

## OBJECTIVES AND FUNCTIONS OF FINANCIAL STATEMENTS UNDER ACCOUNTING INFORMATION SYSTEM AT TRADE ENTITIES

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### **Abstract**

As Radu said (2009, pag. 91) [6] logical approach developed by accounting, presentation of an exact image of the heritage, the financial situation and financial results, based on a rational thought, a gradual knowledge domain investigated, concepts, tools and processes that allow a better understanding of the essence of economic phenomena and processes.

Theoretical framework brings together a number of concepts that are considered fundamental to regulatory or accounting systems applied at the level of the entity to have clearly specified the coordinates of the base and are able to achieve cohesion between the objective of financial statements as true and fair view, financial information and policy characteristics and estimation techniques as a form of expression towards the recognition and presentation of economic reality.

The author considers, in the context of the defined system applied within the accounting entities in general, that principles, presents not only a crucial premise, as well as needed necessity in order to show an exact image of the performance and financial position of the entity.

**Key words:** accounting information system, exact image, annual financial statements balance sheet, income statement and the profit and loss account, trade entities.

**Classification J.E.L. :** M40

### **1. Introduction**

The main source of accounting law from Romania, Law No. 82/1991 republished, stated in art. 9 that official documents presenting the economic-financial situation of the entity are the annual financial statements, set out according to the law, which must give a true and fair view of the financial position, financial performance and other information on the work carried out by the entity.

At the same time, in Order of the Minister of Public Finance no. 1802/2014, point 24 states that annual accounts must give a true and fair view of the assets, debts, financial position and profit or loss of the entity.

If the application of the provisions of these rules is not sufficient to give a true and fair view of the assets, liabilities, financial position and profit or loss of the entity, in the notes to the financial statements to be provided additional information necessary to comply with this requirement.

### **2. Objectives and functions of financial statements under accounting information system at trade entities**

#### **2.1 Financial statements - information support in management decision**

As Radu (2009: pag. 70) [6] said, quoting Paraschivescu each part of the financial statements reflect a certain picture of economic transactions and events in the context of the current financial year as follows:

- *Balance sheet, as image of the financial position* reflects the ability of the entity to adapt to environmental changes by using economic resources (assets), the structure of financing (equity and debt), and with the help of economic and financial indicators of liquidity and the charge. Information about controlled assets are useful to predict the entity's ability to generate cash flow, and financial structure, for anticipating future lending and distribution of future cash flows between the entity's partners;

- *The profit and loss account*, as image of the performance of the entity, reflects the entity's ability to generate profit. The information is useful for anticipating the entity's ability to generate cash flows (revenues) through the use of existing resources (costs), as well as the degree of efficiency in the use of new resources (profit or loss);

- *The situation of cash flows*, as image of the financial solid item of the entity, reflects the entity's ability to generate and utilize the cash flows from operating activities, investing and financing;
- *The situation of own capital* changes as image of the value of the entity, reflects its ability to generate elements of equity (share capital, share premium capital, reserve, the result brought forward, the outcome of the exercise).

As Tabără said (2001a: pag. 48) [7], idea which I agree, the goal of true and fair view signifies the requirement to give the best description of the entity; annual accounts giving a true and fair view if they are not misleading, false if it does not provide a representation of reality. So it is necessary to communicate the information users complete, taking into account that their needs are different, and it changes with the changing economic and social environment (principle of relativity needs).

Considering the above, I am also of the opinion that it is important to know the users of accounting information, the purpose and requirements of these sides, because interests for accounting information are very numerous, all internal and external partners of the entity, such as managers, employees, shareholders, investors, suppliers, customers, public agencies, etc..

At the same time their concerns are, obviously, for different areas, which is materialized in the business plan by the adoption of separate decisions and in need of a suitable approach for their establishment.

Returning to the above, Pahone (2005: pag. 46) [4] quoting Demetrescu, defined the balance sheet, in general, as follows:

- the most representative instrument for recording and accounting control used for the realization of its main purpose, to characterize the work of the economic and financial situation analysis;
- an accounting document compiled on the basis of data from accounting, arising from the current records;
- the main instrument and characteristic of the consolidation and generalization on the basis of the principle of double representation of accounting data and information on the methods and sources of economic training, and the results of all the levels of the national economy: in general, budgetary institutions, subbranches, branches and the national economy as a whole.

