

FINANCIAL STATEMENTS – MAIN SOURCE OF INFORMATION FOR THE PROCESS OF MANAGEMENT AND DECISION MAKING

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ABSTRACT

*Managerial decisions have certain aspects that are different from the analyzed perspective. From the point of view of human resources to be hired, the management of the entity takes decisions based on the amounts invested in resources and exploitation transactions as well as a proper financing mix. These are the reasons for which **accuracy and the level of detail in information** has to be at a higher level in order to support the business and it increase its value.*

*The quality of **decision-making** is dependent to a large extent on the **amount** and quality of information upon which the decision is **based on**, which, once adopted is considered the most important process that takes place in the management of an entity. This, more so today, as IFRS generated changes in the conceptual sense of fundamental elements of financial reporting and results, as well as increased volatility of indicators results, **leading to consolidation of the interest for information, analysis and decision making.***

KEYWORDS: *financial statements, users, financial and accounting information, decision process, reporting entities.*

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1. INTRODUCTION

At entity level there is an organized information system that allows monitoring strategic business. When managers have relevant and timely information they can broaden their vision and perspectives on the business concerned, **using financial information in the managerial act**. Critical areas of business (marketing, sales, production, logistics, human resources, etc.) must be known and treated with deep interest as to not jeopardize the smooth running of the business, but also to lead to development. The most important needs of entrepreneurs and managers are the need to make decisions quickly and accurately, the need to develop management skills, **need to understand and effectively use financial and other business information** in the design and business development.

Studies have shown that among shareholders whose management is based on value, the role of accounting information for decision making becomes evident.

Adequate supply of techniques, for example accurate and complete financial statements, directs managers towards decisions that aim maximizing the value of the entity. Looking at the business environment, there is a similarity between negotiations and accounting practice on how **to earn the trust of users of information in the financial statements, important stake for providers of financial accounting information.**

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2. THE ROLE OF FINANCIAL STATEMENTS IN THE MANAGEMENT OF THE ECONOMIC ENTITY

Building accounting information is based on observation of an entity and its specific activity. Data processing in order to obtain information is done by operating with specific language and means to the accounting system so it will respond to users' needs. Accounting information system is a part of the overall entity specialized in the representation and economic measurement. It proposes a global entity modeling based on rules which ensure the quality of accounting information and not only a list of scattered indicators.

Along with the role it plays in controlling resource management and contribute to decision making by various users, accounting has become more and more the role of social adjustment, lately.

Financial statements are a synthetic information characterizing at some point, blocks of assets and liabilities of each entity and is the official management document, who must render a true, clear and complete financial position and results. They include a system of indicators whose development is based on data supplied by accounting, taken directly or previously processed.

Financial statements also show the results of the entity's management, including the way the management used that resources entrusted to them. Those users who wish to evaluate the administration or management responsibility do so to make economic decisions; these decisions may, for example, focus on the option to keep or sell the investment in the entity or replace or reconfirm the management.

The economic decisions that are taken by users of financial statements require assessing whether an entity is able to generate cash and cash equivalents at a specific time to ensure their safety. Ultimately it depends, for example, on the ability of an entity to pay its employees and suppliers, to pay interest, repay loans and compensate its owners. Users are able to evaluate this ability to generate cash or cash equivalents if they are provided with information focused on the financial position, performance and changes in financial position of an entity.

3. FINANCIAL DIAGNOSIS AND SUBSTANTIATING DECISIONS

As primary source of information, accounting helps prepare the decisions of the entity and its partners. Industrial drive and development of large enterprises, characterized by a separation between shareholders-owners and professional managers, has led during the twentieth century to an increasing need for information of managers and investors. Other external partners, such as banks, customers, suppliers, public power, they also need **reliable information**.

Thus, to the traditional accounting function was added an internal and external decision utility.

The information used for taking decisions by the management of the entity comes mostly from management accounting, which is the main source of information in leadership and

management activities¹. However, financial accounting, synthesized by the **annual financial statements**, still provides the necessary information for managers to handle relationships with third parties, the choice of investment projects and financing resources. In addition to small and medium entities that do not use sophisticated management accounting, it becomes useful for informing and in taking most of management's decisions. But the main role of the financial statements, as means of information, is to provide useful information in taking decisions for stock investors. This outlook on the role of accounting "appeared in the United States before the end of the Second World War, with the development of large companies with vast and dispersed ownership. Predominant in Anglo-Saxon countries, where businesses are financed largely through public call for capital, it spread after more than fifty years in Europe, under pressure from rising equity markets"².

