques, analyzing financial statements, developing an enhanced coefficient system, assessing the informational potential of tax reporting, and qualitatively analyzing reporting formats and audit data.

Additionally, there is, also, evaluation of a normative content in order to identify contradictions between existing guidelines and practical needs of insolvency practitioners. The proposed recommendations are supported by theoretical reasoning and cross-referenced with academic literature and official regulatory documents. The study aims to improve the financial analysis of insolvent companies.

Results and discussion. Features of coefficient analysis in assessing the debtor's financial condition. Financial statements serve as the source for coefficient analysis, which we will primarily refer to as a method for rapid assessment of the debtor's financial condition and the reasons for their insolvency. The current Rules for Calculation and Analysis of Coefficients are characterized by a number of significant limitations: the procedure for evaluating individual indicators is interpreted ambiguously, not all of them can be derived from the balance sheet and income statement, and the calculation methodology does not correspond to the current format of financial reporting [5, 7]. Coefficient analysis should be conducted quarterly. However, since 2013, the preparation of interim reports by Russian organizations is not always mandatory, and their submission to state statistical and tax control authorities is not required.

As a result, the usual practice of requesting relevant information about the debtor from tax authorities, to which bankruptcy trustees frequently appealed, is currently not working [9]. The analyzed coefficients are divided into three groups, characterizing the debtor's solvency, financial stability, and profitability, which generally corresponds to a set of characteristics most frequently encountered in financial diagnostic models [14]. At the same time, the logic of

choosing specific coefficients is not entirely clear [5,15], and no separate justification for this issue is provided.

Certain indicators are missing, without which it is impossible to form a well-founded judgment on the reasons for the loss of solvency. For example, there is no provision for assessing the level of financial cost coverage, the duration of the cash turnover cycle, and, more critically [16], solvency is evaluated using the balance sheet model without considering information about the enterprise's cash flows (Figure 1). A separate problem when conducting coefficient analysis of the debtor is the selection of comparative criteria. The Rules do not establish critical values for financial ratios, which, from the authors' point of view, is quite justified. Nevertheless, there is also no requirement to use industry statistics. At the same time, the possibilities for dynamic analysis are limited, since the preparation of interim financial statements, as noted earlier, is not mandatory.

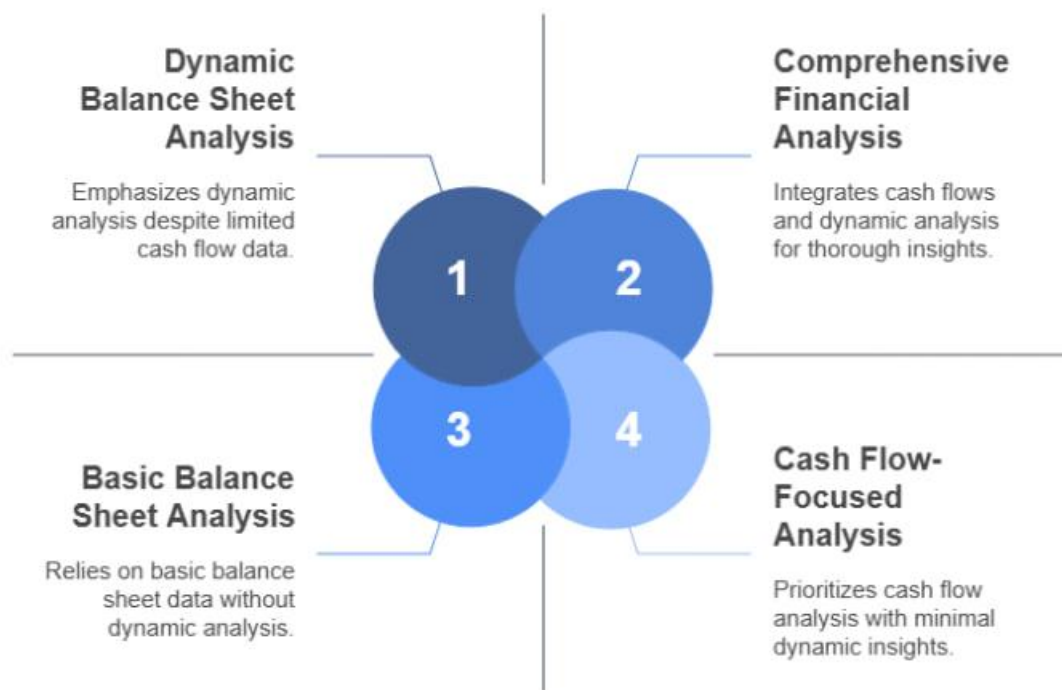


Figure 1. Financial analysis methodology evaluation¹

In the Project, the coefficient analysis methodology is supplemented with a requirement for a dynamic analysis of basic absolute indicators, calculated primarily based on quarterly accounting reports. The composition of the main indicators and coefficients underwent almost no changes. It creates the impression that such a situation is solely due to the pursuit of continuity, which is perhaps justified if we follow the principle of professional judgment, according to which the arbitral manager has the right to apply the repeatedly tested methodology at their discretion.

