Financial records as a product of financial accountancy in the context of the introduction of international accountancy standards

FLORIN BOGHEAN, CARMEN BOGHEAN
Faculty of Economic Sciences and Public Administration, University of Suceava,
Universității Street, no.25, 720229 Suceava, Romania
Phone: ++040741252694 Fax: ++40230520080
E-mail: florinb@seap.usv.ro, carmenb@seap.usv.ro

Abstract

Financial records represent the final product of accounting. They represent the classification and synthetization of a cumulus of financial transactions, some of which are extremely complex. According to the American normalization organism, Financial Accounting Standards Board (FASB), financial records represent the central element of financial reporting, being the main purpose of the communication of accounting information to persons outside the company.

Key words: financial records, accounting standards, decision.

1 Introduction. Definitions and positions regarding financial records

The international normalization organism – the International Accounting Standards Board (IASB), by means of *IAS 1: Presentation of Financial Records*, defines financial records as a structured representation of the financial position of an enterprise and of the transactions performed by it, pursuing to offer information about the economic position, performance, and modifications of the financial position of a company to a various array of users. The *general framework of elaboration and presentation of financial records* specifies that financial records represent part of the process of financial reporting and are made up by the balance, the profit and loss account, the own capital modification record, the cash flow/treasury record, the accounting policies, and the explanatory notes.

Company managers are firstly interested in the information collected from the internal activity reports but also in the information found in financial records, even though they don't have access to supplementary financial and management information that would empower them to enact the processes of planning, decision-making and supervision. While the external reports that contain regular information destined for all users must be elaborated in keeping with certain outlines, the form and contents of the internal reports can be determined by the board so that they can serve the company's own necessities.

Beside the managers' requirements, general financial records meet the demands of those users who are not in position to ask for specific reports. They are destined to offer common-knowledge information for all categories of users; this is why they have to be designed and presented having in mind their necessities.

A study published by Pricewaterhouse Coopers in the magazine *World Watch* (no. 1, 2004) shows that most states enforced IFRS (International Financial Reporting Standards) starting with 2005 for the companies listed on the stock exchange and gave the other companies the possibility to opt for IFRS reporting. China, Japan, and Hong-Kong are the only countries that prohibit IFRS reporting for all types of companies. Other countries, such as the USA, Greece, Austria or Luxemburg forbid the application of IFRS by public companies.

We now present the results of this study in the table below:

Country	Listed Companies	Private Companies	Public Sector Companies
Australia	Obligatory	Obligatory (only for large companies)	Obligatory
Austria	Obligatory	Permitted	Prohibited
Belgium	Obligatory	Obligatory (date of application pending: 2005 or 2007)	Not decided
China	Prohibited	Prohibited	Prohibited
Cehia	Obligatory	Permitted	Not decided
Denmark	Obligatory	Permitted	Permitted (only for LLCs)
Finland	Obligatory	Permitted	Permitted
France	Obligatory	Permitted	Permitted
Germany	Obligatory	Permitted	Permitted
Greece	Obligatory	Prohibited	Prohibited
Hong Kong	Prohibited	Prohibited	Prohibited
Ireland	Obligatory	Permitted after 2005	Not decided
Italy	Obligatory	Permitted/Obligatory	Permitted
Japan	Prohibited	Prohibited	Prohibited
Luxemburg	Obligatory	Prohibited	Prohibited
The Netherlands	Obligatory	Permitted	Permitted
Norway	Obligatory	Permitted	Permitted
Poland	Obligatory	Permitted	Permitted
Portugal	Obligatory	Permitted	Permitted
Russia	Permitted	Permitted	Permitted
South Africa	Obligatory	Permitted	Prohibited
Spain	Obligatory	Permitted	Permitted
Sweden	Obligatory	Permitted	Permitted
Switzerland	Obligatory (IFRS or USGAAP)	Prohibited	Permitted
Great Britain	Obligatory	Permitted after 2005	Not decided
The United States	Prohibited		Prohibited

Table 1. Reporting in agreement with IFRS starting 2005 [1]

For the management board to make decisions to the end of achieving the economic unit’s objectives, they need to know the unit’s situation precisely, either in comparison with other enterprises that function in the field or with relation to previous periods. This is possible due to financial diagnosis.

2 Financial Diagnosis and Decision Fundament

As a main source for information, accountancy contributes to the elaboration of decision-making for the company and its partners. The industrial boom and the development of large enterprises, both characterized by a separation between shareholders-owners and professional managers, have led to an increase in the informational needs of managers and investors during the 20th century. The other external partners - banks, customers, suppliers, public officials - also need feasible information. Thus, to accountancy's traditional function was added a certain decisional usefulness, both internal and external.