In this way, according to the author, the balance sheet can be considered a guide for establishing the conditions under which economic entities in general operates, making use of the experience of the past, indicating the directions to be followed and specifying the deficiencies. As a result, I consider it important to give the some of the issues set out in europeanlaw as regards the balance sheet, which, clearly, off the idea that the entities in the trade they have unconditionally to be applied, thus the possibility of recording of their sources of funds and balance sheet at the same time being a work of synthesis for economic and financial analysis.

At the same time, balance sheet – management model-getting a higher level for information, expresses the sizes with productive character obtained postfactum.

Otherwise, the concept of annual accounts is defined by Directive of the European Economic Community (EEC), taking into account the balance sheet, the profit or loss account and the notes, which together make up one whole. All in the 4th Directive it is stated that, in principle, the structure of the balance sheet and profit or loss account cannot change from one exercise to the next, and if this principle is violated in exceptional circumstances, duly substantiated reasons shall be stated in the notes.

At the same time, Tabără (2001b: pag. 74) [8] shows that IV- European Directive States the following:

- posts from the general diagrams for balance sheet and profit or loss may be provided detailed with condition to follow the structure of diagrams;
- it may add new posts when their content is not in general diagrams, and also add may be required by the legislation of the national accounts;
- each element of the balance sheet or profit or loss account must show the size of the previous year in respect of this post;
- general diagrams for presentation of the balance sheet and profit or loss account may be changed by the national indices;
- compensation is not permitted between actions active and passive, respectively between the expenditure and the revenue.

Even so, as Pahone says, in the current economic legislation and practice of various countries, the annual accounts are known as abbreviated as "balance", considered the most representative recording and control tool used by the accounting department, useful for analyzing financial situation at economic entities in general.

Having in view of other approaches from the specialty literature, Voica (1994: pag. 257) [9] notes that the balance sheet is:

- the main element for the explanation of double registration;
- the way to reflect the situation at some point in the entity's money through the implementation of means and resources;
- Summary of accounting calculation, by presenting themselves at some point the economic situation from a perimeter of stock movements, valued in money, comparing assets with liabilities;

- accounting document compiled on the basis of accounting data arising from current records made in the accounts;
- specific accounting tool, which presents itself in a centralized manner and systematically grouped accounting data on the situation of economic value, the sources of funds for training and the results of an entity generally at some point.

## 2.2 The objectives of financial statements at trade entities

The central objective of financial statements is to provide useful information on a wide range of users by presenting an image true to the financial position, performance and changes in financial position of the entity (Müller, 2010, pag. 54) [3].

According to Pahone (2005, pag. 47) [4], at economic entities in general, financial statements may have a number of objectives, as follows:

- providing the necessary information for economic decision making;
- providing the necessary information for the assessment of economic activity of the entity;
- providing information for the evaluation of monetary flows and potential (for investors and lenders);
- providing information for the evaluation and comparison of the performance of the unit (the ability to produce profits);
- providing information regarding the efficient management method of entity resources;
- providing information about the activities of the entity that can be described and measured.

Considering the above mentions I consider that the objectives listed above may be awarded to entities and trade entities.

FASB considers that synthesis papers should provide useful information to investors and creditors, though as the author asserts above, opinion with which I agree, it should be considered also that the financial statements should provide information to the same extent towards other users, such as: managers, government, employees. In other news, the information offered by synthesis documents is intended to help those who want to conduct business assessment, information not being intended for the direct use in the evaluation of the business.

On the other hand, the IASC stated that the information in the synthesis documents have as objectives:

- verification of business management;
- determination of the capacity of the entity to remunerate the business participants;
- evaluation of the guarantees offered by entity;
- considering the time the capital must be invested;
- establishing the dividends;
- determination of economic policy, trade and tax;
- fixing welfare entity and decision-making in the utilization of resources, the distribution of national resources at macroeconomic level.

The author quoting Lauzon, believes that the most important objective, which affects the quality of the information in the annual accounts, are those aimed at addressing the user and in particular to investors and lenders assuring them the information as follows:

- The information they need in the economic decision-making of investment, taking into account the fact that not all users have the means and resources to obtain additional information about a particular entity;
- Information about how the entity assures protection for the capital invested.

