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THE ROLE OF THE STANDARDIZED ACCOUNTING INFORMATION IN THE FINANCIAL ANALYSIS OF THE ECONOMIC UNITS

Elez Osmani, PhD

Fatbardha Molla, PhD

Brilanda Bushati, PhD

University “Luigj Gurakuqi”, Economic Faculty, Shkoder, Albania

Abstract

There are many reasons for a necessary detailed analysis of financial statements. The financial statements are multi-aim statements. They are prepared to be used by potential groups, state owned agencies and managers. These different groups take decisions which are different from each other; such as, investing (potential shareholder) or lending (potential creditor) or there is also an opportunity to improve the company performance (manager) or if an economic unit is respecting the legal rules of the state (governmental agencies). Each of these decisions requires different information and consequently different analysis. The connections among the units in the income and balance statement or in them both, and the connection among the sums of the following financial statements, are not clear without the financial analysis. The users of the financial statements can be interested to see the progress of a company compared to:

- a. pre-set standard objectives
- b. other companies of the same industry
- c. other investing opportunities

The majority of the people who analyse the financial statements, are interested to invest, to borrow, to manage or to take decisions in connection with the respecting of legal rules.

Keywords: Economic units, Accounting information, Financial analysis

I. The aim of the topic

The role of the financial analysis is very important and irreplaceable in the process of leading the activity of the economic unit.

The work of the accountant does not end with compiling the basic financial statements, but this information should be processed and analysed. Without the financial analysis, we cannot understand the strong and weak points in the activity of the economic unit. There is the analysis of rentability , structure of capital etc. that help in the leadership and decision-making.

II. Objectives of the topic

Starting from the important role of the analysis of activity of the economic unit, the objectives of the topic are:

- To indicate strict connections of analysis and directing.
- To provide the managers the necessary information given by the analysis.
- To help the users of the financial information to read the information coming from the financial statements and to prepare it in function of decision – taking.

To understand that to be successful, they shouldn't lead only by intuition but they should know and use effectively the information offered by the accounting and analysis. In order to face the competition, the accounting information should be standardised, analysed and processed. For this the managers should consult the analysers and professionals.

III. Methodology

The methodology has been chosen regarding the aim of the study, which has to do with the studying of the role of the analysis in directing the unit. Every chapter is completed with analysis such as mathematical analysis, with financial analysis and questionnaire analysis, and respective recommendations by the Albanian reality. Such analyses bring into light the importance of the accounting information analysed under the directing of economic units.

Starting by the fact that the role of the analysis is growing, it is necessary to use a broad domestic and worldwide literature.

This literature is completed with the information accumulated by the interviews realized with the subjects of the economic units. The majority of the questionnaires are completed through the face-to-face interviews asking for a further explanation of some of the questions.

The gathered information will be processed, analysed and there are given the results and appropriate recommendations.

1. Problems connected to the financial analysis

In financing the economic units, an important role is played by the financial analysis.

- the analysts of the credit including the bank credit officers and the bond analysers that analyse the reports to provide the ability of the society to pay its debts.
- the analysts of the bonds that are interested for the perspective of the society related to the efficiency, risk and development.

The comparisons could be deregulated by the usage of inner accounting policies, methods of evaluation of the inventories. The amortisation could influence the financial statements and consequently confuse the comparison among societies. Moreover, if a society rents a considerable percentage of its actives of production, then its actives will appear to be at a low level compared to the sales as the rented actives are not usually presented in the balance sheet. At the same time, the obligations that are connected to the rent could not be shown as a debt. As a result, the renting could improve in an artificial way the circulating indicators as well as the loan report. However, accounting has taken steps to milder this problem.

It is difficult to generalize if a report is “good” or “bad”. For instance, a high report could indicate a strong liquidity position, which is good, or a surplus of money, which is bad because the money in the bank is active and not profiting. In the same way, the high report of the circulation of consistent actives, could indicate if it is a society that uses its actives effectively or a society is under the normal capital and cannot buy enough actives.