But the main role of annual financial records as means of information is to provide useful information in the process of decision-making by stock investors. This view upon the role of accountancy appeared in the United States before World War Two, together with the development of very large enterprises, whose shareholding was vast and dissipated. Predominant in Anglo-Saxon countries, where companies are financed largely through public appeal of capital, this view spread throughout Europe after the 1950's, pressured by the increase in capital markets.[2]

Accounting information allows investors and actual or potential shareholders to formulate value judgments as to past, present, and future events within the company, thus offering a basis for confirmation or invalidation of initial predictions. An investor must be able to extract meaningful elements from the annual financial records that are published, elements that will empower him to decide upon the increase, withdrawal or curtailment of his investment.

But the information's usefulness is greater for the company's management board. Although part of the accounting data may be used in its "rough" form in the decision-making process, much of this data reveals its informational value in the wake of an analysis process, which allows for the setting up of a financial diagnosis of the company.

Since financial analysis is based on norms, in order to be able to correctly evaluate the company's health, the analyst has at his disposal a certain number of indicators that allow him to turn evaluative criteria into value judgments. To this end, it is necessary that he take into account the restrictions and fundamental financial objectives resulted from financial theory at large.

According to financial theory, the general objective of any management unit is represented by the maximization of the firm's value. As such, a company can be assessed with relation to:

- its capacity of producing benefits; to this end is measured the economic profitability of the invested stock;
- its perspectives of evolution with regard to activity and results;
- the financial risk associated with it; this financial risk depends on the degree of financial balance established at company level and on its degree of autonomy.

Through diagnosis, the company's management board, concerned to know the firm's real condition, wants to find answers to the following questions [3]:

1) *Is the company viable?* The balance allows for an assessment of profitability if a structuring process is undertaken in the positioning of assets by the criterion of ascending liquidity (their capacity to turn into money) and a classification of liabilities by the criterion of ascending exigibility. It is all about a patrimonial approach of the company. This traditional optic of the firm's solvency tends to be replaced by a new one, based on a functional structuring of the balance and on the employment of the financing chart;
2) *Which are the firm's performances?* In order to evaluate the performances of an enterprise, one has to compare the means employed with the results obtained. The latter are given emphasis by the result indicators, especially by the intermediary trust

balances;

3) *Which is the company's stage of development?* One has to know the exact increase in the firm's activity during the reported period. Growth rhythm can be an interesting indicator provided it is purged by all influences exerted by prices growth and can be compared with the growth percentage of the entire sector;
4) *Which are the risks the firm is subjected to?* The objective pursued by the diagnosis is to evaluate the bankruptcy risk as a result of the discontinuance of payments. Obviously, other risks will also be analyzed, risks that may affect the company, generally drawn from the study of the socio-economic environment wherein the company functions. We have in mind here the risk of supply intermission, the risk of narrowing down or loss of trade markets and others.

Once the above-mentioned questions are answered, the management board must be in capacity to draw conclusions as to the strengths and weaknesses of the company. The strengths may be represented by the abundance of liquidity, the quality of the relationships established with third parties, especially the banks, while the weaknesses may result from the fragility of financial balance and the insufficiency of own resources proportionally with the degree of indebtedness.

A diagnosis of the company's condition must not be restricted only to the financial diagnosis based on information furnished by annual accounts. It must not lose sight of all the factors that exert influence upon the company's functioning: economic, technological, social, cultural, juridical, and demographic factors. All these key-variables, with qualitative character, interact with one another and must be analyzed before carrying out the financial diagnosis. The census of the company's strengths and weaknesses cannot overlook the following factors:

- the company's position on its markets; it is established after performing a study of the firm's trade potential, which aims at: the branch of activity, the circumstances, the company's role within the branch, the firm's image, the quality of products or services, the price policy, the character of the demand (seasonal or not), the distribution chain, the advertising and promoting activity, the sales as such;
- the company's position in relation to the production factors, determined after performing a study of the firm's technical and human potential (the condition of the working equipment, the research and development activity, the labor's degree of qualification and their attachment to the firm).

3 The Role of Annual Financial Records in Making Predictions

Financial diagnosis must needs presuppose a forward-looking dimension. While the study of past evolutions and the present condition constitutes an indispensable element of exercising leadership, it must nonetheless involve an appreciation of predictable evolutions in a nearer or farther future.