According to Pahone the goals for the annual accounts are different from one country to another and targeting the importance accorded to the different categories of users, either internal or external, and the needs of users by generating goals relating to:

- economic decision making;
- presentation of an information to assess future treasury flows;
- provision of information on the financial situation of the entity, the entity's performance, debt and solvency, liquidity, retention and financial flexibility;

However, according to Horomnea (1986, pag. 103) [2], the financial statements do not provide all the necessary information to users, because:

- in a certain way expresses financial effects of some past events;
- does not contain, as a rule, non-financial information.

According to Feleagă (1998, pag. 73) [1] attainment of these objectives will contribute to the achievement of the accounting system, as follows:

- for decision-making;
- for the control of commitments;
- to provide the necessary evidence to justice organs;

- to establish the diagnosis of entity;
- to provide national accounting data;
- to regulate the business in general.

### **2.3 Functions of annual financial statements at trade entities**

Generally speaking, as Mătiș and Pop said and quoted by Müller (2010, pag. 52) [3], the primordial function of the financial statements is to provide information that would provide a true and fair view of the financial position, on the performance and changes in financial position of the reporting entity for the purpose of the use of this information by the various categories of internal and external recipients.

At economic entities in general, the usefulness of the annual accounts is linked to the existence of trade, the limited nature of the material resources, human and financial, as well as the interests of third parties. The indicators provided by summary documents and accounting reporting are influenced by events, facts and quantifiable, measurable phenomena in order to establish the financial predictions (Pahone, 2005, pag. 49) [4].

As Pântea said (2004, pag. 64) [5], in a conceptual approach, the main functions of annual accounts are:

- generalization and control function of accounting data;
- information function;
- the function of control and analysis;
- prediction function.

• Generalization and centralized function of accounting data is a manifestation of the knowledge process, of the final step of accounting data processing flow; data and information traversing upward, eventually will be given to a system of economic and financial indicators with the character traits that give expression productive entities. The author points out that this function does not stop just at the level of the economic entity but may extend to territorial, sectoral or even nationally level.

• The function of information ensures the summary and accounting report documents the place and role within the information system. Due to the character of synthetic information in the annual accounts shall give rise to an overview of the financial situation and results. Thus the author mentions that it develops the internal information area required for the management of the business, but also the external one, financial and economic indicators being used by third parties. This function is characterized by reality, accuracy, comparability and legality.

• Control and analysis function is achieved through the pursuit of reality the objectives set; the analysis being the checking of various correlations which must exist between the data of annual accounts so as to establish some feedback regarding the unity, risks, performance, etc. This feature is useful for both internal needs serving entity management, employees, business partners and external needs for investors, creditors, tax organs, etc. thus an analysis on horizontal or vertical synthetic indicators. The author notes that, in general, economic entities are putting greater emphasis on the following tasks:

-achieving economic analyses which task is the economic risk assessment, as well as the determination of the correlation between the yield and the risk of exploitation;

-performing a financial analysis based on the determination and use of intermediate management balances, of funding, of cash flows, in order to assess financial risks and bankrupt entity.

• The prediction function results from processing and capitalizing on the higher stage of senior annual accounts. Thus, at trade entities, for example, the predicted calculations in the period ahead, on the participation of the supply factors, provides tactical and strategic decisions more effective. At the same time the author mentions that on the basis of previous annual accounts data you can use several methods to establish the business market. By the help of this function are produced annual predictions accounts, which by their contents provide information necessary for the financial situation of the entity for future management period.

In conclusion, the author mentions the fact that the functions described above are mutually inter-conditioning; so that would not be possible without the generalization of accounting data, and the information would not be able to specify the factors of influence that determined the size of the synthetic indicators and determining responsibilities, without realizing the function of control and analysis. The economic entities in general, and those in the trade, unconditionally, the first three functions have important significance in achieving the predicted decision makers economic and financial; the manifestation of these functions being made both at micro-economic and at macro-economic level, and the products of annual accounts information serving as follows:

-entity's leadership in implementing the economic policy and financial management. Are used, in particular, accounting management information, the clerks of these departments being responsible for drawing up the documents of accounting synthesis and reporting. At the same time taking into account certain rules for drawing up the annual accounts in the framework of financial accounting, managers of trade entities, for example, are able to pretend, to ask for other documents to be drawn up and corrected with the effects of inflation, these documents being required by managers for decision-making.