The society could have some reports that seem to be “good” and others that might seem “bad” making it difficult to say whether the society is in balance, strong or weak. However, to analyse the neto effect of a group of reports, statistical procedures could be used. Many banks and leading organisations use such procedures to analyse the financial reports of the society and afterwards they classify them according to financial problems that they might have.

The analysis of the reports is useful but the analysts should take into consideration the above mentioned problems and should make the necessary adjustments. The analysis of the reports done mechanically and not well thought is dangerous, used with intelligence and with a good judgement, it could provide useful leading for the operative activities of the company.

Many big companies operate in different industries and for such companies it is difficult to provide a typical industrial average group. As a result, the report analysis is more useful for small companies with a wide rage of products as for the large and diversified ones.

Many companies want to be more successful than the average of the industry; therefore the comparison with the average performance is not a good one. Aiming a higher level of performance, it is better to focus at the reports of the industrial leaders.

The inflation could have confused the balance sheet and the registered values are sometimes further from the real value. Furthermore, as the inflation influences directly the amortisation and the inventory cost, it influences as a result the gaining as well. Therefore the analysis of the reports of a company with itself during a certain period of time or the comparison to a unit of a different age should be carefully interpreted.

The season factors could confuse the analysis of the reports. Their influence could be milder by using the monthly average of the receivable account when we calculate the circulation reports.

The companies could use covering techniques to make their financial statements look stronger. For instance, a builder from Tirana, takes a loan for 2 years on the 29th of December and keeps the money for some days, and then he gives the money back on the 2nd of January of the coming year, i.e. after 4 days. This helps in improving the current and fast report that allows for the annual balance sheet to look all right. Anyway, the improvement is only superficial, cosmetic, as only one week later the balance sheet will be at the old levels.

2. The analysis for the small economic units

The reports of the financial analysis are vastly used for the evaluation of the financial situation for small businesses, where the sources providing ready comparative data for different business sizes, are easily available.

When a small business applies for a loan, the banker should predict the possibility of paying back the loan by the company. During this prediction, the banker should pay attention to the indicators of liquidity and to those that allow the predicting of the ongoing of the social rent ability in the future. The banks are ready to give loans for new clients, when there is a high chance for them to pay back the loan within a given period of time and that they are stable clients of the bank. In this case, the long-term bank-business relation as well as the short-term ones is an interest to the banks. At the same time, the perceptions of the bankers for the business are important for the manager owner, as there is a chance for the bank to be the main funding source of the business activity.

The first problem that a banker could meet in this case, unlike the big companies, is that the financial statements of the small companies are not audited by the respective auditing

companies. The fact that the financial statements might not be periodically prepared is another problem. In case when the business is new, then the historical data will belong maximum to the previous year. The financial statements might be compiled by a relative of the owner, and not by an expert accountant.

The low quality of the financial data could be a barrier for establishing the relations among the bank and the small business. Therefore, a small company cannot be accorded a loan, although it might be financially stable. Thus, it is a benefit of the owner for the financial data to be reliable although the cost for it might be quite high. Furthermore, if the data is unsuitable for the banker, then it is unsuitable for the direction of the company, for the decision-making is based on the data by the financial statement.

For a given group of reports, the risk for a small company is higher than for a big company. Often, the small companies produce one type of product or/and they are directed towards a small consuming category. While the big companies that make offers to the domestic consumer as well as the foreign one are not that much exposed to such a risk. The same situation could be proved also for the societies that produce only one type of product.

The extension of the loan for a small business especially for companies where the role of the manager is played by the owner, often it is involved another risk which is not to be found in large companies. It has to do with the dependence of the business leadership on a sole person. It is in the family and creditor interest to compile a successful plan for the things to be clear before any of these problems arises.

As a result, in order to evaluate the potential of a small company to be a regular and stable client of the bank, the financial analyst should go beyond the reports and should analyse the future of the products of the society, consumers, leadership and market. However, the analysis of the financial reports remains only the first step.