Accounting information allows investors, current and potential shareholders to make a value judgment about past, present and future events of the enterprise, thus providing confirmation or denial based on initial forecasts. An investor must be able to extract from the published financial statements elements enabling it to decide on the increase, withdrawing or reducing of its investment.

In fact, the other partners of the entity resort to annual financial statements for taking decisions. For example, banks use them to determine lending, public power to grant or deny a subsidy, providers to accept certain terms of settlement etc.

But the usefulness of the information is much larger for the entity's management. Although some of accounting data can be used in a "gross" state in decision-making, many of it reveal its informational value from the review process, which allows establishing a financial diagnosis for the entity.

In general, financial diagnosis³ aims to analyze the strengths and weaknesses of the entity. To do this, it relies on economic, social, and financial accounting information. Most of the information used, however, is financial and accounting and is extracted from the **analysis of financial statements**.

4. THE ROLE OF FINANCIAL STATEMENTS IN FORECAST PREDICTION

Financial diagnosis necessarily requires a **forecasting dimension**. If studying the evolution of the past and the present situation constitutes an indispensable element of leadership, it requires especially an assessment on developments foreseeable in the near or distant future.

Accounting information has, as you know, a retrospective character or, at best, a timely one. "Of course, temporary limiting of accounting is not as radical as it would appear at first sight and it provides guidance that can lend itself to a forecasting exploitation "⁴. For example, on-balance sheet receivables will generate future revenue and incurred debt, at

¹ Oprea C., Man M., Nedelcu M., Managerial accounting, Ed. Didactică și Pedagogică, Bucharest, 2008

² Esnault B, Hoarau Ch, Comptabilité financière, Ed. PUF, Paris, 1994

³ A.Deaconu, Diagnosis and evaluation the company, Ed. Universitatea Babes-Bolyai, Cluj, 2012

⁴ Cohen E., Analyse financière, Ed. Economica, Paris, 1994

some point will require subsequent payments. As a result, the information contained in the balance sheet will form the forecasting basis for the study of short-term solvency of the entity. However, exploiting the possibilities offered by the accounting data in a forecasting perspective is not always sufficient, they should be complemented by a clairvoyant perception of the entity's financial prospects.

Ongoing work in, in a highly competitive environment, compels entities to provide leadership to rule. Thus, the forecast becomes a primordial task of modern management and "financial forecast is perhaps the most important activity planning"¹. Financial forecast uses certain specific means, the entity's budgets, unlike the balance sheet, are not destined for the general public, but to domestic needs guidance in order to achieve the objectives set by management based on realistic forecasting and on managerial activity to achieve it, subsequent events will evolve, more or less, through budget orientation.

Because the accounting information is generally the only information that is subject to a normalization and a public disclosure, public - user information - tends to believe that the information emanating from entity will be confused with **producing financial statements or accounting documents synthesis - the balance sheet and profit and loss**. In reality, the accounting information is generally only a tiny part of the information produced by the entity.

In the totality of information, essential is the statistical information which includes data that is not necessarily linked together by the principle of double entry. Most often, **long-term forecast information is considered statistics**, given the difficulty of obtaining the forecast data that will allow making appropriate accounting paperwork.

Without being a historian, the analyst of the entity's performance is interested in the forecast data also. As a general rule, all entities must have a minimum of short, medium or long term statistical forecasting data that allows him to finalize the strategy.

In general, the forecasting demand of the entity is materialized in three forecasting documents and a financing plan².

- a) **Long term plan.** It is a document related to long-term statistics, announcing in a summary form, the entity uses and resources on a horizon of 5 to 10 years.
- b) **Medium term plan.** Uses and resources in the long term plan are detailed and specified when drawing the medium-term plan whose horizon is basically from 3 to 5 years.
- c) **Forecast budgets and accounts.** These are annual successive documents that complete the medium-term plan ranking them first on the different functions of the entity. Therefore distinguishing them from the expenditure and revenue:

- 1. **sales budgets**, vented by main types of income or benefits;
- 2. **budgets of direct production costs** (decomposed as income) **to reveal margins** on direct costs related to the various revenue;

¹ Stancu I., Finance, Ed. Economică, Bucharest, 2007

² C.G. Dumitru, Accounting. Solved problems, applications, case studies, Ed. Universitară, Bucharest, 2011

3. budgets of indirect production costs and general expenses.

Previous budgets are then synthesized into a forecast account which enables determining the **forecasted result**. Considering, however, that the forecast is a random field, in general the forecasted result is accompanied by a **probability index**.

