The economic result of financial and internal accounting

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Abstract

This paper deals with the problem of the difference between the economic result of the financial and internal accounting, which affects the objectivity of the evaluation of the company, which uses the balance sheet (financial) analysis.
Accounting information system is a tool for assessing the company's success in a competitive environment. The company as a whole is characterized by financial accounting, which is exposed to some external influences that cause that information to be provided to external users, does not reflect fully the current reality. On the contrary, internal accounting is required to display the reality, especially because the management is only possible if real-time information they are available. Therefore there are differences between the two areas of accounting.

Key words

Balance sheet analysis, financial management, financial accounting, profit, cost, valuation, internal accounting indicators.

1. Two areas of accounting

The accounting system is conceptually determined by its two fundamental boundaries. On the one hand, it is an aspect of Accountants - technical, on the other, the organizational aspect.

Single circuit accounting system was used earlier in the centrally planned economy and only one profit for the business as a whole was known. There was no need of double-circuit accounting because of reasons such as uniform and relatively stable prices, wage regulation, standardization, set production limits, etc., the company had only very little decision-making power and therefore did not need to obtain more detailed information about the inner workings of the company.

Accounting generally has a dual mission. First, to record the management entity for the purpose of tax payments, this is precisely standardized in accordance with the laws. [12]

Second, each entity records the data for their own needs analysis, surveys, making the outlook for the future, etc., and it is up to the subject in which way will it work with this information. These include the capture of cooperative relations in various stages of production and pricing of internal outputs. [7]

1.1 Financial accounting

In a market economy it is necessary to ensure the firm and have an accounting system - financial accounting – which would allow the comparison between companies that could be exercised by a tax assessment to be carried out by independent external audits , and some organizations even have the obligation to publish financial data accounting (e.g. for banks , shareholders, ...).

The law therefore establishes uniform rules, policies and procedures of accounting, which are applicable in any company. Double-entry accounting is an inherently brilliant, logical and relatively simple administrative and information system, which is governed by mandatory rules and laws. Clear rules allow for the ease of control. It is then the task of financial accounting to create compromise performance reporting in the framework of rules, first between internal requirements for the minimum tax burden, but also at the same time there is a need to report a result that would be favourably evaluated by external users of information for which they are intended.

The main function of financial accounting:

a) Recording or state measuring and monitoring the movement of business assets, the method of financing the assets, cash flows and monitoring the performance (profitability) of the company in terms of value.

b) Evidence function - that is, each entry must be supported by accounting documents.

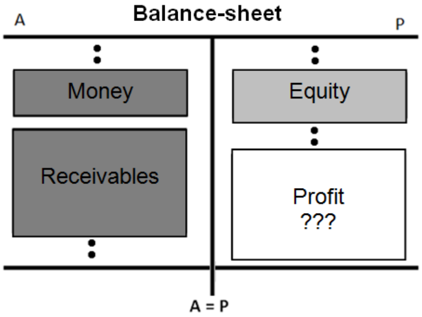
The accounting must be primarily understood as a data base of essential information in the financial statements. To be useful information in accounting must always be current, accurate, reliable and (always) available, no matter if the receiver of information is a business owner, a shareholder, a managing director, an auditor, a tax office or a statistical office, etc. The sponsor, provider of information and at the same time the guarantor that the information is correct, is an accountant.

The mission of accounting is filled when it is possible, according to its output (especially balance sheet and profit and loss) to decide, in real time. If not, on the basis of certain financial data for decision-making, accounting becomes a static and unproductive matter for the company. The downside, respectively accounting problem is that it contains information about events that have already happened.

The result of financial management must be the certainty that the financial statements correspond accurately with the fact that the property is protected, risks are hedged and the company has enough effectively used tools.

The property in the company is saved in different forms (fixed assets, inventories, receivables, cash, etc.). Any of the following types of assets can also be financed from various sources (equity and debt) by proper monitoring of movements and changes, development of individual items, the analysis of relationships between individual items. Management can be measured and therefore effectively managed by proper.

The result of sound financial management is an economically stable company. Financial or economic view must always be superior to accounting and tax perspective. If the company reports profits, it does not automatically mean its successful management, because the realized gain is only when the realized amount is receivable - Fig. 1. Production of the warehouse and billing forms unrealized gains and may confuse the enterprise. Purchases of investments in the absence of own resources may jeopardize the company directly.