However, the Project developers pursued a deliberately different goal: basic indicators, which are present in any financial reporting system, were taken as a basis, which, as expected, will allow for

¹ Author's elaboration.

the necessary analysis based on the currently used accounting system of a specific debtor, even one who does not prepare accounting reports [11]. In any case, it is unlikely that we can talk about a system of indicators here, which is not fully justified from a financial point of view. The analyst was given the choice of indicators and criteria for assessing the debtor's financial condition, depending on the specifics of their financial and economic activities and available sources of information. At the same time, it is not fully clear whether the application of the proposed coefficients is mandatory.

On the one hand, it is noted that the arbitral manager can use the recommended system of coefficients, on the other hand, it is indicated that he has the right additionally to use other indicators that more deeply reveal the specifics of development and crisis in the organization, indicating the source of information. Moreover, finally, the requirement for quarterly accounting reporting analysis appears clearly irrelevant.

It should be noted that the methodology of coefficient analysis does not correspond to the specifics of the debtor's financial condition, which can be of a fundamentally different nature: it can be a matter of actual insolvency or temporary insolvency. A correct assessment of the possibility of restoring solvency, in turn, should take into account the prospects of financial and economic activity.

The purpose of the coefficient analysis in the Project is formulated as follows: "To help the persons participating in the bankruptcy case to form a position regarding the procedures carried out in the bankruptcy case, and to understand the debtor's ability to timely fulfill their monetary obligations and the obligation to pay mandatory payments". However, such a goal is clearly impossible to achieve.

Coefficient analysis according to the recommended methodology does not allow for an adequate understanding of either the actual or, moreover, the projected financial condition of the enterprise [17, 18, 19]. Thus, it is necessary to provide for the possibility of converting retrospective data into a forecast assessment, which can be achieved using financial insolvency forecasting models.

For this purpose, discriminatory models can be used that provide maximum forecast accuracy for 1-2 years before bankruptcy (see work [20] for more details), comparable to the terms of external management and (or) financial recovery. Regressors in discriminant models, as a rule, are financial ratios. Using these models will provide a more justified assessment of the financial condition, allowing for the correlation of the results of the coefficient analysis and the forecast of solvency recovery.

Deep analysis of the debtor's accounting statements, as intended by the legislators, is primarily required for the purpose of assessing the intra-economic reserves for restoring solvency. According to the current Rules, this is done:

1. Dynamic analysis of assets and borrowed funds based on the balance sheet;
2. Dynamic analysis of the debtor's property status, based on information about the acquisition, disposal, write-off, and/or creation of assets;
3. Structural analysis of assets in balance sheet valuations across three groups:
 - assets whose disposal would make core operations impossible;
 - assets whose realization is impossible or significantly difficult;

- assets that can be realized to settle with creditors, cover court expenses, and pay remuneration to the insolvency practitioner;
- 4. Analysis of equity and reserves with respect to their amount and the correctness of how the corresponding balance sheet items are formed;
- 5. Analysis of borrowed funds aimed at identifying debt obligations that can be challenged, terminated, or restructured.

The recommended methodology does not correspond to the current accounting reporting format. In particular, the composition of the analyzed information is now characterized by significant diversity, since the detailing of reporting items is determined by business entities independently.

However, according to the authors, priority should be given to conceptual omissions. Analysis of the balance sheet with the involvement of additional information on assets and liabilities is certainly useful at the stage of preliminary assessment of the debtor's financial condition, and most importantly, the reasons for its undesirable changes. At the same time, the picture of the enterprise's financial condition according to accounting reports may not correspond to reality, and the requirement to analyze the auditor's report is not established in the Rules (it is analyzed if available). In addition, most importantly: contrary to the formulated requirements, the proposed methodology does not allow us to answer the question of reserves for the restoration of solvency. The results of the in-depth analysis of liabilities represent a certain value, but the analysis of assets has no practical significance in this regard, as it is carried out based on balance sheet data.