3. The quality of the accounting information

The reforms in the accounting field

The economic development, especially the economic globalisation, has made possible for the economic-financial decisions to be of a higher importance on an international level. The main international factors are now converged into the same attitude regarding the “common language” of the financial information published through financial statements, economic entrepreneurship of the different countries in the world.

This language will be the one of the international accounting standards, whose implementation is declared to be an obligation, at least for the entrepreneurships quoted in the national and international financial markets.

On this behalf, many countries, apart or grouped in units such as the European Union, have undertaken reforming initiatives in their accounting regulation clause. This process has already started even in the countries, called to be countries in transition or countries that have entered late in the market economy, such as Poland, Czech Republic, Russia, Bulgaria etc.

The reforming process in accounting is neither easy nor unproblematic, for every country that has not a developed regulating clause according to practices and Anglo-Saxon concepts, and especially for countries that have already joined the market economy. In this process, it is involved our country as well, as it aims joining the European Union. The right decision-making is the basis for success in every business entrepreneurship. During an important decision-making it is crucial to use a rational process of decision-making. Without the accounting information, many important financial decisions would be made blindly. The investors, for instance, could not tell a profiting company from one that could be on the edge of bankruptcy; the bankers would not be able to evaluate the potential risk of loans; the corporate managers would not have a basis for the control of the costs, price setting or investing the company sources; and governments would have no basis for taxing on the income. No list of examples could represent completely the vast usage of accounting information in our economic, social and political institutions. When the accounting information is used effectively as a basis for economic decision-making, the limited sources could be divided more efficiently. Therefore, accounting is a service activity, created to accumulate, measure and communicate the financial information of several decision-makers such as: investors, creditors and managers. Accounting includes a system of concepts and procedures that organises and includes economic activities of a unit.

4. Albania for the implementation of accounting standards

According to the law nr. 9228 date 29.04.2004 “For Accounting and Financial Statements”, article 4, there are defined the accounting standards for compiling the financial statements as it follows:

- a. The economic units that implement this law, excluding the cases presented in points 2 and 3 of this article, implement the national accounting standards for the compiling and publishing of the financial statements. The accounting standards are compiled by

the National Accounting Council and within a month, they are declared as obligatory to implement by the Minister of Finance.

- b. The Minister of Finance, after taking the opinion of the National Accounting Council, declares the accounting standards mandatory for implementation for the public economic units, which do not follow profiting objectives.
- c. The standards compiled by the Board of International Accounting Standards and translated into Albanian, under the responsibility of the National Accounting Council, without changes from the original text into English, are declared by the Minister of Finance and are implemented mandatory:
 - By the companies listed on an official exchange of bonds and their branches, subject of consolidating accounts,
 - By the banks of the second level, financial institutions similar to banks, insurance and re-insurance companies, funds of bonds and all companies licensed to perform activities of investing in bonds, even when they are not listed on an official exchange of bonds,
 - By other large economic units, not listed on an official exchange bonds, when they get over the limits defined by the Council of Ministries for the annual income and the number of workers.

5. The concept of Break-Even, indicator of Break-Even of the capital invested in total¹

We know that calculating gaining and loss brings the net economic result of the exercise period. Such a result expressed in absolute magnitude does not take into account the size of the capital used to achieve this gain.

Therefore there is a need to calculate the indicators of the break-even.

The indicator of the break-even of the capital in total invested, is calculated through the report:

(the result of the main activity: the capital invested) x 100 > or equal to the cost of the monetary means borrowed.

Where the result of the main activity is calculated from the difference among the income and expenditure, only from the main activity of the entrepreneurship.

¹ Hidajet Shehu, Financial Analysis 2004 pg. 167

The indicator of the break-even of the capital in total, informs about a break-even that:

- a. It is not influenced by the financial structure of the economic unit, because it is not taken into consideration the influence of financial expenditure. It is not influenced by the non-main and extraordinary economic results, therefore it does not take into consideration the gains or loss with non-normal and extraordinary origin.
- b. It is not influenced by the fiscal system, not taking into consideration the influence that the taxes have on the final result.

a. The indicator of the break-even of its capital

The possibility to realize gaining, should be studied on the ability of the economic unit for the rewarding of the owner, the one that owns the decision-making power, although he does not own the whole financing sources, but which carries the risk of the capital invested.