- to investors and creditors which, as a rule, do not have any other information than those of annual accounts. They must know the synthetic indicators, the ability of the entity to enhance wealth and to convert the riches in availability in order to obtain the future profits; in this respect are particularly important the following information, as follows:

- the market value of the shares;
- the size and nature of the economic resources owned and controlled by entity, compared to the nature of its liabilities;
- the ways in which entity finances its activities and manner in which invests funds;
- the way in which resources were used effectively by administrators;
- the way in which administrators have ensured the protection of assets.

But, according to the author in practice the investors have other studies that provide the necessary information within the time limits, namely:

- the creditors which lends entity and for which significant is information about the solvency of the guarantees granted to the person (pledges, mortgages);
- entity trading partners (customers, suppliers) who are interested in the entity's solvency, of her ability to meet payment deadlines;
- employees and unions willing to improve working conditions and earnings; they are interested in ensuring the profitability and stability of entity.
- tax authorities aimed at achieving income from taxes and fees;
- macro-economic institutions for the establishment of national accounts, the budget balance issues and monetary, of measuring the relationship between the effect and result, for the determination of fiscal policy, the statistical indicators of national income policy, protection of the environment, the rising prices, the price-performance ratio, etc.;
- financial analysts which establish the diagnosis, information provided by the entity's annual accounts being useful alongside other information from management and financial analysis for the interpretation of the figures and decisions to sale, purchase a business, the change in the financial structure of the business, etc.;
- the courts, the prosecution in the case of dispute, the use of annual accounts as evidence in legal proceedings.

In another opinion, as Pahone said (2005, pag. 77) [4] at economic entities in general, and those in the trade, without a doubt, in my opinion, the role of the balance in decision-making-information system can be completed through the functions that it performs in the process of knowledge, of which the author mentions the following:

- Systematic function or summary of ballance sheet which is manifested at the level of the balance sheet accounts, balances of accounts in order to obtain the value indicators. At the same time the author mentions that it is possible that the function of systematization to unfold by centralizing the information contained in the balance sheets of several entities that form a group or by centralizing macroeconomic balances
- Referential or information function of the balance that is essential for the place they occupy in the information system of decision-making-entity. The information in the balance sheet (assets, resources and situation of the entity's financial results serve as a basis for substantiation of economic policy decisions. The author quoting Lopez argues that the process of decision-making on the basis of balance sheet data involves three stages: reading, analysis and interpretation of data. Thus, reading the data contained in the balance sheet leads to obtain information about the type and size of the means available to the entity and the extent to which these assets are financed from own or foreign sources, i.e. whether the exercise ended with a profit or loss.

This information function of ballance sheet extends beyond the limits of organizational property unit in this sense can be considered external users of the information contained in the balance sheet: associates or shareholders, customers, suppliers, banks, tax organs, etc.

- Analysis function is, as Pahone mentioned, quoting Demetrescu, a sequence and a depening of information review function. Particularly important for economic policy decisions for pricing at the level of an economic unit is the analysis and interpretation of data provided by the balance. In this way knowledge is carried out and the results obtained, heritage, making predictions on the development in the future development of the property unit.

At the same time the author quoting Păvăloaia asserts that this function of balance sheet analysis is accomplished by checking the various correlations which must exist between the data and the information in the balance sheet, analysing past management of the economic heritage unit, financial balances, profitability, solvency, the liquidity risk, financial risk, economic activity, etc. Also at trade entities, analysis function is manifested in the process of tracking and interpretation of how to achieve the objectives in terms of the use of resources and results, and determining measures to be taken to correct the irregularities, and this feature is enabled by the financial analysis based on the actual balance sheet and profit and loss account.

And Pahone in conclusion, considers that the three functions of balance complement each other, users being informed through the systematization of data and information from accounts in order to obtain useful information to both the management entity, as well as external users.

### 3. Conclusions

In conclusion, I also agree that at trade entities, in our case, the accounting information adjustment, through modeling concepts confers, on the one hand, the "objectivity" of the accounting system chosen, and, on the other hand, allows to obtain an exact image. At the same time managing the entity trade, for instance, requires that balance sheet to satisfy multiple and complete goals of information and control of economic activity, of comparative analysis and substantiation of decisions regarding the next period; so that theory has demonstrated and practice has confirmed the balance sheet, as a tool of decision-making information base of the management entity.

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