In the draft, the procedure for in-depth analysis of the financial statements of insolvent enterprises has been supplemented with new requirements and is more thoroughly regulated. In this regard, at least five positive changes can be noted:

- the introduction of a requirement for auditing the financial statements under analysis;
- the allowance for deviations from general standard requirements, taking into account the specifics of the business;
- the provision for varying levels of detail in financial statement items, which may affect the nature of financial statement analysis;
- the provisions regulating the procedure for analyzing assets and liabilities no longer require the inclusion of interim reporting data;
- forecasting potential break-even performance is now mandated to be conducted in connection with the analysis of the organization's income, expenses, and financial results.

At the same time, the complication and detailing of the methodology cannot be regarded as entirely positive, since this will increase the debtor's costs and, consequently, reduce the coverage of creditors' claims. According to expert assessments, the current regulations are already excessive: in order to conduct a financial analysis, an insolvency practitioner currently needs about nine months, which usually requires the involvement of additional specialists. Moreover, the key issues mentioned above have not been constructively addressed. In particular,

the valuation of assets for liquidation is still proposed to be carried out at book value. For this, two methods are provided, the practical meaning of which remains far from clear.

$$A_s = A - A_p - A_d, (1)$$

where

A_s - assets for sale;

A - total assets;

A_p - assets whose realization is not allowed if business continuity is to be maintained;

A_d - assets that are impossible or difficult to sell;

$$A_s = DV + VA_{on} + FV + AR + C + OA_{oc} + Z, (2)$$

where

DV - income-generating financial investments in tangible assets;

VA_{on} - other non-current assets;

FV - financial investments (long-term and short-term);

AR - accounts receivable;

C - cash and cash equivalents;

OA_{oc} - other current assets;

Z - finished goods, goods held for resale, shipped goods

The requirement to assess the liquidity of the debtor's assets without involving a professional appraiser is also questionable, as appraisers are only engaged when the source of payment for their services is determined by bankruptcy legislation or a creditors' meeting. Although market valuation of assets is conducted when possible, assessing asset liquidity remains a mandatory requirement. Generally, the informational value of financial statements is clearly overestimated, and this misconception is accompanied by new methodological requirements. Notably, the tasks of analyzing the debtor's financial statements include assessing potential profits from asset sales (see table). It is evident that based on financial statement information alone, the bankruptcy administrator cannot evaluate either the amount of liquid assets for sale purposes or, more importantly, the expected profit in such cases. It should be acknowledged that an in-depth analysis of the debtor's balance sheet and statement of financial results is primarily aimed at preliminary assessment of the financial condition and, to a greater extent, the reasons for its undesirable change. Regarding reserves for the restoration of solvency, it is necessary to regulate the methods of forecast analysis with the involvement of information on the market (liquidation) value of the enterprise's assets.

Table 1. Tasks of analyzing the assets and liabilities of the debtor based on financial statements

Task	Task Description
Asset Analysis	<ul style="list-style-type: none"> - Characterization of all asset groups according to their classification in the financial statements. - Determination of the possibility of realizing assets for the purpose of settling obligations. - Identification of assets required for the continuation of operations, including consideration of potential modernization and re-profiling. - Assessment of profit that may be obtained from the sale of assets, the disposal of which would not significantly complicate or prevent economic activity. - Assessment of profit that may be obtained from the sale of assets in the event of liquidation.
Passive Analysis (liability & equity)	<ul style="list-style-type: none"> - Determination of the dynamics of changes in equity sources of asset formation. - Determination of the dynamics of retained earnings (uncovered loss) as part of the equity sources. - Analysis of the composition, structure, and dynamics of the debtor's liabilities. - Assessment of creditor claims, their satisfaction level, and potential bankruptcy coverage ratio.

The importance of tax reporting as a source of information about the debtor's financial condition. The current Rules declare that tax reporting is the basis for assessing the debtor's financial condition. The project provides for the analysis of accounting and other documents reflecting the economic activity of the debtor. In particular, tax accounting and tax reporting data are included in the approximate list of documents and materials used in conducting financial analysis. However, the directions of tax reporting analysis and relevant sources are not specified in either the Rules or the Project, which, according to the authors, is a significant shortcoming. In this regard, it should be noted that tax reporting represents information on the financial results of the organization, compiled:

- with a higher frequency compared to accounting reports (for example, for corporate income tax reporting, a regularity of monthly to quarterly preparation is legally prescribed);
- more formalized procedures that allow for the unambiguous interpretation of information about the debtor's accounting policy for tax purposes;
- with a slightly different structure of income and expenses from accounting reports.