It is calculated through this report:

(Net result: own capital) x 100 higher or equal to the bank interest.

The net result is the final result of the exercising as it is presented in the gain-loss account. It is the result that practically belongs to the entrepreneurship.

The own capitals are the net capital, reserves, the not-delivered gaining by deducting the loss accumulated.

This indicator informs for a break-even:

- a. It takes into account the financial structure of the economic unit, as it is calculated id deducting the result of the main activity of financial expenditure. The higher the level of liability, the higher the financial interests, resulting in diminishing the availability of the economic unit.
- b. It takes into account the non-main and extraordinary economic results, as they are involved and influence the calculating of the net result and the expenditure and the income originating outside the main activity. The fact that during a year, it is proved the extraordinary income does not change the ability of the economic unit to realise gaining and the break-even of the capital invested does not change. Therefore, it is not influenced by such phenomena, but it modifies the evaluation of the break-even of its own capital.
- c. It takes into account the fiscal liabilities that weigh differently through special mechanisms to which these phenomena are related. In case of tax saving or when

there are calculated more financial obligations detracting the taxed income, then the net income will be influenced by these obligations, otherwise by the main activity, as the economic unit is the last to profit in the range of delivering the net income of the exercising.

- d. The indicator of break-even of its own capital should aim the maximal value, regardless the influence of the several aspects of leading the economic unit. The higher this indicator, the stronger the economic unit will be in the process of further development and of the rewarding of the capital risked by the owner and shareholders.

Case studies from the financial reports of some Businesses in the region of Shkoder

In the region of Shkoder, we have a range of businesses, which have different indicators of break-even. Comparing the financial information, we have extracted different indicators of break-even.

There follow as a summary and grouped the main businesses that operate in the region of Shkoder and their financial data related to ROE for different sectors in the years 2003-2008.