Projected costs and revenues are then "translated" in terms of cash, leading to the preparation of a **forecasted financing plan** aimed to track annual financial balances.

4. **financing plan**. Once forecasted resources are determined then a financing plan is established for good.

This device is complemented by an **annual forecast balance**.

All essential data of this planning are highlighted in a **scoreboard**, the latter being a statistical statement of the utmost importance.

Obviously financial forecast must be accompanied by budgetary control of achievements towards forecasts, of causes that determined the misconduct in order to modify the forecast if reality ass for it or to act on activity to connect forecast achievements.

In the system budgets are summarized the main areas of activity of the entity. Through budgets, resources and responsibilities affecting each activity center are established. "The budget is therefore a forecast number of resource impairments and insurance responsibilities for the entity's objectives in viable conditions"¹.

Forecast income statement is a summary of the estimated revenue and expenditure. He is the main instrument for budgetary synthesis at the forecast level and at budgetary control stage. The form given to this account may be different from the regulated one for profit or loss account, depending on the entity's needs.

Resulting in a forecasted account, revenues and expenses will be generally divided by months or quarters, in order to allow budgetary control and treasury budget developing. Income statement forecast is a projection of future results over a period. As with the Treasury budget, sales forecast is central to programming production and estimating production costs. We can go from evaluating each component of cost of sold goods. It is highly unlikely that a detailed analysis of purchases, production-related wages and general expenses will provide the most accurate forecasts. However, cost of sold goods is often estimated based on past relationships between cost of sold goods and sales.

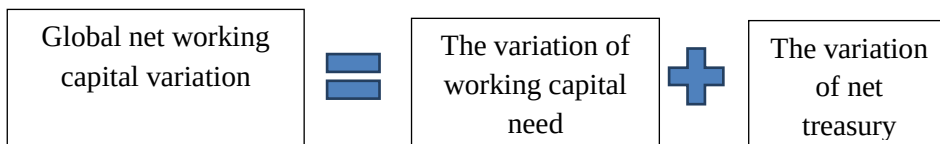
In terms of content, it is stated that in the forecast income statement it must appear "forecasted results", so by analogy with the annual profit and loss account it must contain:

- Operating result;
- Financial result;
- Current result before tax;
- Net result.

The financing plan enables comparison between the provisions and achievements, resulting in a structural identity between the financing plan and **cash funding board**.

¹ Stancu I., Finance, Ed. Economică, Bucharest, 2007

The cash funding board presents the predictable evolution of financial entity based on the relationship.



The forecast balance sheet can be discussed as a "**balance plan**"¹ that includes decisions and objectives on the assets and liabilities of the balance indicators showing the forecast balance of these elements at certain intervals. Also, the forecast balance sheet may be presented as a "**variations of forecasting**", variation stating the balance of elements at the beginning and the end of the projection period.

Income statement and balance sheet forecast is based on cash budgeting forecast.

The treasury budget allows forecasting at the input and output of liquidity in order to avoid the risk of cessation of payments or the appearance of any unnecessary surpluses. Actually, to revenues and operating expenses (excluding depreciation and provisions), financial transactions and investments will correspond receipts or immediate payments or within a certain timeframe. If during certain periods there is a surplus cash and if it is important, you need to provide opportunities to placing it. Whether, at other times it appears a cash deficit then additional resources to cover outstanding debts will be sought.

Treasury budget is obtained by projecting future receipts and payments of the entity at different time intervals. For forecasts done on small periods we use more often, monthly periods because they take into account seasonal variations in cash flows. When cash flow information is volatile but predictable, it is necessary to draw up budgets on closer intervals. To the contrary, if cash flow is relatively stable, we can draw up budgets quarterly or on longer periods, although practice shows that, if the period is very long, the forecast is uncertain.

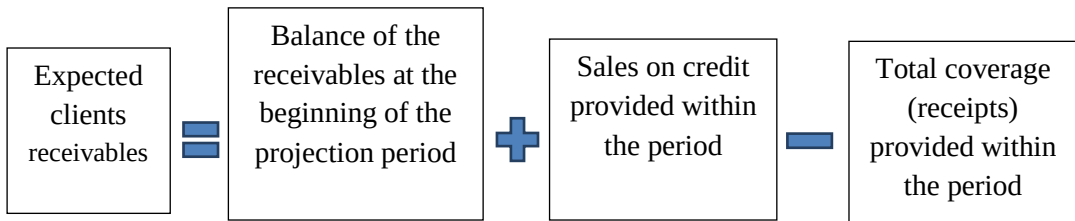
The forecast balance sheet² is presented as a traditional balance sheet and allows the foresight of consequences of estimated actions for the next financial year and financial structure of the entity. He will thus allow estimating: the evolution of working capital; development of working capital needs; return on capital etc. and it can not be developed until after the result and treasury budget is known.

a) Forecasting of accounts receivable.