As is well known, accounting information has a retrospective character or, at best [4], a topical one. Of course, the temporal limitation of accountancy is not as radical as it might appear at first sight, and the indications it provides can lend themselves to a forward-looking employment. For example, the debts recorded in the balance will generate future returns, while the debts appeared at a certain moment will require future payments. As such, the information comprised in the balance will constitute the prediction basis for the study of short-term company solvency. However, the possibilities afforded by the employment of accounting data from a forward-looking perspective are not always sufficient, as they must be added up with a clear-sighted perception of the company's financial perspectives.

Present-day activity, carried out in a highly competitive environment, forces the management board of companies to make predictions in order to govern. Thus, prediction becomes a first-rank prerogative of modern leadership, and the financial prediction is perhaps the most important planning activity [5]. Obviously, the financial prediction must be accompanied by a budgetary control of the achievements-predictions ratio, of the causes that generated deflections, to the end of altering predictions, if reality demands it, or of acting upon the activity so that achievements and predictions “see eye to eye”.

The budgetary system contains the company’s main domains of activity. Budgets help to establish how resources and responsibilities are allotted per each activity centre. The budget is thus a prediction in figures of how resources are allotted and responsibilities are distributed with a view to achieving the company’s objectives in terms of profitability [6]. In order to predict the monetary and patrimonial situation resulted from the implementation of the budgetary policies mentioned above, the predicted treasury budget, account of results, balance and financing chart are drawn up.

The predictive account of results represents a summarizing picture of estimated incomes and expenses. It is the main instrument of budgetary synthesis both at prediction level and during the budgetary control stage. The form ascribed to this account may be different from the normalized form of the profit and loss account, according to the company’s needs.

In a predictive account of results, incomes and expenses will be in general divided into months or trimesters, with a view to allowing for budgetary control and the drawing up of the treasury budget. The predictive balance looks like a traditional balance and allows for the prediction of future consequences upon the patrimonial condition and financial structure of the firm in the case of actions estimated for the next budgetary exercise. It will thus allow to estimate the following: the evolution of the working-capital fund, the evolution of the necessary working capital, the profitability of invested capital etc; and it can be drawn up only after the predictive result and the treasury budget are known. The predictive financing chart displays the predictable evolution of the company’s financial balance by dint of the following relation:

Variation of overall net working capital = Variation of necessary working capital + Variation of net treasury.

4 Conclusions

Economic activity, a fundamental component of the existence of human society, acquires ever larger and more complex valences. Within its bounds, just like in the ensemble of socio-economic and competitive life – which characterizes the beginning of this millennium – information represents the quintessence of every action. The management of economic systems – regarded as entities that make up the economy and ensure its overall functioning – has become a complex and important activity, perpetually given impetus by the increase in their dimensions, the dynamism of environmental factors, the variety of production factors, and the limitedness of resources.

The existence of numerous information necessities in the financial-accounting sector, the complex problems pertaining to the management and administration of patrimonial entities, the preoccupation to elaborate studies (static and dynamic analyses), and the fundamentation of correct decisions that would fully correspond to reality and contribute to the solving of multiple problems related to economic-financial activities, have constituted chief elements in choosing this research theme.

At firm level, nearly 70% of all the information that makes up its informational system is economic information, as follows:

- 55-60% information provided by accountancy;

- 5-7% information drawn from socio-economic statistics;
- 3-5% information furnished by operative records.

Under market economy circumstances, part of the accounting information becomes transparent. This information refers to the patrimonial condition, the results, and the financial situation of the company.

The large number of users this information addresses, as well as the satisfaction of the usefulness prerequisite in economic decision-making, requires that financial-accounting information display certain qualitative characteristics. From the four categories of characteristics presented in "The General Framework of Elaboration and Presentation of Financial Records" - the "Qualitative Characteristics of Accounting Information" paragraph -, two can be singled out in terms of importance: one specific to the user (intelligibility) and one specific to the financial-accounting information (relevance and dependability).

In order to meet the users' needs and answer their eliciting of information as well as to eliminate the distortion of investment decisions on European and international markets, nowadays, in most countries, accountancy is normalized on the basis of common terminology and regulations in what concerns the drafting and elaboration of annual financial records, whose models are identical for all enterprises. The main purpose of accounting normalization is to harmonize the manner of presentation for the information offered via synthetic accounting documents, so that they may provide homogeneous information to various users, as well as the certainty that their drawing up observed certain regulations.

