



AN EMPIRICAL INVESTIGATION OF THE RISKS DISCLOSURE IN THE FINANCIAL STATEMENTS OF THE REAL ESTATE INVESTMENT TRUSTS

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ABSTRACT

The paper aims to investigate how the real estate investment trusts disclosure risks in their financial statements. This question is very important for external users of the financial statements information of the trusts. They interested in which risks are typical for the real estate investment trusts, and how the trust management will minimize.

The author is investigated the financial statements of the real estate investment trusts, listed on the Bulgarian Stock Exchange.

As a conclusion, the risks disclosure is not useful in the investigate statements.

Key words:

financial statements, risks, real estate investment trusts

1. INTRODUCTION

The objective of this paper is to present the outcomes of the study on how risks are disclosed in the real estate investment trusts' financial statements and whether the disclosed information is useful for the users of the financial statements [1]. For attaining this objective, a practical study of the financial statements as at 31.12.2015 submitted by the real estate investment trusts listed on the Bulgarian Stock Exchange has been carried out. In particular, 16 financial statements have been submitted as at this date which are published on the website of the Bulgarian Stock Exchange and have been studied by the author.

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2. THEORITICAL STUDY

Every enterprise is obliged to submit general purpose financial statements that should inform the users of the data therein about its financial position. Such users may not request the information they are interested in from the enterprise that has prepared the financial statements and should thus be satisfied with the information provided therein. Thus, the information in the financial statements should be useful for their users in terms of making economic decisions. The disclosed information refers to the financial position, the performance results and the cash flows of the enterprise. Furthermore, the financial statements demonstrate the results from the management of assets entrusted to the enterprise's management. On the basis of the information in the financial statements and the explanatory notes thereto, the users are facilitated to estimate the future cash flows of the enterprise, when they will be received and to what extent their receipt is sure.

However, we should remember that the information in the financial statements refers to a previous period and there is no guarantee that the enterprise will continue working in the same economic context and will achieve the same financial results during the next periods. Therefore, it is essential for the financial statements to provide information about the risks that might occur in the course of the trust's operation and that might have substantial impact on its financial position. It is important to provide information also about the ways in which the management plans to minimize the impact of some of the risks the enterprise is exposed to.

The real estate investment trusts are joint stock companies that carry out different operations in terms of real estate management. There is a Real Estate Investment Trust Law in the Republic of Bulgaria. On one hand, it is aimed at establishing conditions for the development of investments, through securitization of real estates and receivables, and for the development of the equity market, and on the other hand, at ensuring the protection of the investors' interests in the real estate investment funds [2].

The scope of business of the real estate investment trusts is to invest money, raised by issue of securities, in real estates /securitization of real estates/ by means of purchase of title and other property rights of the real estates, constructions and improvements therein, for the purposes of being granted for management, rent, lease, tenancy and/or sale. The real estate investment trusts may not carry out other business transactions, may not acquire real estates or receivables that are subject to litigations. Real estates acquired by the real estate investment trusts should be located on the territory of the Republic of Bulgaria.

In the course of drafting this report, we found out a conflict between the Real Estate Investment Trusts Law and the Ownership Law. There is no legal definition of the term "property" in the Ownership Law [3]. It states that "Immovable belongings comprise: land, plants, buildings and other constructions, and in general anything, natural or man-made, that is permanently attached to the ground or to the construction.

Any other effects, including energy, are movable belongings". Immovable belongings are namely described as real estates. We can say that this terminology discrepancy in the two acts is good being eliminated by the legislative power.

The information disclosed in the financial statements refers to a previous reporting period, and the decisions that will be made by its users will be implemented during the subsequent period. Probably, the disclosed information may be outdated and therefore unsuitable, as the real estate investment trusts' business is exposed to different risks. In some cases, such risks may lead to financial results that are materially different from those achieved during the preceding period and disclosed in the trust's financial statements. These are namely the risks which the real estate investment trusts should disclose in order to enable the information users to become aware of them and their management. Thus, they will be able to justify their decisions more successfully.

The corporate risk – the risk that refers to the specific sector or enterprise, is essential for the users of information in the financial statements.

However, along with the disclosure of those risks the real estate investment trusts' business is exposed to, it should also be disclosed how the enterprise's management plans to mitigate their impact.

3. CONCLUSION

We studied 16 financial statements of listed real estate investment trusts published on the website of the Bulgarian Stock Exchange [4].

Based on this study we can make the following conclusions:

1. None of the submitted statements separately disclose the corporate risk inherent to the real estate investment trusts.
2. Most statements contain disclosures only for the financial risk and its types – market risk and credit risk. In all statements the currency, interest and price risks are disclosed separately as types of market risk. All statements contain disclosures only for the financial risk and its types – market and credit risk.
3. There are some statements that do not contain any disclosure of risks the trust's business is exposed to.
4. All statements clearly disclose how the management intends to mitigate the impact of different risks.
5. In most of the published statements, the price risk resulting from the changes in the prices of real estates that can be identified as real estate agencies-specific risk is only described as an existing risk, without disclosing how the trust's management intends to mitigate its impact.

Based on the above, we can make the conclusion that the risks the real estate investment trusts' business is exposed to are not appropriately disclosed and thus the

disclosures do not provide useful information for the users of the financial statements in order to enable them to make effective decisions.

REFERENCES

[1] International Financial Reporting Standards

[2] Real Estate Investment Trusts Law

[3] Ownership Law

[4] <http://www.bse-sofia.bg/?page=FinancialReportsOfIssuers&year=2015&>