We can predict the loans and advances to customers on the date of the preview by adding to the balance at the beginning of the period of forecasting total sales on credit provided for in the period laid down and by subtracting the total of the cladding materials provided for within the same period, on the basis of the relationship:

¹ M. Ristea, C. Ionescu, Gh. Zaman, Current challenges in company accounting. Compendium of Accounting, Ed. Foundation of Tomorrow's Romania, Bucharest, 2015

² C.G. Dumitru, Accounting. Solved problems, applications, case studies, Ed. Universitară, Bucharest, 2011

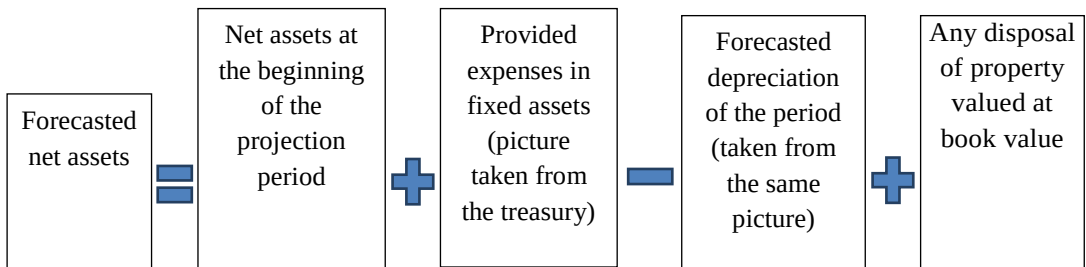


b) Forecast of stocks. Stocks can be predicted based on the rotation rate expressing the ratio of cost of sold goods and stocks, resting on past experience. Based on the average we can determine according to the formula the end stock:

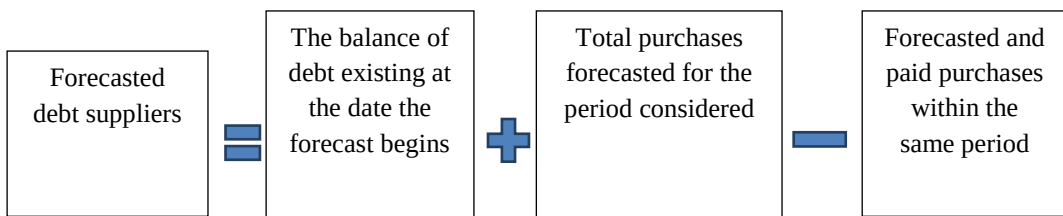
$$\text{Rotation rate} = \text{cost of sold goods} / (\text{initial stock} + \text{end stock}) / 2$$

Where End stock = $2 \times \text{cost of sold goods} / \text{rotation rate} - \text{initial stock}$

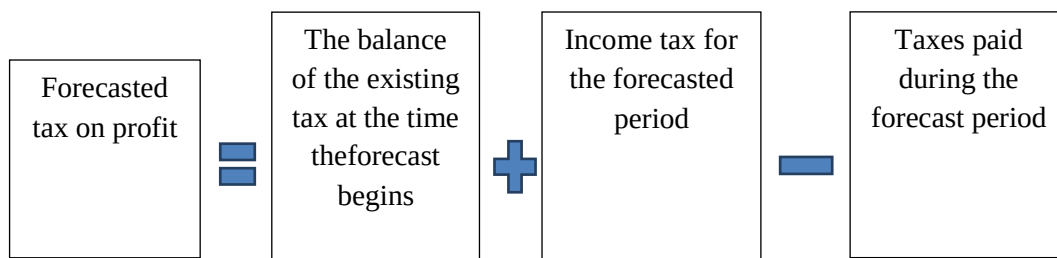
c) Forecast of net assets. Future net assets are estimated by adding to the net assets owned and by subtracting total expenses and depreciation provided for the period increased, as appropriate, with the transfer of property valued at book value, the relationship of calculation used in this case is:



d) Forecast of debt - suppliers to be paid. Debts - suppliers to be paid, will be estimated by adding to the existing balance at the beginning of the projection period the total purchases provided for in the period considered, less the forecasted and paid purchases within the same period and paid for,



e) Tax profit forecast is estimated by adding the balance of current taxes scheduled for the corresponding profit forecast and subtracting taxes paid.