Through its finite products – the annual financial records – accountancy furnishes information regarding the patrimonial situation, the financial record, and the results of an economic entity. The accuracy, honesty, and regularity of the financial information that makes up these records depend on the application of several accounting principles: the principle of caution, of method permanence, of independence, of exercise, of activity continuity, the principle of prevalence of the economic upon the juridical, the principle of separate evaluation of assets and liabilities, the principle of non-compensation and others.

Furthermore, in order to have a faithful image of the patrimony, of the financial records and results of the firm, one has to respect certain principles of evaluations in determining the values with which financial record structuring will be ascertained in the balance and the profit and loss account. The most important of these is the historical cost principle.

To conclude with, new phenomena, such as the reorganization of Romanian enterprises on commercial bases, the modification of the property structure, and the formation of the financial market, have all established a new vision, as well as new objectives, that were put into practice stage by stage, during the reform process of the Romanian accounting system, whose final stage is represented by the harmonization of how financial records are drawn up and presented with international accounting norms and European directives.

The assessment of the company's activity and the economic decision-making are both based on information collected from annual financial records. For the analysis, management, and control activity they constitute the most systematic and complex source of information.

The financial analysis on the basis of annual accounts aims at formulating certain value judgments as to the balance and financial health of the company, at giving a diagnosis of its financial condition and its present and future profitability. In broad lines, this analysis refers to:

- the assessment of the main financial results obtained [by the firm];
- the assessment of formation mode, of source structure and use of resources;
- the highlighting of the modes to achieve financial balance;
- the evaluation of the firm's financial solvency;
- the evaluation of how financial resources are managed;

- the assessment of financial, exploitation and bankruptcy risks;
- the examination of profitability for inve4sted stock;
- the analysis of the firm's value.

Financial records present the results obtained through the management of resources by the company's board. It is of utmost interest the company's capacity to generate cash or cash equivalents as well as its continuity of such activity. The mentioned parameters show if the firm is capable of paying its employees and suppliers, of remunerating its owners (shareholders), of reimbursing its credits and correspondent interests.

Information about how activities of exploitation, financing and investment are carried out within a given time frame can be detached from the document entitled the "Chart of financial flows". Using this instrument, one can also draw up assessments as to the company's capacity to generate cash or cash equivalents in the future.

The conditions generated by the transition to the competitive market economy, the increase in firm management complexity, the necessity to adopt quick and right decisions, the knowledge of patrimonial situation and performances – in time and space – of a patrimonial entity have all led to an increase in the informational needs of all those who make use of financial records, as well as to the opening of new directions of research and analysis.

Starting from the conditions levied by market economy, from the competitive dimension of economic activities and the necessity to make them ever more efficient, analysts pursue a financial analysis and management control by the use of company solvency indices.

A specific instrument of analysis employed in firm management is the so-called 'panel board'. Due to the structural financial and economic parameters, to the synthetic presentation form and the informational level, the panel board may serve as an efficient working tool in the management of any organization.

The importance of the information contained in annual financial records derives from the fact that it stands for the "panel board" of the firm's activity, being the fundament of all decisions: economic, financial and of patrimony management, adopted by the board in exercising their leadership. The principle that underlies a modern, healthy management is encapsulated in the cycle "*information-decision-action*".

Although immaterial, the accounting information represents an important factor in the assessment of results and analysis draw-up, in decision-making and in setting the course of action – all manifested in the financial-accounting sector – with roles at both the microeconomic and the macroeconomic level.

The relationship "accounting information - decision-making" has an ever greater degree of dependency, due to an increase in the complexity of management and to the development of cutting-edge modes of decision-making. Under the circumstances, a new notion appeared: the "information value" notion. The value of an item of information can be defined as the difference between the net gain generated by a decision made after obtaining the information and the net gain generated by the making of the same decision, this time unaffected by the given information. Its level must be analyzed in relation with the user and the purpose to which the information is employed. Similarly, the information has a predictive value, as well as a value of confirmation. The predictive value results from the fact that information regarding the financial situation and past performance is used as the predictive foundation for future financial records and performances. The confirmation value consists in the confrontation of the current situation with past predictions and in the identification of achievements, deflections, as well as of corrective decisions.

In conclusion, confronted with the difficulties of transition and facing the ever stronger phenomena of internationalization of economies and globalization of financial markets, Romania opts for a radical change in the evolution of its accounting system, that is for its alignment to the letter and spirit of the international referential code. We appreciate that the accounting reform in Romania has had as an objective the development of an accounting and audit system fully compatible with the European and the international ones.

References

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