The features of tax reporting listed above allow it to be used as a source of information on the financial condition of the debtor, serving as a supplement to the data provided in financial (accounting) statements. The high frequency of submitting corporate income tax declarations ensures the possibility of a more accurate assessment of the timing of changes (deterioration) in the enterprise's financial condition. The analysis of tax reporting allows for an evaluation of the debtor's tax burden and tax discipline, which aligns with the objectives of assessing both external and internal business conditions. The volume of information available from tax reports

depends on the applied taxation regime. For debtors operating under the general taxation system, it is advisable to focus primarily on the corporate income tax declaration.

According to the authors, the key areas of analysis using this source should include:

- **Dynamic analysis of the tax base** by years and by periods corresponding to the frequency of declaration submission;
- **Analysis of the correlation between financial result indicators, as well as income and expenses**, according to accounting and tax data over time, evaluation of changes in their relationship, and identification of the reasons behind those changes;
- **Identification of the sources of differences between accounting and tax records**, indicating temporary or permanent discrepancies between the respective financial results;
- **Analysis of tax losses (if reported) for the fiscal year**, which are carried forward to reduce the tax base in future periods, and the timing of such carry-forwards;
- **Analysis of the financial result from the sale of depreciable assets**, including any losses incurred from such transactions (if applicable), which are carried forward to reduce the taxable base over the remaining useful life of the disposed asset;
- **Analysis of specific types of income and expenses reported in the tax return**, and comparison of these with corresponding items in the financial statements.

When conducting a financial analysis of a debtor applying the simplified taxation system (hereinafter – STS), the need to supplement accounting data becomes even more apparent. However, compared to the corporate income tax return, the declaration submitted under the STS is less informative. Specifically:

- it is submitted to tax authorities only once a year (although it includes data on the tax base — either revenue or revenue reduced by expenses — for each quarter);
- it is prepared in accordance with the cash method of income and expense recognition;
- it is based on the data recorded in the Income and Expense Ledger maintained by organizations using the simplified taxation system.

The analysis approach for the Income and Expense Ledger and tax declarations follows the same logic as the analysis of profit tax declarations, taking into account the available volume of information. In cases where the debtor applies special tax regimes, such as the single tax on imputed income or the patent taxation system, which do not reflect actual financial results, the analysis of the corresponding declarations is, evidently, of limited informational value.

Tax reporting is an important source of information about the debtor: its analysis can clarify conclusions about the financial condition of the enterprise and the reasons for the loss of its solvency. However, due to the non-publicity of tax reporting, only internal analysts have access to its data, of which, probably, it is for arbitrators that this source is of greatest interest.

Conclusion. The analysis of financial (accounting) statements is very important in assessing the financial position of a company, however, it should not be overestimated. The primary task in this case is arguably to substantiate preliminary conclusions about the reasons of insolvency. As

for evaluating the possibility and feasibility of business rehabilitation, the information contained in the reporting forms is insufficient. It is necessary to conduct a forward-looking (predictive) analysis, including the use of data on the market (liquidation) value of the property, which will subsequently be useful to compare (including debt obligations) with the results of the business valuation.

It is important to clearly distinguish the objectives of ratio (coefficient) analysis as a rapid assessment tool for the company's financial health and an in-depth analysis of financial statements, which allows for more accurate and comprehensive conclusions. The methodology of ratio analysis, as presented to the authors, should be based on the principle of systemacity. A system of financial ratios must be developed to meet the goals of diagnostics and, ideally, allow for the transformation of retrospective data into forward-looking assessments of financial solvency, for example, by applying discriminant models for bankruptcy prediction. It is advisable to conduct an in-depth analysis of financial statements using descriptive methods, focusing on accounting data and the auditor's report. Enhancing the assessment of financially distressed companies with an analysis of tax reporting — which contains relatively more up-to-date information that can be tracked over time — will allow insolvency practitioners to better specify the period of financial decline and refine the results of financial analysis.

In conclusion, it should be noted that the development of effective methodological approaches to the financial diagnostics of insolvent enterprises requires further research. According to the authors, the most difficult task is to maintain balance. On the one hand, the methodology should not be overly burdensome, as excessive complexity would make the financial analysis too costly and reduce creditor claim coverage. On the other hand, decisions regarding the debtor's future must be financially sound, which will ultimately have a positive impact on other participants in the economy.

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