***Picture 1**: Partial (Czech) corporate balance (source: own)*

Financial accounting is a tool that can be used to control and also for mutual comparison between undertakings.

1.2 Operating (internal) accounting

On the other hand, however, every business is an individual entity that has a need to keep their accounting for decision making and other management, the corporate accountancy, which is a systematic tool of accounting, operational, also called internal accounting.

Internal accounting is characterized by the absence of strictly defined rules for its management, or just it sets internal rules for the purposes of compliance with certain financial accounting - for example, it's the same breakdown of costs, prescribed reporting formats, etc. Internal accounting provides information that financial accounting does not detect, such as the distribution of costs between unfinished and finished production, balances of finished production, etc. In addition, internal accounting provides data to calculate their own cost outputs (products or services, i.e. products) and thus information about their profitability, provides data to monitor deviations (controlling) and is used to control the activities of departments and centres.

Internal accounting is capable of certain objectification information for internal management in the financial statements.

Internal accounting monitors the financial information on the manufacturing and non-manufacturing flows. It records the power of transmission between the centres that financial accounting does not record. Internal accounting provides information about how a balance sheet profit arises as reported in the balance sheet and the income statement in the financial and internal accounting. The internal profit and loss are, however, significant differences between actual and predetermined costs. Each centre can have savings, compliance, or cost overruns, and can put together a detailed income statement. Reports and statements about actual and projected cost are used to analyse the causes of deviations.

Original coherent and workable system, composed of the elements of financial management, control (audit) and financial accounting, is complemented by in-house accounting. This system is based on the integration of selected elements in the company management system, but also represents a "firming" or "strengthening" of the entire system. The advantages of this new structure stems from the above benefits of intercompany accounting.

2. The emergence of differences

Other considerations focus on the central problem, namely to ensure a real and true picture, which makes the operating accounts of the financial aspects of the projects, products, services, or activities in internal control. In order to achieve procedural attribute of internal financial circuit, it is necessary to define the factors that cause the difference between the economic results arising between the two accounting circuits.

2.1 Examples of differences

a. Valuation and depreciation of capital assets - fixed assets (financial accounting uses the statutory depreciation, internal accounting depreciation calculation used):

   - Calculation (accounting) depreciation should accurately express wear property, it should lead to a real recognition of the value of assets and spread the acquisition cost of the asset over its useful life. Their determination is left entirely to the decision of the entity.

- Tax depreciations are determined outside the accounts only for the purpose of determining the tax base and do not always faithfully the actual depreciation of assets. It is actually a law for depreciation amounts that are admissible for the purpose of determining the tax base.

b. Inventory - during the fluctuating price levels, being made for the highest price, or a predetermined price which was used in the calculations.

   - The problem with the valuation of work in progress, respectively not including all overhead costs, because not only production overhead costs but also directed administrative, supply and marketing are included in a finished production, while work in progress includes a system of production, although the calculation counted all mode (and possibly even the entire completion of production).

c. Reserves and amortization for receivables:

   - Reserves - in Financial Accounting high reserves are created with due care, while the internal bookkeeping is the creation of realistic reserves, respectively the provision is necessary, or none.
   - Creation of accumulated depreciation of receivables in the financial accounting - especially for loans to foreign borrowers, as they are at risk of recovery, foreign exchange, transfer, political, ... (and vice versa, "profit" from the devaluation of the crown).

d. Prepayments (in financial accounting) - especially the cost of intangible activities such as research and development, implementation and start-up of new production ... because they have a relative value (may be completely worthless), but are reported in financial accounting, while internal accounting charges realistically, that does not include the costs accrued to current costs, but watching them (if they are not on the balance sheet) as the hidden reserves, which reduces the amount of relevant.

   Silent reserve profit is hidden in the balance sheet items. It creates the:

   - Lower valuation of economic instruments, such as inventory or fixed assets.
   - Overestimation sources such as depreciation and provisions (for repairs…).

   It follows that the amount of hidden reserves is not ascertainable from the balance sheet – it is hidden. Quiet reserves arise either consciously or deliberately (price reduction work in progress omitting overhead), or automatically (e.g., formation of higher amortization of basic resources than their degradation or due to the rise of foreign currency to which the enterprise claim sounds).