Business 1 Selling different articles

YEARS	2003	2004	2005	2006	2007	2008
ROE	11.5%	11.5%	10.5%	10.4%	10.4%	10.1%

Business 2 Underwear production

YEARS	2002	2003	2004	2005	2006	2007	2008
ROE	3%	2%	2.9%	3.2%	5%	6.9%	4.2%

Business 3 Handling food articles wholesale

YEARS	2003	2004	2005	2006	2007	2008
ROE	17.3%	16%	13.3%	14%	16.2%	18.3%

Business 4 Wholesale industrial articles

YEARS	2002	2003	2004	2005	2006	2007	2008
ROE	15.5%	19.8%	16.8%	15.2%	15.5%	13.9%	12.8%

Business 5 Wood products

YEARS	2002	2003	2004	2005	2006	2007	2008
ROE	5.9%	9%	7.8%	3.9%	5.1%	6.9%	7.5%

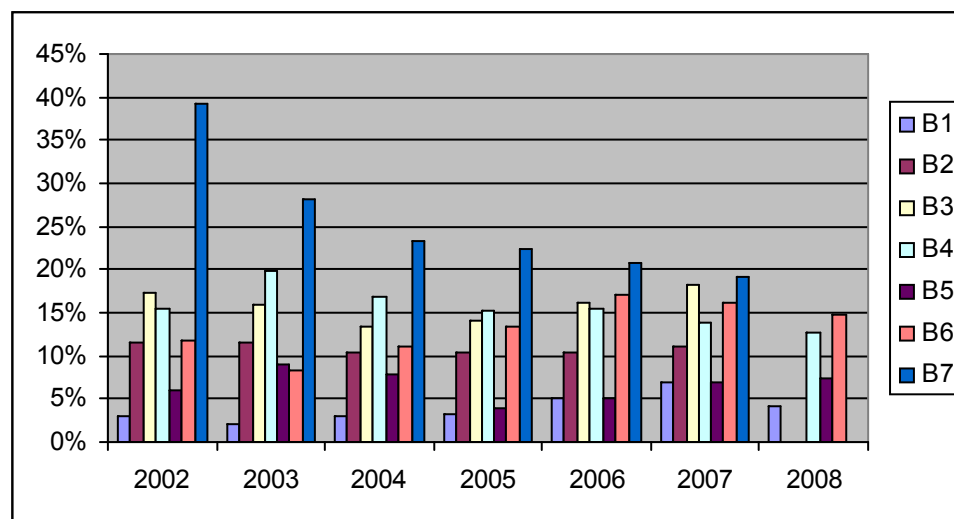
Business 6 Selling different articles

YEARS	2002	2003	2004	2005	2006	2007	2008
ROE	11.7%	8.2%	11.1%	13.15%	17%	16.1%	14.8%

Business 7

Building Firma

YEARS	2002	2003	2004	2005	2006	2007
ROE	39.3%	28.2%	23.4%	22.4%	20.8%	19.2%



Graph 1² Financial data related to ROE

By analysing the existing businesses in the Region of Shkoder, one can fully say that that most profiting actual business is “Building Firma”.

By analysing the return at its own capital to the Building Firms, we notice that from year to year, the own capital invested has increased such as the gaining. From year to year, the return from the invested capital has decreased, although it remains the most profiting.

The less profiting business is the one of underwear being followed by the business of wood producing. The financial data of these businesses are almost standard for the period 2002-2007, with an oscillation that does not go beyond 3%. If we compare the business of the underwear with the business of the building firms for the 2006, we will notice that the return to the own capital for the business of underwear is 5% and for the business of a building firm it is 20.8% and with a difference of 15,8 among them.

² This information is taken by BKT (Banka Kombetare Shkoder – National Bank of Shkoder)

Conclusions and recommendations

Referring to the work and results of the questionnaire realised with financial directing of the economic units, it resulted that the economic units are interested to work with two types of financing, but taking into consideration that the among the main ways of financing of the economic unit, there are still the banks or the banking system. Knowing that there is a relation among the increase of economy consolidation of the financial system (King and Levine 1993), we reached the conclusion that the development of the financial system is a good predictor for further increase of the economy.

Thus, as a conclusion, the more developed the banking system, the larger the possibility of the economic units to be financed with profiting loans. In spite of the improvements of our banking system, with the increase of their number and the continuous decrease of the bank concentration, it remains that the banking intervening should increase.

And as a conclusion towards reaching the optimum of mixing the financial sources:

- the mentality of the businessmen to work with borrowed sources,
- High uncertainty for the future,
- The inner political and economic situation,
- The non-favourable conditions of financing, insufficient sums, high interest rates etc.
- There should be a lot of work done for mediation among banks to be a culture.

Which is the way to increase the capital?³

Which is the way to be followed and how can it be defined? The decision is difficult and it is related to the balance of the agricultural farm with the market conditions, with the level of loan and many other factors.

The observations indicate that the majority of the financial leaders in the large economic units believe in the concept of optimal structure, approximated by the aimed levels of the loan report. A factor that influences the aimed level of the report is the ability of the society to cover the fixed financial costs. The other factors include:

1. Preserving a satisfactory classification for the debts,
2. Providing a reserve for loans,
3. Using the advantages offered by the financial lever etc.

The financial leaders should take into account many factors, including the report among the income before interest and taxing and the income per unit, for several financing possibilities in defining an optimal capital structure. Furthermore, the financial leaders of the

³ Magdalena Bregasi, Financial Policies of entrepreneurship, 2004, pg. 52

units could learn a lot from the comparison of the capital structure reports and the cover reports (the report of covering the interest and the report of covering the loan) for similar societies and for the same society during the time. It is to be given more importance to the financing of agriculture by the banking sector, the creation of banks for this sector, the accumulating of funds for investments in agriculture.