5. THE ROLE OF FINANCIAL STATEMENTS WHEN CONTROLLING THE REPORTING ENTITIES

Management of economic and financial resources available to the entity, with maximum efficiency and protection of assets, requires organization and continuous practice or periodic control for some actions.

Control is a function of management that allows knowledge and improvement on the way the assets are managed, provides information to orient the activity of production, distribution and sale. An instrument to measure wealth created by the entity, **accounting and financial statements** provide the elements necessary to determine various pecuniary rights, such as: dividends due to shareholders / associates, employee participation in profits, taxes and similar payments imposed by state. It also provides qualitative elements that allow to ascertain whether explicit or implicit contracts made between the entity and its partners have been respected. Thus, accounting is a tool for economic, financial, legal and social control.

Economic and financial control can be exercised within the entity, in which case it takes the form of internal control, or by outsiders, known as external control.

Internal control seeks to protect the interests of the entity through expert knowledge of current management operations and setting responsibilities on keeping the integrity of assets.

Although in this form of control the information contained in the financial statements is used, the largest part of the data are drawn from the accounts of the entity and in particular the internal management accounting.

External control is exercised by persons outside the unit that safeguard the interests of specific organs which they represent: the state, other public bodies, investors, banks etc. With some exceptions, the vast majority of the information used in the external audit is contained by financial statements.

So, the annual financial statements serve most of all in actions of control and evaluation exercised outside entity, depending on the purpose of external control. This form of control is found in: control distribution and to control the outcome of the calculation and determination of taxes.

5.1. Control of profit sharing

Financial accounting provides at certain periods in the form of the **annual financial statements**, information useful to the owners of an entity with regard to the financial position at a given moment and the result of the operations conducted in a limited period. The latter increased by profits of prior periods which were not subject to distribution, form the basis for calculating **distributable dividends** to shareholders or associates. Besides the right to dividends, shareholders or associates benefit for the value of capital invested in the entity, the right to intervene in economic and social life of society, particularly through participation in the decisions of the general assembly, and the right to information on the management of the entity.

In order to exercise these rights, **accounting and annual financial statements** provide information that allow associates to control the activity of the management of the entity. Thus, based on the elements contained in the financial statements, associates and shareholders may appreciate the influence of investment and financing decisions on the financial situation and distributed earnings/results.

Ensuring quality of information contained in the financial statements is performed by professional accountants (auditors). Through verifying and certifying financial statements it is confirmed that they give a true, clear and complete financial position, financial performance and results of the financial year.

5.2. Controlling the settlement of taxes

Accounting data is used to establish multiple taxes and assimilated payments to the state budget or other public bodies. The whole of tax legislation applicable to entities is based on **information from accounting**, to the extent that the returns taxable depend, first, on the correct determination of the accounting result. This is corrected to take account of the differences arising between specific accounting rules and tax. Accounting also provides the necessary data calculation of VAT due to budget, and other taxes and duties that are the responsibility of the entity.

Thus, data from the financial statements constitute a tool that favors control by fiscal authorities, the purpose is that the entity will pay the fiscal obligations in time and to prevent tax evasion¹.

In order to ensure the fulfillment of this objective, the legislator has intervened through multiple laws that determine tax obligations of taxpayers, the conditions for deductibility of expenses (by registering them in the accounts) and the right of tax authorities to verify the entity's accounting. This verification is to examine the accounting documents of an entity and to face the facts, to control the statements submitted by the entity and eventually to determine if there are additional taxes. The control of establishing taxes and fees tries to reinforce the fiscal and financial discipline of entities.

As a result, the role of annual financial statements in controlling entities comes first, constituting a support and a guarantee of quality for the information included, for decision-making by both internal users and those outside the entity.

¹ Munteanu V., Financial and accounting control in companies and public institutions, Ed. Universitara, Bucharest, 2015

6. CONCLUSIONS

The foundation of the financial statements is financial accounting, which requires registration, classification and centralization of information on economic events and transactions denominated in a currency unit.

The financial statements are the end product of accounting, their quality depends to a considerable extent on the quality of accounting processing. The financial statements are the result of interaction of three parts: entities as the subjects whose activities are subject to financial information, accounting information users and professional accountants or accounting profession in general. From all these pieces, the role of improving the content of financial statements and the credibility of accounting information is attributed to the accounting profession.¹ Hampton² stated in his studies that the financial statements are an organized collection of data according to logical and consistent accounting procedures. By default, the financial statements present the results obtained by managing resources by the entity's management, which means, in fact, that this structure is competent and legitimate.³

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