   The opposite of hidden reserves are "negative latent reserves," which are hidden in the loss of balance sheet items, such as stocks overvalued or disproportionately low reserves for repairs. These negative nature reserves are inadmissible.

e. Other causes of differences in economic and financial results of internal accounting:
   - claims for damages,
   - obligation to pay damages,
   - interest (FU real interest VPÚ calculating interest),
   - change in the exchange rate - the impact on claims,
   - change in the value of securities,
   - …

2.2 Change in internal inventories

The following section is devoted to the accounting treatment of factual disagreements between the costs (generically segmented operating costs) and revenues, which occurs particularly in entities with production activities. This disagreement arises particularly for items in inventory (work in progress, finished goods), when the expenses by nature, if they are not adjusted for changes in inventory, include the cost of unfinished and finished, but lost production and are confronted with revenues from sold (realized) performances. Thus established profit therefore compares the incomparable and therefore has no explanatory power. As a result, we compare, for example, the cost of 100 units produced, with sales to 20 units sold, or vice versa 20 units produced, with sales of 100 units sold, which were already in stock from the previous period. Failure to complete treatment using items "Change in inventory", thereby is violating the principle of allocation of costs and benefits in terms of time and material context.

In order to have profit explanatory power when using the generic classification of costs, we have to make an adjustment to change the status of work in progress and completed, but unsold production and, on the contrary sold but not manufactured in the period of production. These items in terms of balance sheet items affect assets finished goods and work in progress and liability item Result of the period. Change in unfinished and finished goods is recognized profit, i.e. … that translates directly into profit. Item Change in work in progress (finished products) can be considered as income or expense. There are different approaches in the Czech Republic according to the valid methodology these items are treated as income; international accounting standards deem these items for shipment, IV. Directive EU considers increase in state revenue, reduction of cargo.

The basic procedure in this issue reflects both the conceptual framework for international accounting standards and the standards of IAS 1 - Presentation of Financial Statements.

Krupová, Vašek, Černý, (2005, p. 49) state: "IAS explicitly state that the change in finished goods and work in progress during the period of adjustment means operating costs. In some jurisdictions, including the Czech Republic, the increase in finished goods and work in progress during the period is regarded as income. This is in contradiction with IAS / IFRS".

The procedure for the member countries of the European Union regulates the fourth EU Directive (Fourth Directive 78/660/EC). This directive in § 24 for the generic classification of costs and revenues uses in comparison with the national adjustment of accounts in the Czech Republic and the International Accounting Standards IAS / IFRS combined modality - the increase in the deemed income, reduction of cargo.

The following table shows how editing changes in inventory according to the aforementioned accounting standards.

Table 1: *Comparative table of reporting changes in inventories*

Accounting standard	Increase in inventories	Decrease in inventories
Czech accounting regulations	**R+**	**R-**
IAS/IFRS	**C-**	**C+**
IV. directive	**R+**	**C+**

3. Interested parties, or, "Who cares?"

Financial statements and other corporate data is intended primarily for managers, analysts, employees controlling and internal audit departments who need to navigate quickly the economic situation of the company and want to get acquainted with the state of management for future management and decision making. It is essential to link art information on elements of financial statements, which flows into the understanding of the information presented in the financial statements on the basis of the necessary amount of theoretical knowledge of function of the accounting system.

Financial, and also the financial statements, are documents showing the financial situation of the company. The objective of financial statements (under IFRS) is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in the creation of economic decisions.

For practical reasons, it is necessary that a statutory body, respectively each economic entity had knowledge of structure, meaning statements (as well as the information it contains). It's also because the statements must usually be signed by a statutory authority and it should be good practice to be signed only when they understand them.

The basic financial statements are the balance sheet, income statement, cash flow statement, statement of changes in equity and notes to the financial statements. According to the Czech accounting legislation parts of the financial statements balance sheet, income statement and notes to the financial statements are mandatory. The cash flow statement and statement of changes in equity is mandatory only for the selected entity.

3.1 The relevant information

3.1.1 Data detectable in assets:

a) Information on tangible personal property must be viewed so that the balance sheet included in particular types of property are gross values, if we want to know the actual amount of assets, we have deducted to the items from accumulated depreciation (accumulated depreciation). Accumulated depreciations are also categorized by the type of property.
b) Information on real property may not modify, because the property is not depreciated.
c) The value of small tangible assets after the deduction of depreciation should be zero.