The importance and the implementation of the practices of accounting in economic units in the Region of Shkoder

The economic units give different opinions related to the loopholes of the accounting information. According to them, these loopholes are related to:

- ✓ The incomplete justifying information;
- ✓ The non-availability of the information at the proper time;
- ✓ The inability to understand the information available;
- ✓ The fact that not everyone knows the accounting information at the same time;
- ✓ The incorrect and systematic registration of the accounting actions.

Furthermore, they indicate that the largest distortions of the accounting information have to do with the changing of the real figures and in hiding the income from the taxes.

Based on the analysis of the questionnaire, the non-correct accounting information, has a negative impact on the financial result, as the non-correct information shows every financial non-exact result, resulting in not knowing the real financial situation of the firm in a given moment.

Conclusion and recommendations

By the study made, I have reached some conclusions:

The financial information given by the majority of the small and middle economic units is not considered to be reliable. This weighs on the weakest level of law implementation and to a certain point, to the limited domestic capacity to prepare and audit financial statements, as well as of the high level of informality in the economy, and of the high tendency for tax-evasion.

The percept level of financial transparency in Albania does not encourage the domestic and foreign investment. In general, the low levels of transparency hinder the small and medium economic units (SME) in getting loans by the formal financial sector. This is important in the actual context of Albania, where almost 92% of all business units are small

and medium. Furthermore, the conditions of lack of a reliable financial information, the shareholders and the third party do not come to the point to know the break-even of the leading staff, and therefore it is hindered the monitoring on market basis of the companies and the effective distribution of scare sources.

The availability of the published accounting information is very limited in Albania. The actual demands for the depositing and publishing the financial statements are not compatible to the good international practices of this field.

The legal framework for the financial reporting in Albania is characterised by a lack of corresponding. Apart from this, the many laws and regulations should be enough communicated to the economic units which should follow and implement them in order for the law to be well implemented.

The need for qualification in all fields of economy, related to the accounting and financial reporting is very high. The level and quality of education and qualification in the process before and after the certifications of the accountants is insufficient to complete the existing need for knowledge and experience.

The mechanisms of monitoring and implementation are not efficient to urge the accounting standards. It is noticed a limited implementation of the accounting standards by the economic units. The monitoring reasons and the non-efficient activities of implementation include the unclear legal authority, lack of capacity or acting/operational authority, the impossibility of the economic units to fulfil the necessary demands because of limited capacities, and the neglecting of the authorities in fulfilling such an important role.

Recommendations:

Implementing the given recommendations is very important to strengthen and improve the framework of the financial reporting with positive effects on the ability of the financial system, economic growth (Including the mobilisation of the capital for investment) and the fight against corruption.

Strengthening the stature framework that leads the accounting and financial reporting.

- Strengthening stable structures for compiling qualitative accounting standards and guides on their implementation.
- Creating mechanisms of systematic monitoring and implementation to provide compatibility with the accounting standards.

- The improvement of the work quality of the accountants through initiatives for the vast development of the capacities for the actual professionals.
- The increase of the number of the accounting professionals, skilled to prepare financial statements of a high quality. This would include providing stimulation to draw into the profession students with high marks, in order to increase the level of knowing the qualifications.

These recommendations will contribute in the development of the business and its financing through:

- Strengthening the Albanian financial architecture and decreasing the risk of crisis in the financial market and the negative impacts related to it;
- Attracting foreign direct investments of the portfolio ones, and the support in mobilising the inner domestic savings;
- Facilitating the loans by creditors of small corporations from the financial sector, by diminishing the barrier of the range of information and the costs of loans;
- Supporter towards the investors of large companies in evaluation the potential/vision of the corporations and in decision-making through voting, which will lead to a lower cost of the capital and a better delivery of the sources. The financing reporting is also a way/form of monitoring on market basis of companies, which makes it possible for the shareholders and the public in general to know the performance of the leadership staff, by influencing thus their behaviour.

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