3.1.2 Data detectable in liabilities:

a) Information on the amount of equity. Its development can indicate the status of the management units. In extreme cases, it is even possible to have negative equity value. This situation is not desirable and should be actively addressed.
b) The value of income (in approval process) gives the accounting profit for the previous financial year. From this account it is necessary to convert the value into profit items. Retained earnings, accumulated losses from previous years. Also the state on this account should be monitored.
c) The sum of foreign resources should be in ordinary cases at least balanced with the sum of resources. When lending or financing from external sources, then the ratio of debt-to-total liabilities is higher than 0.5.
d) A separate item of liabilities are liabilities divided into short-term and long-term. When the accounts should be done, the identification of various liabilities and detailed control should be carried out (can be part of inventory).

3.1.3 Data detectable in costs:

a) You can check the value of the materials used (accounting group 50).
b) The travel account 512.
c) The value allocated to labour costs account 521.
d) It should follow the value of the account 549, which is used for charging different "non-standard".
e) On account 551 the values of depreciation.

3.1.4 Data detectable in revenues:

a) Proceeds – performance of company.
b) Activation – self-help returns.
c) Change in unfinished and finished production - see the issue in paragraph 2.2.
d) On account 601 is shown how much the entity earned within complementary activities (rent, advertising).
e) On account 681 is the sum of all listed billed subsidies.

4. Impact on financial analysis

Financial Analysis (in older literature and now exceptionally also balance analysis) is a specific part of the analysis of resources, which in practice means that it is the analysis of activities in which the primary role is played by finance and money, and time. The aim of such an analysis is to identify strengths and weaknesses, to determine its performance and to evaluate the information so that the financial analysis could become one of the tools used to manage a business.

4.1 Distribution

4.1.1 External financial analysis

External financial analysis is the financial analysis which is done only on the basis of publicly known information. The basic published information is accounting and financial information. An example of such information may be considered especially the information from the financial markets, as well as relevant forecasts of economic developments and forecasts for the field. The second group of calculated data changes, is expected, especially exchange rates and feedstock, which can be traced using macroeconomic forecasts or stock exchange. This type of analysis can be carried out without the knowledge of the company; the results can be disclosed without its knowledge also. External analysis is done for the needs of banks, investors, strategic partners and major trade partners, it may be carried out at the request of the company itself to get an idea of how to operate their partners. This type of analysis is interesting also for brokers or competition. For analysis, it is important to realize that not quite accurate data are used and, its importance should not be overestimated.

4.1.2 Internal financial analysis

On the contrary, internal financial analysis is done from inside, companies and all accounting and other documents, in particular the financial plan and any statistical data are available to analysts. Practically all company operations, including such areas as the evaluation of investment opportunities are reflected in their conclusions. The conclusions of such an analysis are aimed at the management of the company and are incorporated into the management of the company.

4.2 Methods of implementation of financial analysis

In general it can be said that the primary objective of financial analysis is to do an analysis of the financial situation of the company, to find and exploit the strengths of the company and at the same time to correct the weaknesses of the company. In this respect, the use of statistical data from past periods, their comparisons, a comparison with the results of the whole field are used and the analysis also includes the prediction of the future.

To create a financial analysis there are two basic techniques, namely the percentage analysis and ratio analysis, these tools are not able to include some aspects that are desirable in the internal financial analysis to be taken into account therefore it is necessary to supplement the results by the funding rules, Altman analysis, or IN index, in some cases it is necessary to take into account Du Pont´s decomposition analysis of working capital or cost-benefit analysis and other economic indicators.

4.2.1 Key ratio indicators

a) Liquidity ratio - the firm's ability to repay debts.
b) Profitability ratios – ROE, ROA, ROI, EVA…
c) Indicators of activity - the firm's ability to rapidly exploit its assets (inventory turnover, receivables turnover time ....
d) Debt ratios and financial structure (leverage measure).

5. Conclusion

The financial situation of the company is detected in financial accounting, which poses some external influences that cause that information to be provided to external users does not reflect fully current reality. On the contrary, the internal accounting is required to display a reality, especially because the management is only possible if real information is available.

Between the two areas of accounting there are differences that arise from the view the company as a whole in relation to its surroundings and the differences that arise from the specific internal control. The link between the financial and internal accounting can provide connecting accounts, authentication data, adapting, respectively unification of the data base and the inclusion of appropriate control mechanisms, but the basic problem remains the entire balance sheet valuation.

The above facts then affect the structure respectively value of items in the balance, which serves as an information base for financial analysis. If the financial analysis uses different inputs (arising from different concepts and calculations) of the companies compared, the resulting data are not true, respectively comparable or meaningful.

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